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Sole Proprietorship Transition and Incorporation to Limited Liability Company in Uyo, Akwa Ibom State

Ekpelinwa Obinna Pius[1]; Brownson Christabel[1*]; Uwah Inemesit E.[1]

[1]*Department of Business Administration, Faculty of Administration and Management Sciences, Akwa Ibom State University, Obio Akpa Campus, Oruk Anam, Akwa Ibom State.*

[*]*Corresponding Author's Email: christabelbrownson@yahoo.com*

Abstract

The study sought to investigate why many businesses are not transitioning from sole proprietorship to a limited liability company (LLC) with a focus on Uyo, Akwa Ibom State, Nigeria. Specifically, the study examined the effect of financial constraints and taxation on the transition of businesses from sole proprietorship to a limited liability company in Uyo, Akwa Ibom State. The sample size for the study was 302 out of a population of 1240 sole proprietorships. Survey research design was employed, and Linear Regression analysis was used in testing the hypotheses. Findings revealed that financial constraints had a significant negative effect on the transitioning of businesses from sole proprietorship to limited liability company (Beta = - 0.569; R^2 = 0.324, F-value = 60.984, $p<0.001$). Taxation had a significant negative effect on the transitioning of businesses from sole proprietorship to limited liability company (Beta = - 0.740; R^2 = 0.57, F-value = 362.701, $p<0.001$). The study recommended that the government and financial institutions should design transition-focused funding schemes specifically for sole proprietors intending to incorporate with a transitional tax relief period or reduced compliance requirements during the first few years to encourage formalization.

Keywords: Financial Constraints, Limited Liability Company, Sole Proprietorship, Taxation.

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INTRODUCTION

Despite Nigeria's vibrant entrepreneurial environment and the proliferation of micro, small, and medium enterprises (MSMEs), most businesses remain trapped in the informal sector, predominantly operating as sole proprietorships. According to SMEDAN and the National Bureau of Statistics (2021), over 96% of Nigeria's MSMEs function as sole proprietorships, with only a small fraction transitioning into formal business structures such as Limited Liability Companies (LLCs). This persistent low rate of legal and structural transformation significantly impedes business growth, limits access to external financing, and restricts participation in formal economic activities, thereby reducing potential contributions to GDP and employment creation (Eze & Okpala, 2015).

While the sole proprietorship structure offers simplicity and full managerial control, it exposes business owners to unlimited liability, limited access to institutional credit, and a lack of business continuity beyond the owner. In contrast, LLCs provide benefits such as legal separation between the business and its owners, enhanced credibility, and access to larger financial markets (Corporate Finance Institute, 2024; Levene Energy, 2024). Despite these advantages, the transition rate remains low, especially in semi-urban and rural areas like Akwa Ibom State, where entrepreneurship is prevalent, but formalization is rare (Udofot & Etim, 2017).

Many sole proprietors in Uyo, Akwa Ibom State, have continued to operate under the sole proprietorship structure for many years without transitioning to limited liability companies. This situation limits their growth potential and reduces their ability to compete effectively in a formal business environment. Several intertwined factors contribute to this problem. Financial constraints are a major barrier; many sole proprietors are unable to afford incorporation fees, legal advisory services, and recurring compliance costs. Nigerian MSMEs remain overwhelmingly dependent on personal savings and informal sources rather than formal credit for business financing (SMEDAN & NBS, 2021; Raimi et al., 2020).

Furthermore, Nigeria's tax system, although reformed in stages to support MSMEs, most recently through the Nigeria Tax Act 2025, which took effect in 2026 and substantially widened the turnover band within which small companies are exempted from Companies Income Tax (CAMA, 2020) transition remains complex and burdensome in practice. Compliance costs, multiple taxation, and regulatory complexities discourage formalization, leading many sole proprietors to deliberately avoid registration to remain outside the regulatory and tax net (Oladimeji and Aremu, 2019). Similarly, complex and burdensome tax policies characterized by high tax rates and multiple levies exacerbate proprietors' reluctance to formalize.

Although previous studies like Bem et al. (2023), Ben (2025) and Olayye (2025) have examined the effect of taxation on SMEs in Nigeria, limited empirical attention has been given to how financial constraints and taxation influence the transition of sole proprietorship businesses to limited liability companies, specifically in Uyo. This creates a gap in knowledge that this study seeks to address. Therefore, this study investigated the effect of financial constraints and taxation on the transition of sole proprietorship businesses to limited liability companies in Uyo, Akwa Ibom State.

Objectives of the Study

The primary objective of this study was to investigate why many businesses are not transitioning from sole proprietorship to a limited liability company (LLC) with a focus on

Uyo, Akwa Ibom State, Nigeria. Specifically, the study aimed to:

1. Examine the effect of financial constraints on the transition of businesses from sole proprietorship to a limited liability company (LLC).
2. Investigate the effect of taxation on the transition of businesses from sole proprietorship to a limited liability company (LLC).

Research Questions

1. What is the effect of financial constraints on the transition of businesses from a sole proprietorship to a limited liability company (LLC)?
2. What is the effect of taxation on the transition of businesses from a sole proprietorship to a limited liability company (LLC)?

Research hypotheses

Ho_1: Financial constraints have no significant effect on the transition of businesses from a sole proprietorship to a limited liability company (LLC).

Ho_2: Taxation has no significant effect on the transitioning of businesses from sole proprietorship to limited liability company (LLC).

LITERATURE REVIEW

Concept of Business Transition

Business transition is an essential strategic process whereby enterprises deliberately change their organizational form, operational scale, or legal status to achieve enhanced sustainability, competitiveness, and growth. Specifically, it involves the evolution of a business from a smaller, simpler structure such as a sole proprietorship to a more complex and formalized entity like a limited liability company (LLC) or corporation. This transition reflects a fundamental shift not only in legal identity but also in governance, resource mobilization, risk management, and market engagement.

At its core, business transition encompasses the reconfiguration of internal structures and external relationships to meet new demands in a dynamic economic environment. It is driven by motives such as limiting personal liability, accessing broader financial resources, improving organizational credibility, and capitalizing on market opportunities that are often unattainable under less formal arrangements. Such formalization requires compliance with legal frameworks, establishment of professional management systems, and adherence to regulatory and financial reporting standards.

Theoretically, business transition is situated within broader frameworks of organizational change and development, where incremental or transformative adaptations are necessitated by environmental pressures, technological innovations, or sustainability imperatives. It is understood as a complex, multistage process involving decision-making under uncertainty, resource allocation, and stakeholder negotiations (Leipziger, 2024; Sarasini & Linder, 2018). In emerging economies such as Nigeria, transitions present both substantial opportunities for entrepreneurial growth and significant challenges stemming from financial constraints, regulatory complexities, and socio-cultural factors.

Moreover, transitions imply a shift in entrepreneurial identity and managerial capabilities, where owners must adopt new mindsets and competencies to navigate the formal business landscape effectively. They encompass strategic planning, risk-taking, and long-term visioning necessary for business scaling and institutional legitimacy. Consequently, understanding the concept of business transition provides critical insight into why some enterprises progress towards formalization while others remain confined to informal structures, setting the stage for analyzing the specific barriers to such transitions within contexts like Uyo, Akwa Ibom State.

In this study, transition is not treated as a binary legal event, that is, whether a firm has or has not completed formal conversion from a registered business name to an incorporated company under CAMA 2020, because actual conversion events are rare and difficult to sample directly within a cross-sectional survey of active sole proprietors. Instead, transition is operationalized as a composite readiness/disposition construct capturing the sole proprietor's awareness of LLC requirements, perceived benefits of incorporation, perceived reduction in personal financial risk, and readiness to incorporate.

Sole Proprietorship

Sole proprietorship is the simplest and most common form of business ownership, characterized by a single individual who owns and operates an unincorporated business. This business structure is widely prevalent in sectors such as real estate, construction, and the arts due to its ease of formation and operational simplicity. Legally, a sole proprietorship is not distinct from its owner, meaning the business and the individual are treated as one entity for tax and liability purposes (Crelin, 2024). This structure allows the owner to retain all profits but also exposes them to unlimited personal liability for business debts and legal actions. Unlike corporations or limited liability companies (LLCs), sole proprietorships do not provide personal asset protection, which poses significant risks to the proprietor (Crelin, 2024). From a tax perspective, sole proprietors report business income as personal income, simplifying tax filing but requiring the payment of self-employment taxes and quarterly estimated taxes. This tax simplicity is a key advantage; however, the lack of liability protection remains a critical drawback (Ibid.).

Empirical research has identified several factors influencing the performance of sole proprietorships. A quantitative study among sole proprietorship owners in Noveleta, Cavite, found that age, marital status, educational level, previous entrepreneurial experience, access to finance, government support, and land ownership significantly affect business outcomes. The study highlighted that younger entrepreneurs tend to bring innovation and energy, while experienced owners contribute wisdom and resilience. Moreover, government support packages, including policies, technology incentives, and social recognition, positively impact business performance. Tax policies also play a crucial role; lower tax burdens correlate with higher profitability and sustainability (Crelin, 2024).

Sole proprietorships can transition to other business forms such as LLCs. This conversion involves procedural changes, including obtaining new employer identification numbers, transferring ownership of assets, and drafting new organizational documents. Debts incurred under the sole proprietorship transfer to the new entity but require negotiation with lenders. Despite its risks, sole proprietorship remains the dominant business form in many economies, including Nigeria, underscoring the economic significance of understanding what keeps proprietors from formalizing (Crelin, 2024; SMEDAN & NBS, 2021).

Factors that Hinder the Sole Proprietorship Transition

Businesses in Akwa Ibom State, Nigeria, face several significant barriers that hinder their transition from sole proprietorships to limited liability companies (LLCs). Financial constraints remain a critical obstacle, as many entrepreneurs lack the necessary capital to meet the costs associated with formal registration, compliance, and operational expansion required for this transition. Taxation policies also play a discouraging role, where complex tax structures and perceptions of high tax burdens deter business owners from formalizing and scaling their enterprises. Together, these factors form a complex web that impedes many businesses in Akwa Ibom State from evolving into an LLC, potentially limiting their growth and sustainability (Adom, 2026; Bruhn & McKenzie, 2014).

Financial Constraints

Financial constraints have been consistently identified as a critical barrier to business formalization and structural transition, particularly in developing economies such as Nigeria. Sole proprietorships, while being the most accessible form of business ownership due to low entry costs and simplified legal procedures, often face severe challenges in accessing the capital required for expansion, formalization, and transition into Limited Liability Companies (LLCs) or corporations (Okeagu, 2022). Cross-country structural evidence similarly showed that where financial constraints are absent, the formalization of existing informal firms increases substantially, confirming that access to capital more than any single factor determines whether an operating informal firm chooses to formalize (Adom, 2026; Bruhn & McKenzie, 2014).

One of the key obstacles preventing sole proprietorships from transitioning into an LLC is their limited access to start-up and working capital. Most sole proprietors rely on personal savings, family funds, or informal lending to finance their businesses, restricting their capacity to cover the financial requirements of incorporation, including registration fees, legal documentation, capital structuring, and professional advisory services (SMEDAN & NBS, 2021; Raimi & Uzodinma, 2019).

Incorporations also introduce recurrent compliance costs such as auditing, tax filing, and corporate governance reporting - costs that sole proprietors often deem unnecessary or burdensome in the absence of immediate revenue expansion (Aleke, 2024). As a result, many small business owners opt to remain informal to avoid additional financial obligations, despite the long-term benefits of formalization. Sole proprietors are particularly disadvantaged in accessing formal financing from banks and financial institutions. Traditional financial institutions typically demand credit histories, audited financial statements, or tangible collateral - requirements that most sole proprietorships cannot meet. This lack of collateral limits their borrowing capacity and perpetuates informality. Microfinance banks and development finance institutions (DFIs), which are intended to serve this segment, are often unable to meet demand or offer loans with high interest rates that further deter borrowing (Udofot & Etim, 2017). This scenario creates a credit market gap that excludes the very businesses most in need of formalization funding. The costs associated with incorporation - ranging from ₦25,000 to ₦100,000 in Nigeria depending on the business size and location - can be prohibitive for micro-enterprises operating on minimal margins (Counseal, 2025; LexPraxis NG, 2025). The fuller cost of formalization once professional, statutory, and post-registration compliance costs are included has been estimated at an average of roughly ₦641,737 for Nigerian MSMEs (Okeagu, 2022) a materially higher figure than the headline registration fee alone, and one that better explains why cost remains a significant deterrent even after CAMA 2020's fee reductions. Beyond the initial cost, formalized entities are subject to annual filing fees, tax returns, and, in some cases, statutory audits. For sole proprietors with unstable or seasonal cash flows, these obligations introduce financial unpredictability, discouraging them from transitioning into LLCs.

Moreover, sole proprietors often lack access to affordable legal and business advisory services that could help them understand and navigate incorporation requirements. This lack of financial literacy and professional support further compounds the cost barriers, especially for entrepreneurs in rural or semi-urban areas like Akwa Ibom State. Nigeria's macroeconomic environment - characterized by inflation, currency volatility, and inconsistent policy reforms - further heightens the perceived financial risk associated with formalization. Entrepreneurs may delay or avoid transitioning due to fears of increased exposure to regulatory changes and tax reforms (Parthian Partners, 2025). Such macro-financial uncertainty makes informal operations appear safer and more adaptable for sole proprietors, who often operate on thin profit margins and short planning horizons (Olalekan, 2021).

For many sole proprietors, the opportunity cost of formalizing a business - especially in the absence of immediate market or financial benefits - can outweigh perceived advantages. When faced with financial constraints, business owners prioritize day-to-day operational survival over long-term strategic formalization goals (Agwu & Emeti, 2014). This survivalist mentality leads to stagnation in business growth and a continued preference for the flexibility of sole proprietorship over the formal discipline of corporate structures. Despite these financial challenges, transitioning to an LLC or corporation offers substantial benefits, including enhanced credibility, legal protection, and improved market access (LexPraxis NG, 2025). The Companies and Allied Matters Act (CAMA) 2020 in Nigeria has simplified some aspects of incorporation, such as lowering minimum share capital requirements, yet the upfront and ongoing financial commitments remain significant obstacles for many MSMEs. Goidara.com (2025) provides a practical guide to converting a business name (sole proprietorship) to an LLC, underscoring the importance of strategic timing and careful financial planning to manage the transition costs effectively. The process involves not only registration fees but also the transfer of assets, updating of contracts, and establishment of new corporate bank accounts - all of which require financial resources that many sole proprietors lack.

Taxation

The decision to transition from a sole proprietorship to a Limited Liability Company (LLC) is heavily influenced by tax considerations. Tax regimes shape business owners' incentives regarding formalization and structural changes, impacting economic growth and entrepreneurship. Taxation is a central determinant in business structure decisions. Sole proprietorships are subject to pass-through taxation, where business income is taxed as personal income and is subject to self-employment taxes. LLCs and corporations offer alternative tax treatments, such as the option for corporate-level taxation and various deductions, influencing the attractiveness of transitioning. High personal income and self-employment taxes motivate sole proprietors to incorporate to access lower effective tax rates, deductions, and retained earnings options. The risk of double taxation in corporations can deter transitions, though strategic tax planning often offsets this (Alderton, 2024).

The Finance Act 2019/2020 first introduced a CIT exemption for 'small companies' earning ₦25 million or less in annual turnover. More recently, the Nigeria Tax Act 2025 signed into law on 26 June 2025 as part of a wider package of tax-reform statutes and effective from 2026 consolidated and repealed much of the preceding patchwork of tax legislation. Among other changes, it redefines a 'small company' as one with an annual turnover of ₦100 million or less

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and fixed assets of ₦250 million or less, and taxes such companies at 0 percent CIT (Nigeria Tax Act, 2025; Adeoye & Oyelami, 2025).

LLC Flexibility: LLCs' ability to choose tax treatment offers a strategic advantage to minimize tax liability. Complexity and Compliance Costs: Transitioning introduces complex filings and compliance obligations, which can be costly and discouraging for small business owners. Tax Administration Quality: Effective tax administration reduces compliance costs and encourages formalization, while weak administration and bureaucratic bottlenecks discourage transitions. In Nigeria, multiple taxation from federal, state, and local authorities, including corporate income tax (CIT), VAT, withholding tax, and levies, creates a significant barrier to formalization (Oladimeji & Aremu, 2019). Transitioning from sole proprietorship to LLC often means moving from personal income tax under PAYE to corporate taxation, with CIT rates of 30% for large companies or 20% for small companies. These introduce fixed compliance costs perceived as unaffordable by many micro-enterprises. A major deterrent is the lack of awareness about tax incentives and exemptions. For example, companies earning less than ₦25 million are exempt from CIT under the Finance Act 2020/2021, yet many sole proprietors remain unaware, fearing increased tax burdens post-incorporation (Olalekan, 2021). Despite digital initiatives like the TaxPro-Max portal, compliance remains difficult for many, especially in rural areas with low digital literacy (SMEDAN & NBS, 2021). Fear of audits, record-keeping demands, and perceived harassment by tax officials further dissuade transitions.

Reforms such as the Finance Act 2020 and CAMA 2020 have introduced graduated tax rates and simplified registration, but uptake is low due to poor dissemination, low trust, and limited post-incorporation support (Parthian Partners, 2025). The perception of taxation as punitive rather than developmental discourages formalization and long-term investment (Chukwuemeka, 2020; Agwu & Emeti, 2014). Lack of visible government support for businesses reinforces this view (Aleke, 2024). Studies in Lagos and Akwa Ibom State reveal that taxes and inconsistent enforcement are major barriers to incorporation (Udofot & Etim, 2017). These findings highlight the need for region-specific tax strategies.

Formal structures facilitate investor attraction and capital access, often driven by tax considerations. Liability protection is important, but tax factors often determine the decision to transition. Strategic Planning: Professional tax advice is crucial to optimize structure amid evolving tax laws (Alderton, 2024). Taxation significantly influences the transition from sole proprietorship to LLC or corporation. While liability protection and capital access are important, tax burdens, compliance costs, knowledge gaps, and administrative quality often tip the balance. In Nigeria, multiple taxation and poor tax education remain formidable barriers despite reforms. Addressing these requires simplifying tax systems, enhancing taxpayer education, and building trust through visible Government support.

Limited Liability Company (LLC)

A Limited Liability Company (LLC) is a distinct legal business structure that offers protection to owners by limiting their personal liability for business debts, unlike sole proprietorships, where owners have unlimited personal liability. LLCs combine the operational flexibility of partnerships and the liability protection of corporations, making them attractive for entrepreneurs aiming for growth, credibility, and investment opportunities. In Nigeria, transitioning to an LLC involves regulatory registration with the Corporate Affairs Commission (CAC), financial commitments, and compliance with corporate governance requirements (Counseal, 2024; LinkedIn, 2025).

The Limited Liability Company (LLC) is a hybrid business entity that combines characteristics of corporations and partnerships, offering both limited liability protection to its owners (members) and pass-through taxation benefits. This form of business organization has gained widespread legislative acceptance due to its flexibility and efficiency. Historically, limited liability was a feature primarily associated with corporations, designed to shield investors from personal liability for business debts and obligations. However, the emergence of LLCs and limited liability partnerships (LLPs) represents a significant evolution in business organization, offering liability protection without the formalities of corporate governance (Hillman, 1997). Despite the broad legislative acceptance, scholarly debate continues regarding the economic efficiency of limited liability in LLCs, with some studies finding inconclusive evidence on whether limited liability enhances or detracts from economic welfare (Hillman, 1997). Macey (1997) argued that the rise of LLCs challenges traditional corporate law assumptions, particularly regarding the necessity of formal incorporation and the balance of costs and benefits related to limited liability.

LLCs are recognized for their structural flexibility. Unlike limited partnerships, which require at least one general partner with unlimited liability, LLCs allow all members to participate in management without losing limited liability protection (Sargent, 2002). This flexibility makes LLCs attractive for small and medium-sized enterprises seeking to combine operational control with liability protection. Tax treatment is another critical advantage. LLCs generally enjoy pass-through taxation, where profits and losses flow directly to members' personal tax returns, avoiding the double taxation faced by corporations. However, LLCs can elect to be taxed as corporations if advantageous (Investopedia, 2025). This tax flexibility, combined with liability protection, positions LLCs as an optimal business form for many entrepreneurs (Sargent, 2002). In Nigeria specifically, transitioning to an LLC involves regulatory registration with the Corporate Affairs Commission (CAC) under CAMA 2020, financial commitments, and compliance with corporate governance requirements, several of which were eased by the 2020 reforms (Obagboye & James, 2024). LLCs are increasingly viewed as the preferred organizational form for new businesses due to their combination of limited liability, tax benefits, and management flexibility. However, challenges remain, including potential creditor risks if LLCs fail to meet legal requirements or engage in fraudulent activities (Investopedia, 2025).

Experience and Willingness Related to LLC Transition

Experience, or lack thereof, plays a significant role in whether sole proprietors choose to transition. Many entrepreneurs exhibit limited management skills and inadequate knowledge of regulatory procedures, which creates hesitation and low willingness to formalize as an LLC. Complexities of compliance, higher costs, and the requirement for shared ownership in LLCs are reported barriers to transition (Bushe, 2019; Counseal, 2024). In Nigeria, the willingness to transition often hinges on reaching business growth stages where risks of unlimited liability are no longer bearable or external investors demand formal structures (LinkedIn, 2025). Moreover, the owner's personal attitude and readiness to adopt structured management also influence the shift (Bushe, 2019).

Expectations from Transitioning to LLC

Entrepreneurs expect several benefits from becoming LLCs. Key expectations include limited personal financial liability, improved access to funding and investment due to formal corporate identity, enhanced business credibility, and potential tax advantages. Transitioning is perceived to support sustainable business growth through a clear ownership structure and succession

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continuity, unlike sole proprietorships, which dissolve on the owner's death or exit. Additionally, the ability to separate personal and business assets is a powerful motivator for entrepreneurs facing growing business risks. Nevertheless, the transition also introduces expectations for stricter regulatory compliance and potentially higher operating costs (Counseal, 2024; LinkedIn, 2025).

METHODOLOGY

A descriptive survey research design was used for the study. The population consisted of all registered sole proprietorship businesses operating within Akwa Ibom State, Nigeria. According to SMEDAN (2017), there are 1887 SMEs in Akwa Ibom State of which 65.7% of them are sole proprietorship (family-owned) thus, making the population of the study to be 1240. The sample size was determined using the Taro Yamane (1967) formula for finite populations:

$$\mathbf{n = N / [1 + N(e)^2]}$$

Where n = sample size, N = population size (1,240), and e = margin of error (0.05). Substituting these values: $n = 1{,}240 / [1 + 1{,}240(0.05)^2] = 1{,}240 / [1 + 3.10] = 1{,}240 / 4.10 \approx 302$. Accordingly, a sample size of 302 sole proprietors was drawn for the study.

A stratified random sampling technique was employed to ensure that all sole proprietors in major business locations in Uyo are proportionately represented. The population was divided into seven (7) strata based on business locations. The specific business locations included the following locations and specific samples: Table showing the distribution of the 302 respondents equally among the seven business locations, with 43 respondents each for six locations and 44 respondents for the Building Material Market, Oron Road. Questionnaires were randomly distributed to respondents.

Table 1: Sample Determination Table

S/N	**Business Location**	**Respondents**	**Explanation**
1.	Abak Road	43	302 ÷ 7 = 43
2.	Aka Road	43	302 ÷ 7 = 43
3.	Building Material Market, Oron Road	44	302 ÷ 7 =43 + 1
4.	Ikot Ekpene Road	43	302 ÷ 7 = 43
5.	Nwaniba Road	43	302 ÷ 7 = 43
6.	Oron Road	43	302 ÷ 7 = 43
7.	Udo Umana Road	43	302 ÷ 7 = 43
	Total	**302**	Sum of respondents

Explanation of how values were obtained:

- The total sample size is 302.
- The number of locations is 7.
- Dividing 302 by 7 gives 43respondents per location with a remainder of 1 (i.e., 302 = 7*43 + 1).

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- The remainder (1) is added to one of the locations (Building Material Market, Oron Road) making it 44 respondents for that location because it's the most populated area.

Analysis of the data was carried out using simple linear regression analysis.

Research Instrument

Data were collected using a structured questionnaire developed by the researchers (see the Appendix), consisting of four sections. Section A captured demographic information (age, gender, educational qualification, years in business, and business location). Section B measured Financial Constraints using five statements. Section C measured Taxation using five statements. Section D measured Transition operationalized as awareness of, and perceived benefit from LLC status using five statements. Sections B, C, and D were each measured on a five-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree).

Validity of the Instrument

The content and face validity of the instrument were established through review by experienced researchers and lecturers in the Department of Business Administration, Akwa Ibom State University, who assessed each item for clarity, relevance to the construct it was intended to measure, and appropriateness of language, following the procedure recommended for Likert-type instruments in social science research (Creswell & Creswell, 2018). Corrections suggested by the reviewers were effected before the instrument was administered to respondents.

Reliability of the Instrument

The internal consistency of the instrument was assessed using Cronbach's alpha, computed from a pilot administration of the instrument to a small sample of sole proprietors outside the main study sample. A Cronbach's alpha coefficient of at least 0.70 was adopted as the threshold for acceptable internal consistency, in line with the convention recommended for social science instruments (Nunnally, 1978).

Table 2: Reliability test result table

Variables	Cronbach's Alpha	Items
Financial Constraint	0.846	5
Taxation	0.881	5

Ethical Considerations

Ethical considerations central to this study included voluntary participation, informed consent, and confidentiality of responses. Prior to administration, respondents were briefed on the purpose of the study and, as stated in the instructions accompanying the instrument, they were assured that all information provided would be treated in strict confidence and used solely for academic purposes. Participation was voluntary and respondents retained the right to decline or withdraw at any point without consequence. No identifying information, such as names or business registration numbers were collected, and completed questionnaires were coded numerically to preserve respondent anonymity during data entry and analysis.

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ANALYSIS

The primary objective of this study was to investigate why many businesses are not transitioning from sole proprietorship to a limited liability company (LLC) with a focus on Uyo, Akwa Ibom State, Nigeria.

Table 3: Number of questionnaires administered and returned

Distribution of Questionnaire		Percentage
Copies of Questionnaire Retrieved	302	**100**
Copies of Questionnaire not retrieved	0	**0**
Copies of Questionnaire Administered	302	**100**

Source: Fieldwork, 2026

From Table 3 above, 302 questionnaires administered were successfully returned in good form and were used for the analysis.

Hypothesis One

H_{O1}: Financial constraints have no significant effect on the transition of businesses from sole proprietorship to Limited Liability Company (LLC).

Table 4: Linear regression analysis showing the effect of Financial constraints on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.569[a]	.324	.321	.53126
a. Predictors: (Constant), Financial_Constraints				

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	18.783	1	18.783	60.984	.000[b]
	Residual	92.397	300	.308		
	Total	111.179	301			
a. Dependent Variable: Transition						
b. Predictors: (Constant), Financial_Constraints						

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.770	.173		10.221	.000
	Financial_Constraints	-.434	.056	-.569	7.809	.000
a. Dependent Variable: Transition						

Source: Researcher's Computation (2026)

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The R-squared value of 0.324 in Table 4 indicated that about 32.4% of the variation in the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC) was explained by the financial constraints. The remaining 67.6% are factors not captured in the model.

In order to test the hypothesis, the researcher relied on the p-value of the F-statistic. The result showed the p-value of 0.000, which implied that the independent variable (financial constraints) had a significant negative influence on the dependent variable (the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC)). Therefore, the null hypothesis, which stated that there is no significant effect of financial constraints on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC), was rejected. The study revealed that every unit change in financial constraints would lead to a 56.9% decrease in the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC) (Beta= .569, p=0.000).

Hypothesis Two

H_{O2}: Taxation has no significant effect on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC).

Table 5: Linear regression analysis showing the effect of Taxation on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC).

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	-.740[a]	.547	.546	.40959
a. Predictors: (Constant), Taxation				

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	60.849	1	60.849	362.701	.000[b]
	Residual	50.330	300	.168		
	Total	111.179	301			
a. Dependent Variable: Transition						
b. Predictors: (Constant), Taxation						

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	.452	.141		3.204	.002
	Taxation	-.783	.041	-.740	19.045	.000
a. Dependent Variable: Transition						

Source: Researcher's Computation (2026)

The R-squared value of 0.547 in Table 5 indicated that about 54.7% of the variation in the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC) was explained by taxation. The remaining 45.3% are factors not captured in the model. To test the hypothesis, the researcher relied on the p-value of the F-statistic. The result showed the p-value of 0.0000, which implied that the independent variable (taxation) had a significant negative influence on the dependent variable - the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC). Therefore, the null hypothesis, which states that there is no significant effect of Taxation on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC), was rejected. The study revealed that every unit change in Taxation would lead to a 74.0% decrease in the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC) (Beta= .740, p=0.000).

Table 6: Summary of Regression Analysis

Variables	Beta (β)	R^2	F-value	Sig.
Financial Constraints	-0.569	0.324	60.984	$p < 0.001$
Taxation	-0.740	0.547	362.701	$p < 0.001$

Source: Field Survey, 2026

Table 6 above presents the summary of the regression analysis showing the influence of selected factors on the transition of sole proprietorship businesses to limited liability companies. The results revealed that all the variables examined are statistically significant at $p < 0.05$. Taxation has the highest explanatory power with $R^2 = 0.547$, showing that it accounts for 54.7% of the variation in business transition, while financial constraints explain 32.4% of the variation having $R^2 = 0.324$. The beta coefficients indicated that financial constraints and taxation both had negative relationships with business transition. Based on the regression results, taxation emerged as the most influential factor, followed by financial constraints, as shown in Table 7 below.

Table 7: Ranking of Factors Influencing Transition

Rank	Factor	R^2	Influence Level
1	Taxation	0.547	Very Strong
2	Financial Constraints	0.324	Moderate

DISCUSSION OF FINDINGS

To examine the effect of financial constraints on the transitioning of businesses from sole proprietorship to a Limited Liability Company (LLC).

The results of the first hypothesis showed that the independent variable (financial constraints) had a significant negative influence on the dependent variable (the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC). Therefore, the null hypothesis, which stated that there is no significant effect of financial constraints on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC), was rejected. The study revealed that every unit change in financial constraints would lead to a 56.9% decrease in the transition of businesses from sole proprietorship to Limited Liability Company (LLC) (Beta= -569, p=0.000). This is in agreement with the finding of Cruzado, Dimaano, Manahan, Medes and Villarma (2023), who found that financial constraint had a significant relationship with accessing finance for micro, small, and medium businesses in Calapan City, Philippines; while that study is drawn from a different national context, the convergence of findings across two very different regulatory environments strengthens the inference that financial constraint is a structural, rather than purely local, barrier to formalization. The result is further consistent with Adom's (2026) structural modelling of Nigerian firms, which shows that financial constraints are the dominant determinant of whether an already-operating informal firm such as the sole proprietorships sampled in this study ,chooses to formalize, and with Bruhn and McKenzie's (2014) cross-country review of formalization programmes, which similarly identifies the cost of compliance as the single most consistently binding constraint on microenterprise formalization.

The result of the first hypothesis indicated that financial constraints have a significant influence on the transitioning of businesses from sole proprietorship to a Limited Liability Company (LLC)**.** Since the null hypothesis was rejected ($\beta = -0.569$, $p = 0.000$), the study confirmed that access to adequate financial resources is a critical factor affecting whether sole proprietors are able or willing to formalize their businesses. This finding implies that sole proprietors facing financial limitations are less likely to transition to an LLC structure. Limited availability of funds, high costs of registration, and difficulties in accessing credit make the transition financially burdensome. Many business owners may prefer to continue operating as sole proprietors to avoid the additional expenses and obligations associated with forming an LLC.

Furthermore, the result showed that every unit increase in financial constraints led to a 32.4% decrease in the likelihood of transitioning to an LLC. This demonstrated that financial barriers are a substantial deterrent, directly impacting business owners' capacity to formalize, expand, or protect their businesses under a limited liability framework. Another implication is that financial constraints limit the potential growth and sustainability of sole proprietorships. Businesses that remain informal due to a lack of funds may face personal liability, limited access to investors, and restricted opportunities for market expansion, all of which hinder long-term development.

To examine the effect of Taxation on the transition of businesses from sole proprietorship to a Limited Liability Company (LLC).

The result of the second hypothesis showed that the independent variable (taxation) had a significant negative influence on the dependent variable - the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC). Therefore, the null hypothesis, which stated that there is no significant effect of Taxation on the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC), was rejected. The study revealed that every unit change in Taxation would lead to a 74.0% decrease in the transitioning of businesses from sole proprietorship to Limited Liability Company (LLC) (Beta= -.740, p=0.000). This is in agreement with the study and findings of Okitiakpe and Ehiedu (2025), who also found a significant negative relationship between tax burdens and profitability in their work on the relationship between tax obligations and profitability of Nigerian firms using a mixed-methods approach.

This finding implies that higher tax burdens, complex tax regulations, and perceived tax obligations associated with LLCs discourage many sole proprietors from transitioning to a limited liability structure. Sole proprietors may prefer to maintain their existing business structure because it is perceived to have simpler tax requirements and possibly lower tax liabilities. The result showed that every unit increase in taxation led to a 74.0% decrease in the likelihood of transitioning to an LLC. This suggests that taxation is a strong deterrent to business formalization. This means that as tax obligations increase or are perceived to increase, sole proprietors become less willing to adopt the LLC structure.

Another implication is that tax-related concerns may limit the growth and formalization of small businesses. By remaining as sole proprietorships, business owners may continue to face unlimited liability and limited access to investment opportunities, credit facilities, and large markets that are often associated with formal business structures such as LLCs. Overall, the findings imply that tax policies and regulations play a critical role in influencing the structural decisions of small business owners. Therefore, if governments intend to encourage the transition of sole proprietorships to LLCs, there may be a need to simplify tax procedures, reduce perceived tax burdens, and introduce tax incentives for small businesses that formalize their operations.

CONCLUSION

The paper sought to investigate why many businesses are not transitioning from sole proprietorship to a limited liability company (LLC) with a focus on Uyo, Akwa Ibom State, Nigeria. From the findings, financial constraint and taxation have a significant influence on sole proprietorship transition into a limited liability company, with taxation having the most influence. This study therefore concludes that financial constraints, such as limited availability of funds, limited access to credit facilities, among others, and taxation both have a significant effect on the transition of sole proprietorship into limited liability companies in Uyo, Akwa Ibom State.

Limitations And Suggestions for Further Research

This study deliberately estimated two separate simple linear regression models rather than a single multiple regression model, because its two objectives were framed to test the independent effect of financial constraints and of taxation, respectively, and not their combined or interactive effect. This was a considered methodological choice rather than an oversight, and it should not be read as a limitation of technique so much as a boundary of scope: the study establishes, with reasonable statistical confidence, that each factor independently and significantly deters transition, but it does not, and was not designed to, establish how the two factors combine, interact, or trade off against one another in a proprietor's actual decision to incorporate.

This boundary of scope, together with the study's cross-sectional, single-city, perception-based design, points to several concrete directions for further research. First, future researchers can build directly on the two independent effects established here by employing multiple or hierarchical regression to test the combined explanatory power of financial constraints and taxation together, and moderated or interaction-term regression to test whether the effect of one factor depends on the level of the other, for example, whether the deterrent effect of taxation is weaker among sole proprietors who face fewer financial constraints. Second, because transition in this study was operationalized as a readiness/perception construct rather than an observed conversion event, a longitudinal design that follows a cohort of sole proprietors over time, ideally matched against actual incorporation records from the Corporate Affairs Commission, would allow future researchers to test whether perceived readiness translates into actual formalization behaviour. Third, the transition from the Finance Act regime to the Nigeria Tax Act 2025 regime offers a natural before-and-after setting in which future researchers could examine whether the widened small-company tax exemption measurably changes sole proprietors' taxation perceptions and transition readiness once it becomes more widely known. Finally, replicating this study across other commercial centres in Akwa Ibom State and beyond would help establish whether the relative strength of taxation over financial constraints observed in Uyo holds more generally.

Recommendations

Government and financial institutions should design transition-focused funding schemes specifically for sole proprietors, intending to incorporate soft loans, incorporation grants, and subsidized advisory services that can reduce the cost burden of registration, legal documentation, and compliance. Institutions such as the Bank of Industry and the Small and Medium Enterprises Development Agency of Nigeria can create dedicated transition funds to ease short-term liquidity pressure during restructuring. The Federal Inland Revenue Service and the newly established Nigeria Revenue Service should simplify tax registration and compliance processes for newly incorporated LLCs and should consider a transitional tax relief period or reduced compliance requirements during the first few years of incorporation to encourage formalization. Many sole proprietors avoid incorporation due to perceived high tax burdens. Awareness campaigns should clarify the tax advantages of incorporation, small business exemptions, and incentives under reforms such as the Finance Act 2020. The Corporate Affairs Commission and relevant state government agencies should intensify outreach on the CAMA 2020 reforms most relevant to sole proprietors particularly single-member company incorporation and the reduced share-capital requirement since awareness of these specific provisions, rather than of CAMA 2020 in general, is what would most directly lower the perceived barrier to transition documented in this study.

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APPENDIX

QUESTIONNAIRE

Instructions to Respondents:

Please read each question carefully and provide your response by selecting the number that best represents your opinion or situation.

For most questions, use the following 5-point scale to indicate your level of agreement:

- 1 = Strongly Disagree
- 2 = Disagree
- 3 = Neutral (Neither agree nor disagree)
- 4 = Agree
- 5 = Strongly Agree

For the transitioning status questions (Section B), please select the option that applies by marking the corresponding box.

Your honest and thoughtful responses are very important for the success of this study. All information provided will be treated confidentially.

Section A: Demographic Information

1. Age: _______

2. Gender: □ Male □ Female

3. Educational Qualification: □ No formal education □ Primary □ Secondary □ Tertiary □ Others (specify)

4. Years in Business: _______

5. Business location:

□ Building Material Market (Oron Road)
□ Ikot Ekpene Road
□ Oron Road
□ Abak Road
□ Aka Road
□ Nwaniba Road
□ Udo Umana Road

Section B: Financial Constraints

Please indicate how much you agree or disagree with the following statements:

1. My business has limited availability of funds needed for transitioning to an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
2. Accessing credit for transitioning is difficult for my business.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
3. I find the financial cost of transitioning to an LLC too high.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
4. Lack of financial resources is my major barrier to transitioning.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
5. Uncertainty about financial returns discourages me from transitioning.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

Section C: Tax Impact

Please indicate your agreement level:

1. The tax burden on LLCs is higher than that of sole proprietorships.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
2. Tax regulations for LLCs are complex and difficult to understand.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
3. I am concerned about potential tax penalties after transitioning.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
4. Filing tax returns as an LLC is more complicated than as a sole proprietor.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)
5. Lack of tax incentives discourages my business from transitioning to an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

Section D Transitioning Status: Awareness and Perception of Limited Liability Company (LLC)

Please indicate your agreement with the following statements regarding LLCs:

1. I understand the operational requirements of an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

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2. I am aware of the benefits of transitioning from a sole proprietorship to an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

3. I believe that operating as an LLC reduces my personal financial risk.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

4. I consider limited liability protection an important reason to transition to an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

5. I have sufficient information about the process of incorporating an LLC.
(1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)