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Venture Capital Management Practices and Financial Performance of Fintech Startups in Lagos, Nigeria: An International Perspective

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Abstract

Venture capital has emerged as a critical source of funding and support for small businesses and FinTech startups. It is playing a vital role in driving their growth, innovation, and overall performance. This study presents a comprehensive analysis of the relationship between venture capital and the performance of small businesses and FinTech startups. Drawing on existing literature and empirical data, this research provides valuable insights into the various aspects of this relationship and its implications for entrepreneurs, investors, and policymakers. The analysis highlights the positive impact of venture capital financing on the performance of small businesses and FinTech startups. Findings reveal that a majority of participants recognized venture capital as a catalyst for growth, expansion, and improved operational efficiency. The study highlights the positive relationship between venture capital and performance. The findings underscore the significance of venture capital financing as a catalyst for growth, innovation, and competitiveness in the entrepreneurial ecosystem. The insights provided can inform entrepreneurs, investors, and policymakers in optimizing the benefits of venture capital investments, fostering sustainable growth, and driving economic development.

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Keywords: Venture Capital; Performance; Small Businesses; FinTech Startups; Effective Management Practices; Financial Literacy; Effective Financial Management

Introduction

The Nigerian business landscape is predominantly characterized by small businesses, which play a significant role in the country's economy. Small businesses are reported to contribute approximately 80% to job creation and 58% to the Gross Domestic Product (GDP) of Nigeria. These statistics underscore the pivotal role that startups play in driving economic growth, creating employment opportunities, and enhancing the overall well-being of the Nigerian population. However, despite the substantial contributions of small businesses, Nigeria continues to face several challenges on multiple fronts. Over the past decade, the country has witnessed a persistent increase in the unemployment rate, particularly among the youth. According to recent statistics, the youth unemployment rate in Nigeria stands at a staggering 33.3%, underscoring the urgent need for sustainable job creation initiatives. Moreover, the GDP growth rate has not been able to keep pace with the increasing population, leading to a decline in per capita income and the standard of living. Capital formation, which is crucial for long-term economic development, has been inadequate, hampering the country's ability to invest in infrastructure, technology, and human capital. This insufficiency in capital formation is reflected in Nigeria's low utilization capacity and limited productive capacity. [5]

Additionally, the poverty rate remains high, with a significant proportion of the population living below the poverty line. Statistics show that over 63% of Nigerians live in poverty, struggling to meet their basic needs and lacking access to essential services and opportunities for upward mobility.[2] In light of these statistics, it becomes imperative to address the existing challenges and explore strategies that can effectively harness the potential of startups and (Fintech) to drive sustainable economic growth, job creation, and poverty reduction. Analyzing the impact of venture capital financing on startup

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[5]Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and National Bureau of Statistics (NBS),National Survey of Micro, Small and Medium Enterprises (MSMEs): Key Findings and Statistics. SMEDAN and NBS(2021).

2Ezenekwe, U. R., A. G, Metu, and C.V. Madichie, "Small and Medium-Scale Enterprise Financing and Industrial Growth in Africa." Unizik Journal of Business *1, no.*2(2018), https://doi.org/10.36108/unizikjb/8102.10.0280

3Franklin, A, A," Evaluating Innovations in Small and Medium Scale Enterprises in Bayelsa State." Journal of Economics, Finance and Management Studies*4, no.*7(2021):8, https://doi.org/10.47191/jefms/v4-i7-03.

4Aremu, M. A., and S. L. Adeyemi,"Small and Medium Scale Enterprises as a Survival Strategy for Employment Generation in Nigeria." Journal of Sustainable Development4, no.1 (2011): 200.

5Ufua, D. E., O. J.et al.,"Operations of Small and Medium Enterprises and the Legal System in Nigeria." Humanities and Social Sciences Communications7, no. 94(2020):6.

6Robb, A. M., andD. T. Robinson. "*The Capital Structure Decisions of New Firms.*"Review of Financial Studies 27, no.1(2014): 155.

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performance, as outlined in the earlier discussion, is crucial for gaining insights into how such support can be optimized to bolster the Nigerian economy and improve the well-being of its citizens.[3]Yet in Nigeria, the small and medium scale enterprises is stagnated and remain relatively small in terms of its contribution to gross domestic product (G.D.P).[4] Due to numerous issues facing the sector, (Fintech) in Nigeria have performed poorly. Poor managerial and entrepreneurial skills, difficult financial conditions, a lack of demand for their goods and services, poor research and development and innovation, a lackluster technology system, corruption, and a lack of transparency resulting from government regulations and regulatory bodies are some of the issues this industry faces .[5] For example, about 222 small businesses have shut down within a year while about 80% of the small businesses are stifled due to monetary policy issues, instability in the economy and poor financing.

As observed from literature, poor financing or inadequate finance constitutes one of the major obstacles to the growth of startups in Nigeria. Even when startups have sourced funds from these traditional financial institutions with many of them going from one level of growth to the next, the majority of them have fallen prey to debt obligation (Robb et al., 2014).[6] As a result, the majority of (Fintech) are unable to innovate, acquire high-quality assets, expand sales volume, hire suitable qualified people, and carry out other crucial responsibilities. Due to a lack of cash to hire specialists like managers and accountants, they are also prevented from documenting improvements in the quality of management and achieving efficient financial management. Their ability to expand and thrive in the challenging business environment is impacted by this predicament. Although venture capital has emerged as an alternate funding strategy to boost the growth and performance of small (Fintech), little is known about the results.

Conceptual Clarifications

(a) Fintech

Fintech, short for financial technology, refers to the innovative application of technology in the financial services industry, aimed at enhancing and revolutionizing traditional financial processes. Fintech encompasses a broad spectrum of technologies, platforms, and business models that leverage advancements in computing, data analytics, artificial intelligence, blockchain, and mobile technology to deliver efficient, convenient, and accessible financial solutions to individuals, businesses, and institutions.

According to an article published in the Journal of Financial Services Marketing, fintech can be understood as "technology-driven companies that provide financial services or leverage technology to deliver financial products or solutions." These companies leverage digital platforms, automation, and data analytics to disrupt and improve various financial activities, including payments, lending, investments, insurance, wealth management, and compliance. There are certain traits characterizing it thus:

1) Technological Innovation: Fintech companies leverage advancements in technology to develop innovative solutions that improve and disrupt

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traditional financial services. They incorporate technologies such as artificial intelligence, machine learning, blockchain, big data analytics, mobile applications, and cloud computing to create unique offerings.

2) Customer-Centric Approach: Fintech companies prioritize providing customer-centric financial services by offering convenient, accessible, and personalized solutions. They focus on enhancing user experiences, simplifying financial processes, and meeting the evolving needs of customers in a digital age.

3) Disruption of Traditional Financial Systems: Fintech companies challenge and disrupt traditional financial systems and incumbents by offering alternative, more efficient, and cost-effective solutions. They often target specific pain points or inefficiencies in the financial industry and introduce disruptive business models and technologies to address them.[6]

4) Agility and Flexibility: Fintech companies operate in fast-paced environments and are characterized by their agility and flexibility. They are able to respond quickly to market changes, adapt their products/services, and iterate based on user feedback and emerging trends. This characteristic enables them to stay competitive and innovative.

5) Emphasis on Data: Fintech companies heavily rely on data to drive decision-making, improve risk assessment, and enhance customer experiences. They collect, analyze, and leverage vast amounts of data to gain insights, develop algorithms, and provide tailored financial solutions.

6) Collaboration and Partnerships: Fintech companies often collaborate with traditional financial institutions, regulatory bodies, and other industry stakeholders to navigate regulatory complexities, access resources, and establish credibility. Partnerships with established players enable fintech companies to leverage existing infrastructure and customer networks.

7) Regulatory Compliance: Fintech companies must navigate complex regulatory landscapes to ensure compliance with financial regulations and data privacy laws. They often invest in compliance measures and collaborate with

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[66]7 Drover, W., M. Wood, and A. C. Corbett.
"Toward a Cognitive View of Signalling Theory: Individual Attention and Signal Set Interpretation."Journal of Management Studies55, no.2 (2018): 211.
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8Grilli, L., G. Latifi, and B. Mrkajic,.
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9Vanacker, T., and S. Manigart.
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10Block, J. H., A.Groh, L. Hornuf, T. Vanacker, and S.Vismara.
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regulatory bodies to ensure transparency, security, and trust in their operations.

8) Scalability and Global Reach: Fintech companies have the potential for rapid scalability and global expansion due to the digital nature of their offerings. With the ability to leverage technology and digital platforms, they can reach a wide customer base beyond traditional geographic boundaries.

(b) ***Venture Capital***

The term VC is used inconsistently in literature, with private equity (PE) being the more common term used by researchers to mean various forms of alternative financing such as venture capital, buyouts, crowd funding, etc., in contrast, a handful of researchers tend to employ venture capital and private equity simultaneously.[7] Since several works of literature consistently regard venture capital to be subset of PE and this is in line with how venture capital is revered in Nigeria, this paper will consider VC as a subset of private equity. Existing literature has also categorized venture capital into two; the supply and demand of venture capital. The purpose of this research is to assess the impact of various exogenous variables on the industry.

VC investment is the expert investment management activity that funnels money from large organizations and wealthy individuals into small, privately held businesses with significant growth potential, this could be at the "seed," "startup," or "growth capital" stage of development .[8] There are many distinguishing features of VC that set it apart from other types of financial products, unlike most alternative forms of asset classes and financing, venture capitalists' duties do not end with the funding and identification of promising investment opportunities .[9] These “business angels” as they are so-called, play a hands-on, often operational role in the growth of the companies in which they have invested. Block et al. (2021) argues that, the reasons why venture capital firms are very invested in the day-to-day activities of their portfolio companies are because of the necessity of[7] accountability to the fund providers and the level of risk associated with VC, as the venture capitalist asserts that nine out of ten VC investments fail. In addition, a VC firm is not finished with its job until all of its investments in a portfolio company have been sold.[10]

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[7]11Block, J. H., A.Groh, L. Hornuf, T. Vanacker, and S.Vismara.
“The Entrepreneurial Finance Markets of the Future: A Comparison of Crowdfunding and Initial Coin Offerings.”Small Business Economics 57, no. 2 (2021): 870.
12Cornelli, G., S. Doerr, L. Gambacorta, and O. Merrouche. (2021).
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Figure 1a Average round size for venture capital

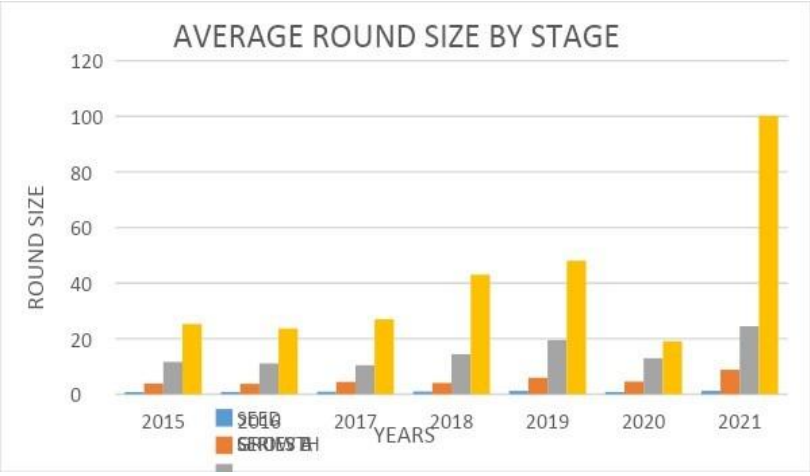
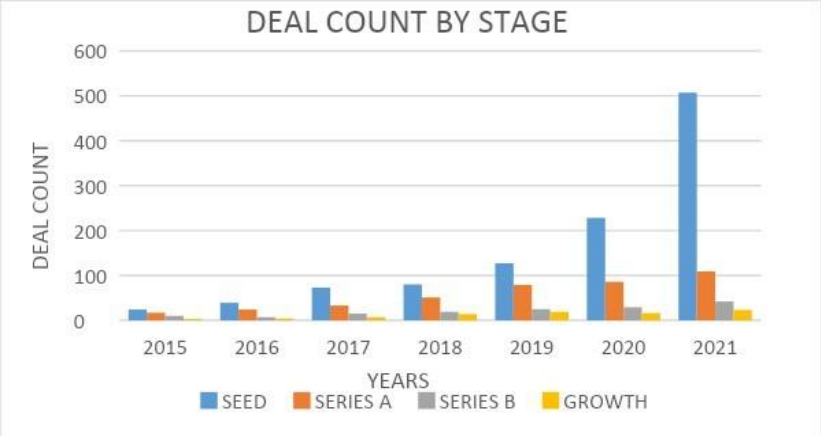


Figure 1b Average deal count by stage



iv. Fund Strategy

Just like any organization aimed at being successful, VCs choose strategies that most increase their chances at a successful investment. Therefore, fund strategy is the modus operandi adopted to aid VCs to maximize returns while considering the ecosystem in which they operate or intend to operate. In simple terms, it is the choice to diversify or specialize. Empirical evidence suggests that the strategy varies across firms, and as stated by Block et al. (2021) some VC firms invest opportunistically. Fund strategy could be based on, sector, geography, or expertise, or a combination of these, as it suits the firm.[11]

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Sector-based strategies are industry-focused approaches to building a network.[12] While the approach is not new, there is mounting evidence that sector-based strategies [8]can simultaneously increase the amount of deal flows and give competitive advantage in industries .[13] The advantages include expertise, more network (in terms of attracting funders), better access to deal flow and due diligence will be easier. A sector-based strategy helps VCs to ask relevant questions, as it is believed that the VC has a team of experts in that sector, hence they are able to verify firsthand the information sold to them by their clients. The disadvantages of this strategy are risks of underperformance and lack of diversification. To mitigate these risks, it is advised that VC firms operate a case of countercyclical sectors whereby if one underperforms, the other is likely to increase in performance, or invest in different subsectors .[14] Gompers et al., found a strong relationship between degree of specialty and success of VC investment, specialists in a specialist firm outperforms generalist, specialist are superior in early-stage investment, whereas generalist investments are safer because most times, generalists are opportunistic investors.[15] Idi and Chiloane-Tsoka found that the strongest indicators of fund performance are entrepreneurial experience and domain expertise.[16]

The Role of Venture Capital in Fintech

1) Capital Infusion: One of the primary roles of VC firms in fintech is providing the necessary capital infusion to fuel the growth and expansion of startups. Fintech companies often require substantial upfront investments to develop and scale their technology platforms, acquire customers, and build their market presence. VCs provide funding at different stages of the startup's lifecycle, ranging from early-stage seed funding to later-stage rounds, such as Series A, B, or C funding. This capital infusion enables fintech startups to hire talent, invest in research and development, and build robust infrastructure to support their operations.

2) Expertise and Industry Connections: Beyond financial support, VC firms bring valuable expertise, industry knowledge, and connections to their portfolio companies. They often have a deep understanding of the fintech landscape, regulatory frameworks, and emerging trends. VCs can provide guidance and mentorship to fintech founders, assisting them in making strategic decisions, navigating regulatory challenges, and seizing market opportunities. Additionally, VC firms have extensive networks within the financial industry, enabling them to connect fintech startups with potential partners, customers, and other investors.

3) Due Diligence and Validation: VC firms typically conduct thorough due diligence before making investment decisions. Their expertise allows them to assess the viability, scalability, and potential of fintech startups. By conducting due diligence, VCs help validate the business model, technology, and market fit of fintech companies. This validation can provide reassurance

17 Achugbu, T. U. "Venture Capital Financing for Innovative Start-up Companies in Nigeria." Texila International Journal of Management 3, no. 2(2017): 10, https://doi.org/10.21522/tijmg.2015.03.02.art001

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to other stakeholders, including potential customers, partners, and follow-on investors, and enhance the startup's credibility in the market.

4) Risk Mitigation and Portfolio Diversification: Investing in fintech startups carries inherent risks, but VC firms often mitigate these risks by building diversified portfolios. They invest in a range of fintech companies operating in different subsectors, geographies, and stages of development. By diversifying their investments, VC firms spread the risk across multiple startups, increasing the likelihood of finding successful ventures. This risk mitigation strategy allows VC firms to support innovation in the fintech space while managing the inherent uncertainties associated with startup investments.

5) Exit Strategy and Returns: VC firms invest in fintech startups with the expectation of generating significant returns on their investments. They work closely with fintech founders to develop exit strategies, such as mergers and acquisitions or initial public offerings (IPOs), that can provide liquidity and an exit for their investments. Successful exits not only generate returns for VC firms but also attract more capital to the fintech ecosystem, facilitating further innovation and growth.

Challenges faced by Fintechs

1) Limited Track Record: Fintech startups often lack an extensive track record compared to more established businesses. Without a proven history of revenue generation and profitability, securing funding from investors can be challenging. Investors may be hesitant to invest in companies without a track record of success, making it harder for fintech startups to secure the necessary capital.

2) Regulatory Uncertainty: Fintech operates in a highly regulated industry, and navigating regulatory frameworks can be complex. Compliance with financial regulations and licensing requirements can be time-consuming and expensive. Regulatory uncertainty can create additional challenges for fintech companies when seeking funding, as investors may be cautious about potential regulatory risks and the impact they may have on the company's growth prospects.

3) Long Sales and Implementation Cycles: In fintech, the sales and implementation cycles can be lengthy due to the involvement of multiple stakeholders, including financial institutions, regulators, and customers. This extended timeline can deter investors who seek shorter return on investment horizons. Fintech companies must effectively communicate their strategies for acquiring and retaining customers to instill confidence in potential investors.

4) Need for Significant Capital: Fintech innovations often require substantial investment to develop and scale their technology platforms. Building infrastructure, investing in research and development, and complying with regulatory requirements can be capital-intensive. This need for significant capital can be a barrier to entry for many fintech startups, as investors may be hesitant to provide large funding amounts without clear evidence of potential returns.

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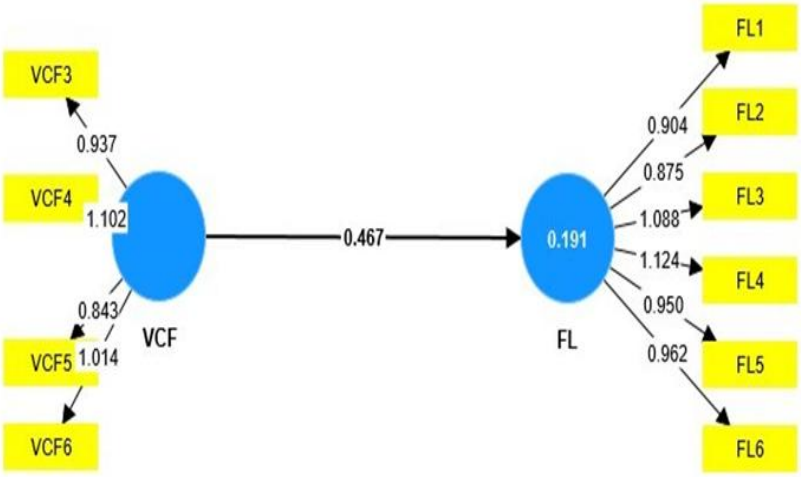
5) Market Saturation and Competition: The fintech industry has experienced rapid growth and has become increasingly competitive. Fintech startups must contend with numerous competitors, both established players and other startups vying for funding from similar investors. The high level of competition can make it more challenging for fintech companies to differentiate themselves and attract funding.

6) Economic Volatility: Fintech companies, like any other businesses, are susceptible to economic downturns and market fluctuations. During periods of economic instability, investors may become more risk-averse and less inclined to invest in early-stage fintech companies. Economic volatility can impact the availability of funding and increase the level of scrutiny faced by fintech startups.[17]

RESULTS AND DISCUSSION

HYPOTHESIS ONE

Ho: There is no significant relationship between venture capital financing and financial literacy among small businesses and fintech startups in Lagos, Nigeria.



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	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)	Average variance extracted (AVE)
FL	0.862	0.95	0.882	0.557
VCF	0.757	0.886	0.837	0.564

For the construct "FL" (Financial Literacy), the reliability measures indicate a high level of internal consistency. The Cronbach's alpha value is 0.862, signifying that the items within the FL construct are reliable and coherent. The composite reliability (rho_a) is 0.95, indicating a strong level of reliability, and the composite reliability (rho_c) is 0.882, further confirming the robust internal consistency of the FL construct. Additionally, the average variance extracted (AVE) is 0.557, which demonstrates that the construct captures a substantial proportion of the variance within its items, indicating good convergent validity.

Similarly, for the construct "VCF" (Venture Capital Financing), the reliability measures also show a satisfactory level of internal consistency. The Cronbach's alpha value is 0.757, indicating a good level of reliability within the VCF construct. The composite reliability (rho_a) is 0.886, suggesting a strong level of reliability. The composite reliability (rho_c) is 0.837, further supporting the internal consistency of the VCF construct. The average variance extracted (AVE) is 0.564, indicating that the construct captures a substantial proportion of the variance within its items, indicating good convergent validity.

In conclusion, the reliability and validity results of the PLS-SEM analysis demonstrate that both the "Financial Literacy" and "Venture Capital Financing" constructs have good internal consistency and capture a significant amount of variance within their respective items

DISCRIMINANT RELIABILITY

Discriminant Reliability	FL	VCF
	0.746	
VCF	0.437	0.751

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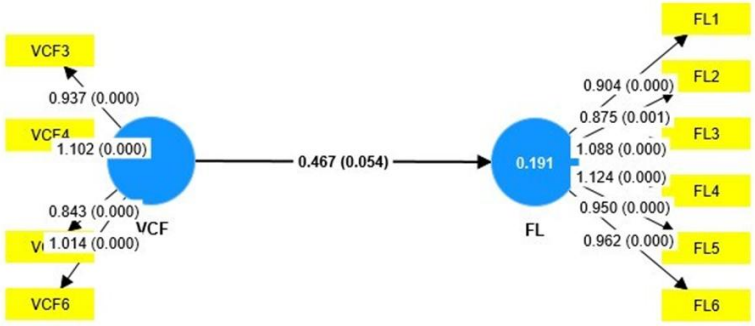
Fornell-Larcker criterion FL

The diagonal values in the matrix represent the square roots of the average variance extracted (AVE) for each construct. For the construct "Financial Literacy" (FL), the AVE is 0.746, and for the construct "Venture Capital Financing" (VCF), the AVE is 0.751. These values indicate that both constructs capture a substantial proportion of the variance within their respective items. The off-diagonal values in the matrix represent the correlations between the constructs. The correlation between FL and VCF is 0.437, which is less than the square roots of the AVEs for both constructs. This indicates that the constructs have discriminant validity since the correlation between them is lower than the individual AVEs. It suggests that FL and VCF measure different underlying concepts and are not highly correlated.



	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
VCF -> FL	0.467	0.534	0.242	1.928	0.054

The original sample value for the relationship between VCF and FL is 0.467. The sample mean is 0.534, which represents the average value obtained from the bootstrap samples. The standard deviation is 0.242, indicating the variability in the bootstrap sample means.

The T statistics is 1.928, which is less than the conventional threshold for statistical significance (typically set at 2.0). The associated P value is 0.054, which is slightly higher than the typical significance level of 0.05. Based on these results, the relationship between VCF and FL is not statistically significant at the conventional level of significance ($\alpha = 0.05$). While the T statistics indicate some degree of association between the variables, the P value suggests that this association may have occurred by chance alone.

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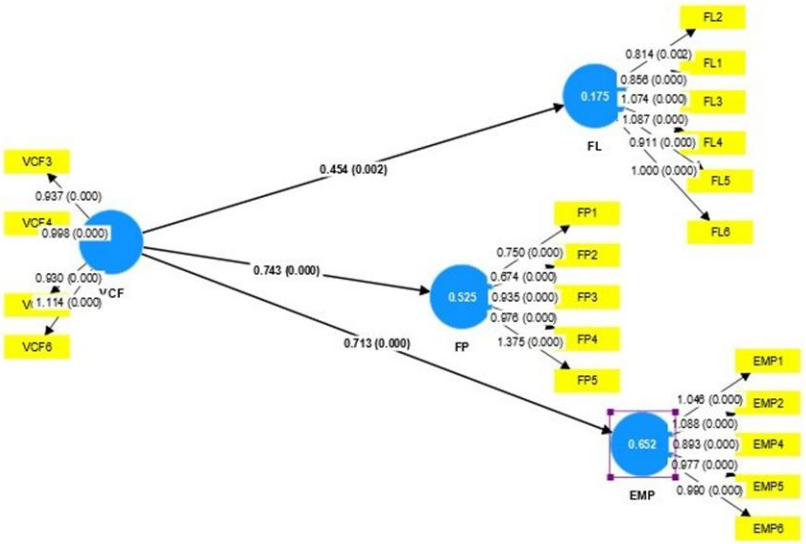
In summary, the analysis does not provide strong evidence to support a significant relationship between "Venture Capital Financing" and "Financial literacy." The results suggest that the observed relationship may not be reliably different from zero, and further investigation with a larger sample size or alternative methods may be necessary to determine the true nature of the relationship between these variables.

TEST OF HYPOTHESIS TWO

Ho: There is no significant relationship between venture capital financing and fintech startup performance in Lagos, Nigeria.



The Path co-efficient and P-values of the test for the hypothesis of the effect of venture capital financing on the overall performance of small and fintech startups in Lagos, Nigeria inedicate that there is a significant relation between the two variables. In summary, the bootstrap analysis provides strong evidence to support a significant relationship between "Venture Capital Financing" and "Overall Performance of Small Business and Fintech Startups". The results indicate that there is a robust and reliable relationship between these variables.

Findings

The majority of participants believe that venture capital financing has a positive influence on overall performance, growth, and expansion. They recognize the importance of venture capital funding in providing critical resources, networks, and expertise necessary for success. This highlights the

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potential benefits that FinTech startups can gain from engaging with venture capital firms and seeking investment opportunities.

Venture capital Financing and Financial Literacy among Fintech startups in Lagos Nigeria

The analysis did not find a significant relationship between financial literacy and venture capital financing. However, it is important to note that financial literacy remains a critical factor for the success of FinTech startups. Participants expressed confidence in their understanding of financial concepts and possession of necessary knowledge and skills. This suggests that entrepreneurs and employees should continue to invest in financial literacy to effectively manage the financial aspects of their companies. While financial literacy may not be directly impacted by venture capital financing, it is still crucial for FinTech startups to develop a strong foundation of financial literacy for sustainable growth and success.

Financial literacy also plays a vital role in the success of FinTech startups. However, there is room for improvement, as some respondents had neutral or negative responses regarding their confidence in financial literacy. Enhancing financial literacy among entrepreneurs and employees in FinTech startups can further strengthen their ability to effectively manage financial operations and make informed decisions.

Venture Capital financing and performance of Fintech startups in Lagos Nigeria

The findings indicate that venture capital financing has a significant impact on various aspects of small bus

There are no sources in the current document.

inesses and FinTech startups. It positively influences effective management practices, financial performance, and the overall performance of companies. Venture capital funding provides critical resources, networks, and expertise necessary for success. It enables companies to achieve significant growth, enhance operational efficiency and scalability, innovate, and improve their market position. The relationship between venture capital financing and these variables suggests that obtaining venture capital funding can be a crucial factor in the success and long-term viability of small businesses and FinTech startups.

Furthermore, participants perceive venture capital financing as a catalyst for innovation and technological advancement. They believe that access to venture capital funding positively influences their companies' ability to innovate and adopt new technologies. This finding underscores the importance of venture capital in driving technological advancements and supporting the growth of the FinTech industry, which heavily relies on innovation.

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Hypothesis 1

The null hypothesis was accepted while we rejected the alternative hypothesis. This implies no significant relationship between venture capital financing and financial literacy and Fintech start-ups in Lagos Nigeria.

Hypothesis 2

The null hypothesis was rejected while we accepted the alternative hypothesis. This implies that there is a significant and reliable relationship between venture capital financing and the overall performance of small businesses and fintech startups in Lagos, Nigeria.

Conclusion

In conclusion, the findings of this study underscore the positive influence of venture capital effective financial management practices and effective management practices on the performance, growth, and sustainability of FinTech startups in Nigeria. By leveraging venture capital opportunities, implementing sound management strategies, and enhancing financial literacy, these businesses can enhance their competitiveness, attract investment, and drive innovation. It is crucial for stakeholders, including businesses, investors, and policymakers, to collaborate and support initiatives that foster a conducive environment for venture capital funding and enable the growth of small businesses and FinTech startups in Nigeria.

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