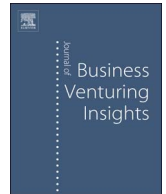


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# Government efficiency and corruption: A country-level study with implications for entrepreneurship



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## ABSTRACT

If and how the efficiency of governments plays a role in determining relationships between corruption and entrepreneurship has not been examined at length. The empirical findings on control of corruption are inconclusive, and our knowledge regarding the moderation of efficient or less-efficient governments is rather limited. Using a multisource panel dataset of 59 countries, we find that any conclusion suggesting that corruption is universally good or bad for entrepreneurship may risk being overstated because the degree to which governments are efficient moderates the nonlinear effects of control of corruption on entrepreneurship.

## 1. Introduction

Corruption, defined as abuse of public power for private gain, is often viewed as a negative phenomenon (Warren, 2004), but can have a complex impact on the economy (e.g. Méndez and Sepúlveda, 2006). Similarly, studies on entrepreneurship suggest that corruption can have nonlinear, insignificant, or moderated impacts at the country level (Aidis et al., 2012; Anokhin and Schulze, 2009; Dreher and Gassebner, 2013). Corruption under different contexts can have varying effects on entrepreneurship. One factor that alters the effects of corruption is the ways in which businesses are regulated (Tonoyan et al., 2010). Red tape, over-regulation, and rigidity could redefine how corruption impacts entrepreneurship as corruption under such conditions can grease the wheels of entrepreneurship (Dreher and Gassebner, 2013).

Put differently, the effects of corruption on entrepreneurship are complex and can have nonlinear and both positive and negative effects depending on the context. To further stimulate the ongoing discussion, we examine the nonlinear relationship between corruption and nascent entrepreneurship with a focus on how it is moderated through government efficiency. Government efficiency refers to the absence of over-regulation, ambiguity, and wastefulness. Although nonlinearity in the relationship has been studied before (Anokhin and Schulze, 2009), we investigate how such nonlinearity is shaped by different levels of government efficiency. Our findings have implications for determining how much effort policy makers should dedicate to combating corruption under different levels of government efficiency while fostering entrepreneurship.

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## 2. Corruption and government efficiency

### 2.1. Control of corruption

Corruption refers to the abuse of public power for private gain (Rodríguez et al., 2005), and control of corruption refers to the extent to which it is contained. Various researchers have studied the effects of corruption on different economic factors (e.g., Mauro, 1995; Mo, 2001; Méndez and Sepúlveda, 2006) and more recently on entrepreneurship. The results concerning entrepreneurship have however been mixed. For example, Dutta and Sobel (2016) and Anokhin and Schulze (2009) found negative effects of corruption while other studies have found no direct country-level effects (Aidis et al., 2012). On the other hand, Dreher and Gassebner (2013) and Belitski et al. (2016) found positively moderated effects. In addition to complex nature of the relationship, differences in methodologies used (especially regarding whether cross-sectional or panel data are used or whether the measure of entrepreneurship used only captures official entrepreneurship) have arguably also contributed to mixed results.

### 2.2. Government efficiency

Government efficiency refers to efficiency of government in terms of regulation burdens, government wastefulness, regulation transparency, and efficiency of legal frameworks (Schwab and Sala-i-Martin, 2015). Scholars such as Lee and Whitford (2009) and Portes and Haller (2010) consider government efficiency as government performance (when resources are not wasted) and non-burdensome of regulations (when there is no over-regulation). Accordingly, we define government efficiency as the extent to which governments do not waste resources or place burdensome and ambiguous regulations on institutions, organizations, and individuals in a country (Schwab and Sala-i-Martin, 2015). Government efficiency and corruption refer to two different phenomena, as corruption is understood as an abuse of public positioning for private gain (Rodríguez et al., 2005). This distinction is in line with what is known as the “grease the wheels” hypothesis. It suggests that corruption can be beneficial when regulations burden businesses, when there is over-regulation and inflexibility, when governments waste resources, and when regulations are not transparent to businesses. In other words, in studying the grease (or sand) the wheels hypothesis (e.g., Méon and Sekkat, 2005), scholars clearly distinguish issues of bribery and other corrupt practices from issues such as over-regulation, red tape, and inflexibility.

### 2.3. Corruption, government efficiency, and entrepreneurship

The findings of Anokhin and Schulze (2009) suggest that corruption and entrepreneurship may have a convex (also known as concave upward) relationship. Other authors such as Dreher and Gassebner (2013) discuss how corruption can grease the wheels of entrepreneurship (i.e., in countries with inefficient governments, corrupt practices such as “speed money” benefit businesses) (Mauro, 1995). Thus, under inefficient governance with over-regulation, initial efforts to combat corruption can harm entrepreneurial efforts. However, as Rothstein and Uslaner (2005) note, when governments continuously combat corruption, they establish trust in a society which in turn benefit entrepreneurship. Consequently, under inefficient governments, the relationship between control of corruption and entrepreneurship is first downward and then upward (i.e., convex).

As governments become more efficient, effects of the grease the wheels hypothesis and trust decrease. First, since regulations are more transparent, less burdensome, and less excessive, entrepreneurs do not need to bribe officials to get their businesses started. Second, as societal trust is higher in countries with efficient governments, pushing for higher control of corruption has a less positive effect. However, when governments become highly efficient, some degree of rigidity and inflexibility (a type of red tape) emerges because of the transparent and unquestionable nature of regulations. In such high-trust societies, some corruption can once again grease the wheels of entrepreneurship. Taken together, as government efficiency increases, the relationship between control of corruption and entrepreneurship grows less convex, and in extreme cases, it can become concave.

H1: Government efficiency negatively moderates the convexity of the relationship between control of corruption and entrepreneurship.

## 3. Data and method

### 3.1. Data

We performed the empirical analysis using a multisource 339 country-year dataset of 59 countries for 2008–2015. Information on entrepreneurship was collected from the Global Entrepreneurship Monitor (GEM) (Acs et al., 2004). In addition to data on two control variables, data on government efficiency was obtained from the Global Competitiveness Report (GCR) (Schwab and Sala-i-Martin, 2015). For control of corruption, we used Kaufmann et al. (2011) measure, which is used in the World Governance Indicators (WGIs). Finally, the rest of the control variables were collected from the World Development Indicators (WDIs) (World Bank, 2016). The resulting panel dataset was strongly unbalanced with several lengthy gaps; therefore, we used observations belonging to sub-panels with at least three consecutive years of data for a country.

### 3.2. Dependent variable

Following Arenius and Minniti (2005), we found the nascent entrepreneurship rate measure of the GEM to be a suitable

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