

## **EFFECT OF CORRUPTION AND POLITICAL INSTABILITY ON ENTERPRISES' PERFORMANCE IN AFRICA**

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### **ABSTRACT**

*The study used World Bank survey data from fifteen African countries to examine the effect of corruption and political instability on performance of enterprise in Africa. The enterprise surveys included small, medium and large-sized type of enterprises as a sample in the two round surveys (2009 and 2016). The descriptive results showed that there is strong relationship between corruption and government owned enterprises as compared with private owned ones. In the same fashion, the corruption problem increases with size of the enterprises. The study performed two regressions considering similar covariates across time (2009 and 2016) to investigate interaction between explanatory variables and the dependent variable, annual sales. The regression result revealed that corruption is strongly associated with the annual sales of enterprises in both 2009 and 2016. Furthermore, other input factors like electricity, internet, working capital and operating license have significant effect on annual sales of enterprises in Africa. The study finally recommended that positive effect of corruption should not be appreciated based on findings from narrowly collected data rather detailed investigation should be there about its long run negative effect on the overall economic systems of African countries.*

**Keywords:** *Corruption; Enterprise; Annual sales; Africa; Infrastructure*

### **Introduction**

Conventionally, corruption is understood and referred as the private wealth-seeking behaviour of government officials or the misuse of public goods by public officials. It is an informal payment that affects firms' growth negatively (Daniel, 2012). Wraaget *al.* (2009) also defined corruption as "the abuse of entrusted power for private gain", "an inducement to show favor" and "the use or existence of corrupt practices especially in a state or public institutions". Additionally, Abdul,

(2015) reported that corruption is the abuse of public office for private gain. This reflects the detrimental effects of unofficial payments on enterprises performance that may causes a loss of efficiency since firms are forced to incur unproductive costs that restricts business activity of small enterprises and newly emerging entrepreneurs. Daniel (2012) identified that bribe payment is one dimension of corruption that slow down performance.

Studies done before have mixed results regarding the effect of corruption on firm level performance. For instance, Williams and Kedir(2016) argued that corruption has positive effect on sales, employment and productivity growth rates of enterprises in Africa. This finding implies that the misuse of resources is creating favorable environment for enterprises' performance. In the other direction, Mohammed (2013) argued that corruption is an enemy that attacks all countries and has strong harmful effect. Corruption affects markets and competition, and causes mistrust amongst citizens of a country, erodes the rule of law, destroys government legality and compromise the integrity of enterprises (Odi, 2014). Mendoza *et al.* (2013) argued that corruption is a disease similar to cancer that has a legion effect on cultural, economic and political development of any country and destroys the well-functioning of the public administration. Corruption is becoming more prevalent, impacting the enterprises' ability to survive and grow (Xavier *et al.*, 2012). Corruption should be fought for ethical reasons since the system is based on abuse of power and seriously affects the overall trust on government, which leads to social unrest and disinvestment (World Bank, 2013).

It can be argued that corruption directly hinders innovation via reducing the overall trust in the legal system and channeling investments away from productive areas (Micheline *et al.*\_\_\_\_\_). The authors also validated that corruption is less correlated with growth in countries of weak governance efficiency, which means it has greasing effect on innovation, but sanding effect on employment growth. However, potentially innovative firms may participate in corruption to overcome the institutional obstacles in their day-to-day activities. This indicates that in sound business environments corruption is a pragmatic tool to overcome bureaucratic obstacles and appears to have a positive effect on enterprises' performance.

In addition to the unpleasant functioning of the legal system that paved the way to corruption in most developing countries, other constraints strongly hold back the growth and performance of enterprises. For instance Haron *et al.* (2013) identified that accessibility to working capital is a major factor affecting the growth of enterprises. The authors identified that more than two-thirds of the enterprise owner/manager believes that access to finance is a major challenge for the growth of their business. Mazanai and Fatoki (2012) singled out that access to finance has been a major constraint that impeded the survival and growth of enterprise. Berger and Udell (2006) had similar finding that enterprises in emerging economies struggle to access finance. Sharmilee and Muhammad (2016) also showed that 52.24% of the enterprise owners/managers faced difficulties in accessing working capital. Given this, Okapar and Kabonga (2009) stated that infrastructure facilities like power supply, telecommunication and access roads were major factors that affect business performance. The authors also argued that sufficiently functioning infrastructure in providing services including electric power; transportation and water sanitation are factors that directly linked to small businesses' success and economic growth. More than 70% of the enterprises understand that power supply is affecting their performance significantly (Sharmilee and Muhammad, 2016).

There are few studies (Williams and Kedir, 2016) done on similar issues with strong limitations in the data management process, since they have considered data collected at different survey times from different countries. Additionally, their analysis did not consider time dimension to evaluate what is going on within a country after certain period of time. Moreover, the data they used from some countries were outdated and it was not logical to have pooled data without one common dimension, either time or geographic location. Thus, this study tried to achieve a better insight about effect of corruption, political instability, production inputs and other infrastructural facilities on the performance of enterprises in Africa considering World Bank Enterprise Survey data in 2009 and 2016.

## **Methodology**

### **Source and type of data**

The study used secondary data collected in 2009 and 2016 by the World Bank from different African countries (Table 1) about performance of enterprises and problems they encountered.

The survey comprised of different aspects of enterprises such as, access to production inputs, political instability, good governance, innovation, annual sales, employment level and other issues. The organization considered sample enterprises from each type in the different surveys to collect the data. The World Bank considered similar questionnaires to collect the data from each enterprise, which could make easy to pool the data if the survey conducted on the same year across countries.

**Table 1.** Sample countries in 2009 and 2016

<i>In 2009</i>		<i>In 2016</i>	
Burkina Faso	Liberia	Benin	Lesotho
Cameroon	Madagascar	Cameroon	Mali
Chad	Malawi	Côte d'Ivoire	Swaziland
Congo Republic	Mauritius	Egypt	Togo
Côte d'Ivoire	Niger	Guinea	
Eritrea	Serra Leone	Zambia	
Gabon	Togo	Zimbabwe	
Lesotho			

### **Method of data analysis**

The study used both descriptive and mathematical tools to analyze the data in order to achieve the predefined objectives. Descriptive statistics like percentage; ratio, deviation and tabulation were used to examine trend and variability as well as simple correlation of covariates. The descriptive explanation and discussions were substantiated through mathematical formulations. Different authors argued that business entities (Access to finance, operating location and number of customers), personal factors (sex, education, age and experience of the owner) and production inputs affect performance of enterprises in different countries. In doing this, the study assumed that performance of African enterprise can be affected by age, sex and education level of the owner, access to production inputs, working capital, corruption, political stability and size of the enterprise). Thus, the dependent variable, annual sales of enterprises, could be a function of the factors mentioned above and have the following form of mathematical representation.

$$\text{Gross sales } (Y_{ij}) = F(A_{ij}, S_{ij}, WE_{ij}, I_{ij}, W_{ij}, C_{ij}, PI_{ij}, SE_{ij}, E_{ij}, T_{ij})$$

Where:  $Y_{ij}$  is the annual sales of firm  $i$  in country  $j$

$A_{ij}, S_{ij}$  and  $WE_{ij}$  represent age, sex and working experience of the enterprise owner/manager

$I_{ij}$  = access to infrastructural facilities for enterprise  $i$  in country  $j$

$W_{ij}$ = access to working capital for enterprise i in country j from different sources.

$C_{ij}$ = how corruption affects enterprise i in country j

$PI_{ij}$ = how political instability affects enterprise i in country j

$SE_{ij}$  = Size of enterprises located in country i

$E_{ij}$  = owner's/manager's experience of the enterprise i in country j

$T_{ij}$  = perception about the tax system in country j by enterprise i

The above mathematical formulation could take the following format:

$$\ln Y_{ij} = \beta_0 + \beta_1 A_{ij} + \beta_2 S_{ij} + \beta_3 W_{ij} + \beta_4 I_{ij} + \beta_5 W_{ij} + \beta_6 C_{ij} + \beta_7 PI_{ij} + \beta_8 ES_{ij} + \beta_9 E_{ij} + \beta_{10} T_{ij} + \varepsilon$$

Scholars who did research works in connection to corruption formulated the covariate in three categories of measurement (internal, external and hybrid)(Elizabeth and James,\_\_\_). Internal measures of corruption are based on the experiences/perceptions of enterprises in their day-to-day business activities. The data collection procedure includes questions about the frequency, and size of bribes and informal payments paid to government officials to get things done informally within short period. The World Bank collected the data about corruption based on Likert scale having five values ranging 0 to 4, and this study use this scaled data to construct dummy variable. Note that the above equation tried to avoid endogeneity and multicollinearity problems through incorporating the potential variables that affect the annual sales of firms.

## **Result and Discussion**

### **Descriptive result**

The following table shows that access to finance was common problem for 22.26% of the sample enterprises in 2009, which was followed by political instability 12.17%. The position of the problem interchanged in 2016 wherein political instability became the primary problem in 2016. Access and availability of infrastructural facilities like electricity and information gap were also common problems for enterprises in African. Thus, it is easy to generalize that access to input facilities like finance, information, electricity and others may have significant effect on performance of enterprises in Africa.

**Table2.** Common problems that affect the enterprises' performance in 2009 and 2016

List of problems	In 2009	In 2016
Access to finance	22.26	16.56
Electricity	11.63	9.07
Political instability	12.17	19.64
Information gap	11.09	10.77
Corruption	8.18	8.32
Tax rates and system	7.68	9.32
Access to land	3.16	1.83
Business licensing and permits	1.08	3.91
Vandalism, theft and disorder	5.19	2.40
Customs and trade regulations	4.15	4.98
Educated labor shortage	3.45	6.56
Tax administration	5.73	4.06
Transport	4.24	2.48

Note: Values in the table are percentage of firms

Table3 shows that the trend of corruption is becoming severe for enterprises that operate in African countries. It was not a problem for around 23% of the sample enterprises in 2009, but the proportion decreased to 12.65% in 2016, which implies that the problem is expanding drastically. Additionally, 10.83% of the enterprises were with minor problem of corruption in 2009, and the percentage increased to 12.17%. Similarly, the proportion of enterprises that suffer moderately from corruption increased to 16.80% in 2016 from what it was 15.05% in 2009. In the same fashion, the proportion of enterprises that suffer from major corruption obstacles increased from 24.21% to 28.91% in the two survey years (Table 3). In general, there is increasing trend in the percentage of African enterprises that participate in corruption, which imply that corruption is becoming severe problem that would be verified through mathematical equations and regression.

**Table 3.** Trend of corruption in the two sample years

Description	In 2009	In 2016	Change
No obstacle	22.84	12.65	-10.19
Minor	10.83	12.17	1.34
Moderate	15.05	16.80	1.75
Major	24.21	28.91	4.70
Very severe	27.06	29.47	2.41
Total	<b>100.00</b>	<b>100.00</b>	

Note: Values in the table are percentage of firms

The corruption problem becomes worst when there is increment in the annual sales based on Table 4 in both 2009 and 2016 survey years. Corruption was not problem for 32.97% of enterprises with lower annual sales in 2009, in which the percentage decreased drastically to 7.14% in 2016 indicating that prevalence of the problem is shocking. About 23.64% of the middle level enterprises had not a problem of corruption in 2009, but the percentage decreased to 13.43% in 2016. At the same time, the percentage of high performing enterprises that were free from corruption problem decreased from 15.66% to 10.15%, which implies that at each level the problem becomes austere from 2009 to 2016.

**Table 4.**Corruption and annual sales in 2009 and 2016

<i>Description</i>	<i>In 2009</i>			<i>In 2016</i>		
	<i>Low</i>	<i>Middle</i>	<i>High</i>	<i>Low</i>	<i>Middle</i>	<i>High</i>
No obstacle	32.97	23.64	15.66	7.14	13.43	10.15
Minor	7.33	11.48	10.5	21.43	11.76	13.36
Moderate	9.89	14.97	17.73	0.00	16.82	17.00
Major	19.78	23.47	28.57	50.00	29.18	27.70
Very severe	30.04	26.45	27.54	21.43	28.81	31.79

Note: Low = Below  $2.2 \times 10^4$ , Middle = Between  $2.2 \times 10^4 - 4.83 \times 10^8$  and High = Above  $4.83 \times 10^8$

Table 5 shows that corruption could not be a serious problem if government's share from the enterprise is above 50% especially in 2009. Nearly half (45.45%) of the enterprises shared by the government had no problem of corruption in 2009. The problem could be very severe for only 9.09% of the enterprises if the government has more than half of the share in 2009. In contrary to this, if the government has a percentage share of below 50% about 67% of the enterprise could be affected by the corruption problem moderate to severely in 2009.

**Table 5.**Government's share in the enterprises and corruption

<i>Description</i>	<i>In 2009</i>		<i>In 2016</i>	
	<i>Above 50%</i>	<i>Below 50%</i>	<i>Above 50%</i>	<i>Below 50%</i>
No problem	45.45	22.68	18.52	12.54
Minor	13.64	10.74	24.69	11.91
Moderate	13.64	15.08	17.28	16.78
Major	18.18	24.25	25.93	28.97
Very severe	9.09	27.24	13.58	29.80

Though there was slight improvement in 2016, but the circumstance was almost similar to the occasion what was in 2009 as to the above table. About 43% of the enterprise had minor and no problem of corruption if the government has a percentage share of more than 50%, but this percentage goes down to 24.45% (12.54% + 11.91%) if share of the government is below 50% in

2016 (Table 5). Nearly 57% of the enterprises that are shared (more than 50%) by the government had moderate to very severe problem of corruption, wherein the percentage increased to 75.55% if the government has percentage share of below 50% in 2016.

Table6 shows that if foreign owner’s share of the enterprise is greater than 50%, then corruption would be a problem for only 18.15%, which is lower than the case for domestic owners (24.73%) in 2009. The problem becomeslow if foreign investor’s share is below 50% in the same year. Large number of enterprises suffers from corruption even if private domestic individual’s shareis above 50%.The domestic owners had a better treatment in 2009 if they owned significant share in the enterprises. This indicates that African investment system was not attractive enough for foreign investors and the problem become most awful in 2016 wherein around 76% of the foreign owners faced moderate to very severe problem of corruption in which only 68.34% suffered in 2009.

**Table 6.**Share of domestic and foreign private individuals

<i>Description</i>	<i>In 2009</i>				<i>In 2016</i>			
	<i>Foreign</i>		<i>Domestic</i>		<i>Foreign</i>		<i>Domestic</i>	
	<i>Above 50%</i>	<i>Below 50%</i>						
No	18.15	23.93	24.73	16.80	9.95	12.94	12.92	11.15
Minor	13.51	10.21	9.92	13.76	14.14	11.95	11.36	16.64
Moderate	16.53	14.71	14.56	16.64	23.56	16.07	15.75	22.63
Major	25.60	23.89	23.78	25.60	27.23	29.10	29.15	27.62
Very severe	26.21	27.26	27.02	27.20	25.13	29.94	30.83	21.96

Note: Above and below were constructed based on 50% share in the enterprise

**Size of enterprises and corruption**

Table 7revealed that more than half (52.88%) of the sampled enterprises in 2009 were small sized and the proportion reduced to 45.33% in 2016 while the percentage of large enterprises increased drastically from 13.63% to 22.64%. This may because enterprises graduation from one scale to the next level.In 2009 19.81% of small enterprises had not a problem of corruption, but the proportion decreased to 13.90% in 2016 for the same sized enterprises. The same circumstance exhibited for medium and large enterprises as to the following table. Corruption was major and very severe problem for 55.85% of the large enterprises in 2009 and the proportion increased to 61.65% (30.13% +31.52%) in 2016. Both small and medium sized enterprises had similar trend wherein the percentage increment in the proportion of enterprises

that suffer from the problem was higher for the latter group. Thus, it is easy to generalize that corruption problem increases parallel with the size of the enterprises.

**Table 7.** Corruption problem among different sized enterprises

<i>Description</i>	<i>In 2009</i>			<i>In 2016</i>		
	<i>Small</i>	<i>Medium</i>	<i>Large</i>	<i>Small</i>	<i>Medium</i>	<i>Large</i>
No	19.81	18.96	18.81	13.90	13.34	9.40
Minor	11.30	11.06	10.45	13.56	10.42	11.97
Moderate	14.63	17.38	14.93	17.32	15.94	16.99
Major	25.70	24.91	25.07	26.94	30.70	30.13
Very severe	28.56	27.70	30.75	28.27	29.60	31.52
<b>Proportion</b>	<b>52.88</b>	<b>33.49</b>	<b>13.63</b>	<b>45.33</b>	<b>32.03</b>	<b>22.64</b>

The survey datashowed that relatively small sized enterprises (19.17%) had higher exposper of participating in informal payment or gift. The trenddecreases while thesize of enterprises increases with the going of time: for instance, in 2009 only 19.17% and 16.46% of small and medium sized enterprises were participant and the percentage reduced to 12.95% and 14.09%, respectively in 2016 after seven years. Additionally,more than 56% of the small enterprises in 2009 that participate in the informal gift paid more than 50% of their annual sales and the percentage reduced to 50.64% only in 2016. The percentage (51.75%) of small enterprises that pay below 50% of their annual sales in 2009 reduced to 42.47% in 2016. In contradiction to this, middle sized enterprises that pay more than 50% were 14% in 2009 and the percentage increased to 18% in 2016. About 13% of large enterprises pay less than 50% of annual sale in 2009 and the percentage increased to 25% in 2016.

### **Econometric model result and discussion**

Interaction of the dependent and independent variables in the two model results (2009 and 2016) presented below are consistent. More than 90% of the covariates have similar direction of interaction with the dependent variable, annual sales, in the two years. Size of enterprises has significant and positive effect on sales, which may be due to economics of scale and resource utilization that could increase with enterprise’s size. Being medium and large sized enterprisehas significant effect on sales as compared to the base enterprise, small. Table 8 shows that coefficient of the large scale was higher than the medium, which implies that economics of scale and overall capital have significant effect on annual sales ofAfrican enterprises. Large size has more than double effect on annual sales than medium in the two survey years (2009 and 2016).

Corruption, which indicates how the legal system failed, has significant and positive effect on performance of enterprises in African in both 2009 and 2016 wherein the coefficient was lower in the latter year. The model results revealed existence of illegal practices that have greasing effect on the performance of enterprise in Africa. This positive effect of the covariate was corroborated with the findings of Williams and Kedir, (2016), but it is contradictory to dozen of findings (Muazu *et al.*, 2015; Méndez and Sepúlveda, 2006; Pellagrini and Gerlach, 2004; Bose, 2004; Guriev, 2004) that have an aggregate country level result about harmful effect of corruption on economic growth and development. The enterprise owners may be active participant in corruption to have smooth functioning administrative practices. The lengthy bureaucracy in government offices would be broken easily through corruption, which guaranteed the enterprises to have better annual sales as to the model result presented below.

Additionally, government officials may be active participants in corruption to fulfill their private interest wherein the spillover effect may facilitate the production and sales of enterprises in Africa. The greedy and unlawful government officials may pave the way for enterprises to involve actively in the corruption process, which finally result in better annual sales. Informal payments are extremely costly for small enterprises that restrict their business activities and reduce profit (Daniel, 2012). Thus, it is easy to generalize that in most African and other developing countries large enterprises highly involved in corruption. Due to such and such a situation corruption and enterprises' performance may have positive interaction with corruption and poor governance.

**Table 8.** Determinants of annual sales for African enterprises in 2009 and 2016

<i>Variable type</i>		<i>For 2009</i>	<i>For 2016</i>
		<i>Coefficient</i>	<i>Coefficient</i>
Enterprise Size♣	Medium	0.953*** (0.105)	0.770*** (0.104)
	Large	2.383*** (0.162)	1.931*** (0.124)
Firm's legal status*	Private	-1.202*** (0.295)	-2.286*** (0.161)
	Sole proprietor	-2.434*** (0.301)	-2.249*** (0.159)
	Partnership	-2.707*** (0.347)	-3.261*** (0.169)
	Limited partnership	-2.727*** (0.356)	-3.095*** (0.185)
	Other	-1.143***	1.597***

	(0.326)	(0.401)
Working capital from banks	0.006** (0.002)	0.006 (0.006)
Working capital from non-banks	0.004 (0.004)	0.009*** (0.003)
Accessing operating license	0.476*** (0.157)	1.123*** (0.101)
Political instability	-0.037 (0.128)	-0.092 (0.144)
Corruption	1.084*** (0.164)	0.302** (0.139)
Tax rate and system	0.357** (0.149)	-0.217* (0.117)
Experience of the manager	-0.005 (0.006)	0.004 (0.005)
Sex of the respondent	-0.407*** (0.134)	-0.370*** (0.127)
Access to electricity	1.563*** (0.135)	0.694*** (0.088)
Access to internet	1.081*** (0.108)	1.231*** (0.104)
Access to telecommunication	0.218 (0.139)	--
Access to training	---	0.897*** (0.109)
Constant	21.050*** (0.574)	19.905*** (0.392)
Number of observation	2302	3420

Note: ♣ Small sized enterprises were the base, \* publicly owned company was the base  
*Values in parenthesis are Robust Standard error*

The World Bank survey data indicated that more than 73.04% of the publicly owned enterprises were medium and large sized type, which may be the reason to have better annual sales due to economics of scale. Firms owned by sole proprietorship, private and partnership as well as limited partnership have significant and negative effect on annual sales as compared to the base enterprise, publicly owned ones. The negative interaction of annual sales and enterprises' legal ownership indicates that publicly owned enterprises perform better than private, sole proprietorship and partnership type. Williams and Kedir, (2016) had similar findings about each category of enterprise legal status and their annual sales performance. Table 8 also indicates that access to some infrastructures and production inputs including access to internet, electricity and access to operating license have significant and positive effect on annual sales of enterprises in Africa in the two survey years (2009 and 2016). Public investment can bring about income growth (Minoru and Masaya, 2017). This indicates that infrastructural facilities have positive

contribution forenhancing performance of enterprises in the continent. This circumstance implies that infrastructural facilities are critical constraints in the well performance of enterprises in Africa. Working capital sourced from formal banks had significant and positive effect on annual sales of enterprises in African countries in 2009, but its role taken by non-bank sources in 2016, which showed how each activity are going informally.

The tax system formulated based on perception of enterprise owners/managers had positive and significant effect on performance of enterprises in Africa in 2009, but the effect became negative in 2016. The magnitude of the coefficient for this covariate in both the above table and the survey report show that African countries are not purely legal based. The survey statistics show that 80% of the enterprises respond that the tax rate and system were creating a problem in the smooth functioning of the business activity in Africa, wherein the proportion increase to 83% in 2016 after seven years of operation. These all indicate that African countries administration system should come to normal and legal track with the going of time to reduce social effect of corruption and other illegal practices.

## **Conclusion and Recommendations**

African governments have not national motive rather they are trying to increase profitability of their enterprise and the corruption problem is not as such critical problem for publicly owned enterprise in both 2009 and 2016.

The model result revealed that production inputs like working capital and other infrastructural facilities have positive effect on sales performance of enterprises operating in Africa. Thus, to enhance performance of enterprise in the continent all the facilities required for the well-functioning of enterprises should be fulfilled. Enterprise may utilize their potential and enhance economics of scale if all the facilities they demand are easily accessible.

The civil service provision should be enhanced to induce legal based tax system and transparent business licensing procedures. Thus, to accelerate well performance of enterprises the concerned party should reduce unnecessary intermediaries and obstacles, induce easy access to information and other infrastructural facilities.

The model results verified that corruption had positive effect on enterprises' annual sales, recognizing the detail evidence; it may not be an optimal strategy at the aggregate country level. The overall social effect of the problem should be investigated even if it has positive contribution for individual enterprise's annual sales. In connection to this, further and detail studies considering successive survey data should be there to identify long run effect of corruption on performance and economics scale utilization of enterprises in Africa.

Corruption should not be appreciated based on findings from a single survey and narrowly collected data. The problem may have long run negative effect on the overall economic systems of African countries that should be studied further. New entrepreneurs would not come into the stage and do not utilize their potential with the existing strong corruption. This indicates that the unlawful and illegal government practices should come into an end and the road should be paved for the whole population, but not for the few, which are already in the system.

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