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THE CAUSES AND CONSEQUENCES OF CORRUPTION FOR FINANCIAL MANAGEMENT: A SYSTEMATIC REVIEW

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ABSTRACT

Purpose: Corruption is widely viewed as an obstacle to a country's development. Therefore, many studies have investigated what causes corruption and how it affects economic growth. However, no systematic efforts have been made to understand the consequences of corruption in the field of financial management. This study analyzes contemporary research published in reputable journals to clarify the multifaceted nature of corruption's determinants and consequences for financial management. The analyses also highlight a broader range of mechanisms through which corruption impedes economic progress, including increased business costs, inefficient resource allocation, and weakened institutional trust.

Findings: The review identifies the contextual factors that exacerbate or attenuate corruption's impact on economic development. The study provides valuable insights for investors, corporate stakeholders, and public policymakers on the complex nature of corruption and its broader effects on financial variables.

Keywords: *Corruption, Economic development, Grease the wheels hypothesis, Sand the wheels hypothesis*

Paper type: Review Paper

INTRODUCTION

Corruption is an undesirable phenomenon that exists within every society, in one form or another. Individuals involved in the corrupt practices lose their respect and dignity in society. Though widely considered an unacceptable norm, corruption persists in various forms. According to Transparency International, corruption is "the abuse of entrusted power for private gain". Shleifer and Vishny (1993) defined government corruption as "the sale by government officials of government property for personal gain".

Corruption is not merely an ethical or administrative problem but also significantly affects financial efficiency and ultimately the firm's value. Targeted reforms rooted in institutional strengthening, corporate governance, financial regulation, and technology can significantly mitigate the negative effects of corruption and unlock sustainable economic growth.

Due to the detrimental effects of corruption on a country's reputation, governments worldwide established Anti-corruption organizations in their respective countries. These anti-corruption watchdogs operate as independent institutions that investigate and prevent corruption by implementing strict regulations, suing corrupt officials, and suggesting improvements to existing regulatory frameworks. The American Government introduced the Sarbanes-Oxley Act in 2002, the British Government's Bribery Act of 2010, and the Government of Pakistan's National Accountability Bureau Ordinance (NAO) of 1999, which represent serious efforts by different governments to curb the menace of corruption. Multilateral institutions, such as the Organization for Economic Cooperation and Development (OECD) and the World Bank, have also issued guidelines pertaining to global principles of sound corporate governance, with the aim of effectively addressing the issue of corruption.

Corruption, being an ongoing phenomenon in every society, has been extensively discussed in the subjects of economics, public policy, political science, and development studies. Numerous scholars have investigated the impact of corruption on various macroeconomic variables (e.g., Tanzi & Davoodi, 1997; Edgardo Campos et al., 1999; Asiedu & Freeman, 2009), while Batra et al. (2003) studied the relationship between corruption at the firm level. Corruption was found to significantly affect a nation's macro-economic reputation. According to Mauro (1995), corruption is more prevalent in impoverished countries such as Zaire and Haiti, while wealthier nations such as Switzerland, the United States, and Canada are comparatively less prone to corruption.

Corruption carries an invisible cost that is detrimental to firms' shareholders (Brown et al., 2021). These hidden costs include potential risk of legal consequences, i.e., if the firm is found in corrupt practices, it would be subject to legal prosecutions, and may result in cancellation of existing contracts and blacklisting in the future. A precedent exists in which the government of Singapore blacklisted five multinational companies (i.e., Siemens, Pirelli, BICC, Marubeni, and Tomen) from public procurement or bidding on government projects for five years because these firms were found to have paid kickbacks and commissions on contracts. Additionally, allegations of corruption

may damage the firm's reputation, thereby decreasing its long-term value (Wu & Wu, 2005).

Previous researchers have focused on the impact of corruption on macroeconomic outcomes, such as economic growth, investment, public expenditure efficiency, and institutional quality. However, there is a lack of a systematic review that connects corruption with the core financial management theories and identifies how Corruption, a macroeconomic phenomenon, affects firm-level financial variables and ultimately the market value of the firm. This gap limits both academic understanding and policymaking, as researchers analyze corruption and financial decisions in isolation rather than within an integrated financial theoretical framework.

The objective of this paper is to fill this gap by providing a systematic review of the link between corruption and foundational financial variables. Unlike previous studies, this review develops a comprehensive framework that explains how corruption affects firm value through five interconnected theoretical pathways.

Causes of Corruption:

According to Transparency International's Corruption Perception Index published in 2024, Denmark. Finland and New Zealand were qualified as the least corrupt, while South Sudan, Somalia, and Venezuela were ranked as the most corrupt countries in the world. However, despite this ranking, the factors contributing to corruption in a country remain a topic of discussion among researchers. Given the sensitivity of the topic, researchers paid close attention to corruption due to its extensive impact on the economy and society. The causes of corruption are multifaceted, that includes professional ethics (Owusu et al., 2017), political environment (Fredriksson & Svensson, 2003), the rule of law (Uslaner, 2008; North et al., 2012), morality (Torsello & Venard, 2016), habits (Hogdson & Jiang, 2007), tradition (Liu, 2016), and demography (Zhao & Xu, 2015).

The negative consequences of Corruption include hindering business operations, outflows of investment, and a decrease in employment opportunities. The reasons for corruption are different across countries, but some common driving forces of corruption have been identified by the literature. According to Goel and Nelson (2005), the effectiveness of public administration, measured by clarity and quality of regulations, determines the level of corruption. When regulations are ineffective and vague, create a monopoly of power for bureaucrats. Thus, it is easy for them to solicit bribes by leveraging their superior position and authority within the system.

Other contributory factors to corruption include low salaries and inadequate fringe benefits. Government officials, in their pursuit of improving their financial and social status, may resort to corrupt practices, such as accepting bribes (Svensson, 2005; Allen et al., 2018). Sardžoska and Tang (2009) compared the moral values of the private and public sectors in their study and found that workplace ethics were higher in the private sector. As a result, bribery payments were found to be more prevalent in the public sector compared to the private sector.

The promotion of corruption can also be influenced by an individual's perception of social status, according to Melgar et al. (2010). For individuals who perceive high levels of corruption, the willingness to pay bribes is higher than for those with lower perceptions of corruption. Unemployed individuals, divorced women, self-employed individuals, people living in urban areas and those working in the private sector were found to be positively correlated with a perception of corruption (Mocan, 2008; Melgar et al., 2010; Ionescu, 2012; Schulze et al., 2016; Mangafić & Veselinović, 2020) while full-time employees, married individuals, individual having at least a secondary education, and who frequently attend religious ceremonies were found to be less corrupt and unwilling to pay bribes (Heyneman, 2004; Marquette, 2013; Marquette et al., 2014). The perception of corruption was higher in African and Asian countries, as well as in most East Asian countries and former socialist countries. In contrast, most European countries and some former British colonies showed lower perceptions of corruption. During economic crises, such as low purchasing power and high unemployment, the perception of corruption tends to increase (Šumah & Mahić, 2015). Swamy et al. (2001) and Torgler and Valev (2010) conducted studies exploring the role of gender in tax evasion in eight Western European countries and found that Women exhibited a higher propensity to reject corruption and tax evasion compared to men. Culture and corporate governance were also found to contribute to corruption, according to Boateng et al. (2021).

Grease the wheels hypothesis:

The grease the wheels hypothesis, also known as the efficiency-enhancing strand, states that in situations where bureaucracy is inefficient and intricate, the provision of personal incentives can expedite the bureaucratic process, allowing firms to obtain licenses, patents, and necessary documents more promptly. This hypothesis was tested in different environments and contexts by many studies, e.g., Leff (1964), Leys (1965), Huntington (1968). Leff (1964) and Bailey (1966) also suggested bribery as a hedge tool against poor public policies. In an article, Kangle (1972) stated that "Just as it is impossible not to taste the honey (or the poison) that finds itself at the tip of the tongue, so it is impossible for a government servant not to eat up, at least, a bit of the king's revenue. Just as fish moving under water cannot possibly be found out either as drinking or not drinking water, so government servants employed in the government work cannot be found out (while) taking money (for themselves).

Numerous studies provide empirical evidence supporting the Grease the Wheels Hypothesis. For instance, Chakravorty et al. (2022) found a significant positive correlation between corruption and firm growth in Russia. Similarly, Beck and Maher (1986) demonstrated that there is no difference between contract awards through corruption and competitive bidding processes. Due to the bureaucrats' role in resource allocation, bureaucratic corruption is difficult to eliminate from the economy. The difference between shadow prices and market prices offered by firms provides an incentive for bureaucrats to engage in corrupt practices, such as accepting commissions and bribes. Huang (2016), while investigating the impact of corruption on economic growth in the Asia-Pacific region, provided evidence supporting the

Grease the Wheels Hypothesis, particularly in South Korea, where economic growth has been directly linked to rising corruption.

In their research, Egger and Winner (2005) categorized corruption into two types: (i) grabbing hand, where firms use bribes as a tool to obtain contracts, leading to reduced profits and lower productivity of public inputs; and (ii) helping hand, where large firms pay bribes to acquire publicly funded projects and expedite bureaucratic procedures. The authors analyzed the data from 73 countries from both less developed and developed countries. They concluded that corruption can serve as a helping hand for both short-term and long-term impacts on foreign direct investment (FDI). Their research was further advanced by Belitski et al. (2016) and Seidel & Thum (2016), who argued that the primary obstacle to firm entry in any country is a high tax rate; however, corruption may counterbalance the adverse effects of higher taxes, facilitating the entry of firms into the country.

Existing research (Méon & Weill, 2010; Méon & Sekkat, 2005) stated that when other aspects of governance in a country are lacking, corruption can become beneficial. Analyzing data from 69 developing and less developed countries, the authors found that in countries with weak institutional structures and poor governance indices, corruption can facilitate economic growth. The authors emphasized the importance of improving their institutional structures in the countries to counter corruption. Highly regulated environments and procedures required to start a business can be detrimental to entrepreneurship (Dreher & Gassebner, 2007). By analyzing data from 43 countries between 2003 and 2005, the authors found that corruption is beneficial in highly regulated economies. Vial and Hanoteau (2010) studied the impact of plant-level corruption on productivity growth and output and found a significant positive correlation between labor productivity, growth, and corruption. Despite a positive relationship, the authors did not view corruption as beneficial to the economy, because some firms may gain at the expense of others.

According to Dreher and Gassebner (2011), corruption serves as a key for firms seeking to enter markets in countries where there are entry restrictions. The researchers found a positive relation between corruption and the activity of enterprises seeking to enter these markets. Despite this positive relationship, the authors view the government-imposed entry restrictions as in society's interest, and using bribes to "grease the wheels" might benefit firms but be detrimental to society. Arif et al. (2020) also supported this argument while studying firms' behavior in Africa. They found that corruption boosts economic development by circumventing laws and regulations on investment, thereby supporting the "grease the wheels" hypothesis.

According to Bardhan (2017), not all illegal transactions can be classified as corruption, and all forms of bribery are illegal or detrimental to the economy. Sometimes, market structures, where existing policies give rise to distortions like black-marketing and smuggling, corruption can potentially increase welfare, despite the allocation of resources towards such activities. Shabbir (2017) found a significant moderating role for the level of democracy in the relationship between corruption and

economic growth. When democratic norms are strong, corruption negatively impacts economic growth, whereas in countries with weak democratic norms, corruption may be beneficial. This highlights the importance of well-functioning democratic institutions for reducing corruption and improving economic performance.

Sand the wheels hypothesis:

According to "the sand in the wheels hypothesis," corruption increases the transaction costs and uncertainty of doing business. That results in decreased investment, innovation, and productivity, and ultimately slow economic growth. Sand the wheels hypothesis argued the negative effects of corruption on the economy are higher compared to potential benefits, therefore, corruption acts as an obstacle to economic growth, leading to decreased competitiveness, lower investment, and low efficiency. The studies supporting this argument include Mauro (1995) and Tanzi and Davoodi (1997), who found a significant negative correlation between corruption and economic growth. The sand the wheels hypothesis suggests that reducing corruption is essential for improving economic performance and promoting economic development.

According to Mauro (1995), corruption may temporarily lead to increased investment and growth, but overall, it is harmful for society. Corruption creates an unfavorable environment for businesses, with those who can pay bribes having an advantage over those who cannot. This results in suboptimal resource allocation and lower economic activity due to the abstractions in the business environment. The corruption also erodes the trust in the government institutions and the rule of law, leading to further economic and social problems. Therefore, while there may be some potential benefits to corruption in some environments, it is generally considered a negative force that should be addressed and minimized.

Wedeman (1997), in his paper, classified the corruption into three types: looting, rent scraping, and dividend collecting. For rent scraping, the author argued, could have one of two effects: either reduce the rate of return on capital investment, resulting in capital outflows, or lead to new investments and growth. Looting creates a sense of insecurity, leading to either domestic consumption of rents or the transfer of funds abroad.

Rock and Bonnett (2004) stated that the impact of corruption on growth and investment depends upon the size of the economy. Countries with large economies possess significant labor supplies and internal markets; therefore, the large countries have ample resources to control corruption. On the other hand, small economies having small market size and scarce resources, therefore small countries face more pressure to conform to international governance and accountability norms.

Nguyen (2020) conducted an analysis of the impact of corruption on the performance of small and medium-sized enterprises (SMEs) in Vietnam. The study surveyed SMEs between 2013 and 2015 and found that the "sand the wheel" hypothesis more clearly explains the firm behavior in Vietnam. The study also found that the effect of corruption on firm performance depends on the purpose of the corruption. The findings of the study indicated that firms that engaged in bribery to obtain permits or

licenses, or to interact with tax collectors, experienced higher sales revenues. However, the overall net effect of bribery on firm performance is negative.

According to studies by Barth et al. (2004) and Cooray and Schneider (2018), corruption causes a lack of transparency, uncertainty in financial contract enforcement, unclear property rights, and asymmetric information. These factors decrease the efficiency of the financial sector by increasing transaction costs and the spread between lending and borrowing interest rates. When regulatory bodies lose their monitoring of financial activities, problems associated with secrecy, lack of transparency, and accountability arise. As a result, the financial system loses its credibility, causing an increase in market volatility and a reduction in investor confidence (Williams & Beare, 2003). There is a negative relation between market volatility and the motivation to save and invest, thereby hindering financial sector development. In this way, corruption supports the "sand the wheels" for financial sector development.

There is a belief that corruption is harmful to foreign investment and society at large; empirical evidence reveals mixed effects on economic outcomes. Zhu and Shi (2019) found that some investors prefer predictable corruption, where bribery ensures service delivery over arbitrary corruption, which amounts to plunder. While one view argues that corruption can "grease the wheels" of commerce by facilitating transactions, another contends it "sands the wheels" by obstructing growth.

Corruption and the value of the firm:

Firms exist to fulfil shareholders' wealth-maximization objectives. Does corruption affect a firm's value? It remains an empirical question (Zeume, 2012; Wang et al., 2018; Brown et al., 2019; Thakur et al., 2019; Banerjee et al., 2022). The purpose of this section is to establish the context and discuss the variables through which corruption can influence the value of the firm in the stock markets. The variables are classified into five categories.

Impact on stock valuation:

According to finance theory, the value of the firm is the discounted value of future cash flows (Copeland et al., 2004).

$$P\,i\,t = \sum_{k=1}^{n} \frac{(\,\mathrm{E(CF)}}{\big(1 + E(r)\big)n}$$

This equation shows that firm value / Stock returns are susceptible to various factors that can influence the anticipated cash flows and/or discount rates, among which corruption plays a significant role (La Rocca et al., 2017; Banerjee et al., 2022). If the firm is operating in an environment where it is difficult to operate without giving bribes, an increase in bribes tends to elevate production costs. Consequently, this cost escalation diminishes profit levels and, subsequently, future cash flows (Bohi, 1991; Mork et al., 1994). Conversely, if firms can obtain government licenses and contracts without paying bribes, they may use the free cash flows to invest in high-NPV projects and thereby earn higher profit margins.

Various studies have documented the relationship between corruption and cash holdings or cash flows, e.g., Xu & Li, 2018; Thakur & Kannadhasan, 2019; Tran, 2020. Firms operating in regions with high corruption levels hold lower cash reserves. Firms operating in corrupt environments cannot maintain optimal cash levels, which ultimately negatively affects firm value (Xu & Li, 2018). Corruption plays a major role in shaping the cash policies of the firms operating in the emerging markets (Tran, 2020). Firms operating in the emerging market economies prefer to maintain higher levels of Cash and Cash equivalents. This strategic approach allows them to capitalize on the corrupt environment by leveraging cash as an asset. However, cash holdings contribute positively to firm value. However, this relationship is moderated by institutional factors, specifically the investor protection (Tran, 2020).

Discount rates:

Given the significance of the cost of capital as a crucial determinant of firm value, numerous studies have examined the relationship between corruption and the cost of capital (Qi et al., 2010; Baxamusa & Jalal, 2014; Tee & Teoh, 2022). Kaufmann and Wei (1999) investigated three multinational firms and found that those firms had a higher cost of capital. Inadequate corporate governance, coupled with pervasive corruption and dishonest practices, has the detrimental effect of amplifying the level of systematic risk faced by firms. In countries with weak shareholder rights, there is a significant positive association between corruption and firm betas (Garmaise & Liu, 2005).

Tee and Teoh (2022) stated that corruption may affect the cost of capital in three ways, first, due to close relationships between businesspersons and top politicians, the former secure numerous advantageous concessions from the government in the form of inflated-priced government contracts, exclusive monopoly licenses, government subsidies, and protective tariff measures (Kroszner & Stratmann, 1998; Shleifer & Vishny, 1993), especially in defense and public infrastructure related expenditures due to absence of open tender systema and involvement of substantial financial sums. Such actions result in misallocation and wastage of scarce economic resources, which results in heightened income inequality (Transparency International, 2018), reduced firm productivity (Lambsdorff, 2003), limited business opportunities (Mo, 2001), and decreased foreign and domestic investments (Wei, 2000), ultimately forcing the central bank to increase interest rates.

Secondly, tax collection is lower in corrupt countries (Braşoveanu & Braşoveanu, 2009; Imam & Jacobs, 2014; Huňady & Orviská, 2015). In such countries, businessmen receive enough tax concessions from lawmakers and high-ranking politicians in exchange for illicit payments or political contributions. Imam and Jacobs (2014) and Mauro et al. (2019) found that governments in corrupt countries spend a lower percentage of their GDP in taxes compared to countries at a similar stage of economic development having lower corruption levels. There is a significant negative correlation between tax revenues and the magnitude of the informal economy, especially in emerging economies (Dreher & Schneider, 2010; Friedman et al., 2000). Consequently, due to corrupt practices and rent-seeking behavior among

businessmen, politicians, and public officials, the governments have to issue risky debt securities to finance their budget deficit (Cooray & Schneider, 2017; Kaufmann et al., 2006). In the long run, the continual risky borrowing restricts the government's capacity to foster economic development, as a larger proportion of tax revenues must be allocated to debt servicing. Ultimately, this situation adversely affects the country's sovereign debt rating and raises borrowing costs (Depken & Lafountain, 2006).

The third factor that mediates the relationship between corruption and the cost of capital is the efficiency of the judiciary system and the quality of political institutions. The efficiency of the judiciary system in a country ensures effective enforcement of contractual rights held by creditors, therefore safeguarding the interests of investors by ensuring the repayment of both the principal amount and accumulated interest (Judge et al., 2008; Haselmann & Wachtel, 2010; Shah et al., 2021). The creditors have limited opportunities for recovering their funds if agreements are not effectively enforced. One of the primary reasons for the lack of enforcement in debt contracts can be attributed to the political protection extended by politicians or public officials (Jain, 2008; Ardiyanto et al., 2022).

When debtors fail to pay interest and principal, creditors resort to legal channels to recover their debts. But if the judicial system is under the influence of politicians or engaged in corrupt practices, it hinders the effective enforcement of contracts. In either scenario, creditors face heightened risks of credit defaults or incur significant enforcement costs when attempting to enforce debt contracts in corrupt nations. Thus, creditors demand higher risk premiums, resulting in elevated debt costs for firms (Tee & Teoh, 2022).

Corruption and tax:

A well-designed and well-managed tax system serves as a backbone for a country's economic growth and stability by facilitating efficient revenue collection and creating a favorable business environment. Tax evasion is considered a threat to government revenues (Picur & Riahi-Belkaoui, 2006; Hadi Akdede, 2006). The performance of a tax system is positively related to good governance and the rule of law, whereas corruption has a detrimental impact on tax collection (Ajaz & Ahmad, 2010). By establishing transparent tax laws, effectively applying them, and addressing corruption, countries can create a more favorable environment for businesses to grow and contribute to national economies.

Tax evasion is defined as "an illegal act or practice of failing to pay taxes which are owed to the state" (Benk et al., 2015). Alleyne and Harris (2017) identified tax evasion as a major obstacle to economic development worldwide. In 2017, the Global Financial Integrity (GFI) estimated that developing and emerging economies suffer approximately $11 TN in losses annually due to crime, corruption, and tax evasion. This amount exceeds the receipts of these countries from foreign aid and foreign direct investment. Tax evasion and capital outflows from emerging economies lead to fiscal deficits, thereby putting pressure on already fragile economies (Alleyne & Harris, 2017). In some countries, there is a disparity among companies in their tax obligations. As a result, executives of such companies may prefer to pay bribes to tax

officers during inspections rather than fulfill their tax obligations (Hadi Akdede, 2006). In other words, businessmen are willing to bribe if they find an opportunity for profit from a specific transaction (Antonakas et al., 2013). Such transactions do not constitute an act of predation wherein tax authorities exploit businesspersons who are subsequently victimized. Rather, it represents a legitimate commercial transaction, with the sole detriment being to government revenue.

There is no disagreement among researchers that corruption has a significant, detrimental impact on tax revenues. Studies conducted in developing countries have found that more than half of tax collection capacity operates at less than 50% due to tax evasion and corruption (Fjeldstad & Tungodden, 2003). When taxpayers require frequent interaction with the tax authority, such as when paying taxes on international trade, the likelihood of corruption increases (Imam & Jacobs, 2014). The authors also found that the tax-to-GDP ratio in Middle Eastern countries is lower than in other middle-income regions due to corruption in the tax system.

Corruption in the taxation departments of developing countries is a demand-side phenomenon, in contrast to corruption in public procurement, which is often referred to as a supply-side phenomenon.

Corruption and dividend policy:

Dividend policy, a critical decision in finance, is among the most researched topics in finance. Dividend policy is influenced by several Macroeconomic factors, including Corruption. Corruption is considered a variable that significantly affects firms' dividend policy, as it weakens regulatory oversight and creates an unstable economic environment, leading to a lack of trust in the financial system. These factors can reduce a company's profitability and, consequently, impact the dividend payments made to the shareholders.

Corruption increases the agency costs of equity, providing shareholders with higher incentives to control managers. For the firms operating in corrupt countries, there are chances for firm managers to use the firm's resources to make unofficial payments and take advantage of this opportunity to expropriate shareholders' wealth. Therefore, shareholders force managers to pay more dividends to mitigate the agency problem Tran, 2020). Using data from 47 countries, Tran (2020) found a positive and significant relationship between corruption and dividend payments.

There is also a negative relation between Corruption and dividend payments due to an increase in the risk of expropriation by governments. In highly corrupt countries, firms tend to save more cash to make unofficial payments and are therefore more flexible in using the firm's cash. Therefore, managers may capitalize on this opportunity by imposing constraints on dividend payments. Dong et al. (2022) provide empirical support for this hypothesis; their research found a negative relationship between local corruption and corporate dividend payouts in China. Tran (2021), Yensu and Adusei (2016), and Yaseen (2018). Caprio et al. (2013) also reported a significant negative correlation between dividend policy and corruption. They argued that there is always a risk that politicians and bureaucrats will extract a firm's assets. To mitigate the risk of political expropriation, firms may either increase their

investment in assets less susceptible to expropriation, such as property, plant, and equipment, or distribute dividends to reduce their cash holdings.

The corrupt behavior of regional government officials can significantly impact the financial climate and internal governance of companies, leading to a reduction in the level of cash dividends distributed. As corruption levels increase, companies may need to establish personal relationships and cultivate political connections with central and local government officials in order to obtain financing qualifications and approvals. This often results in higher financing costs for the enterprise, thereby compelling it to rely on internal financing decisions. Consequently, the enterprise may offer a relatively lower level of cash dividends to its shareholders (Ahlin & Bose, 2007).

In the context of high regional corruption, company management may seek to acquire resources from the government through banquets or giveaways, thereby diminishing the competitive advantages of normal business activities (Cai et al., 2011). This results in a decline in corporate governance, an increased likelihood of cash abuse by controlling shareholders and the firm's management, and ultimately a reduction in cash dividends distributed.

Corruption and working capital management:

Effective working capital management is considered a daily challenge for finance managers, influenced by various macroeconomic factors. The level of corruption in a country can significantly impact firms' working capital management. Corruption creates obstacles that hinder firms' access to external financing, particularly from banks. Firms operating in less corrupt countries have easier access to external financing (Beck, Demirgüç-Kunt, & Levine, 2004). When external financing is readily available, managers can increase investment in working capital (Baños-Caballero et al., 2010; Fazzari & Petersen, 1993).

Corruption can also affect a firm's working capital policies by influencing the investment decisions of the firm. In highly corrupt environments, firms invest heavily in fixed assets, because investing in current assets carries a higher risk of extraction by corrupt bureaucrats and politicians (Caprio et al., 2013).

According to Mo (2001), corruption can impede human resource development, diminish economic growth, and reduce firms' investment in working capital. Corruption also significantly affects the level of investment inflows and cost of capital (Pankajk & Pagano, 2012). According to Chen et al. (2014), firms operating in corrupt countries allocate more resources to secure external financing, particularly from government banks, thereby increasing the cost of capital. Thus, lower corruption reduces the cost of capital and potentially increases firms' investment in working capital.

Corruption and capital structure:

In the context of corruption, researchers have explored the link between capital structure, a topic widely researched in finance. Studying the relationship is important because corruption affects law enforcement effectiveness, and the choice between

debt and equity depends on the country's legal environment (Alves & Ferreira, 2011; Giannetti, 2003). The country in which a firm operates is a more important determinant of its capital structure compared to industry affiliation (Fan et al., 2012; Claessens et al., 2001). The weak legal framework and higher levels of corruption exacerbate investors' fear (La Porta et al., 1997), leading banks to be reluctant to provide capital to firms, which ultimately increases the cost of debt.

The relationship between corruption and capital structure decisions extends beyond the cost of debt. Researchers also proved that firms operating in countries with high levels of corruption prioritize equity financing over debt financing (Alves & Ferreira, 2011; Giannetti, 2003), because equity financing is less sensitive to legal and contractual issues. The equity financing also provides greater flexibility for firms to adjust their operations in response to uncertain legal environments. On the flip side, the increased reliance on equity financing can also result in higher costs of capital for the firm, as equity investors may demand a higher return to compensate for the higher risks associated with corruption and weak legal systems (Fan et al., 2012; Claessens et al., 2001). Consequently, corruption can cause a significant impact on the composition of firm's capital structure and ultimately its cost of capital.

Fan et al. (2012) examined the association between debt financing and corruption across 39 developing and developed economies. Their findings suggested firms operating in countries with inefficient legal systems and higher government corruption rely more on debt financing, particularly debt with shorter maturity. Similarly, Wei and Kong (2017) explored the impact of corruption and financial development, and their interaction on determining the capital structure of Chinese firms. Their study, using a sample of 1,803 companies from 1998 to 2013, revealed a statistically significant, positive relationship between corruption and firms' debt levels. Wei and Kong (2017) found that in regions with higher corruption, financial development is negatively associated with debt levels, whereas in regions with well-developed financial markets, corruption is negatively associated with debt levels of listed firms. This suggests that when credit supply is sufficient, companies can obtain loans without resorting to bribery. Similarly, Lemma (2015), while examining the relationship between corruption and debt financing in ten African countries, reported that corruption lead to the use of more short-term debt in the capital structure. Singh and Kannadhasan (2020), using data from 16 emerging markets, observed a positive and significant correlation between corruption and leverage. The authors attributed this to the difficulty of expropriating debt holders compared to equity holders.

The literature on corruption and capital structure also includes studies that examine the non-linear relationship between these variables. For instance, Baxamusa and Jalal (2014) analyzed data from 72 countries and found that corruption has a conditionally elastic relationship with the cost of capital, which affects the speed of capital structure adjustment. Another study by Çam and Özer (2022) used a sample of 31,749 firms across 65 countries from 1996 to 2017 and found a negative relationship between the level of leverage and the level of governance and control of corruption in a country, as well as a positive relationship between the level of governance and debt maturity.

These findings are consistent with prior research conducted by Papageorgiou et al. (2020), which reported a positive and significant impact of corruption on the capital structure of European-listed SMEs. Other studies, such as those conducted by Claessens et al. (2001), de Jong et al. (2008), and Alves and Ferreira (2011), have also examined the relationship between corruption and capital structure.

Thanh (2017), in his study, examined the relationship between corruption and capital structure in Vietnam and discovered a significant and positive association between corruption and short-term capital structure. However, the relationship was not significant between corruption and long-term debt in the context of Vietnam.

CONCLUSION

The purpose of this paper is to combine diverse strands of research on the interaction between corruption and the key areas of financial management, highlighting corruption's contradictory effects on firm behavior, financial markets, and ultimately economic development. Some researchers consider corruption as a temporary "lubricant" that enables firms to counter rigid institutional barriers. For the other school of thought, the corruption negatively affects financial decision-making by eroding investors' trust, increasing the cost of capital, and ultimately undermining long-term economic performance. By studying the impact of corruption on firm value, dividend policy, capital structure, working capital management, and tax compliance, it is demonstrated that corruption is not merely a governance problem but a core financial issue to be considered by the finance managers.

Despite extensive literature, several avenues are open for future research. There is a need for more context-specific research to explore how corruption interacts with institutional quality, legal enforcement, and political structures to affect the value of the firm. Researchers may also examine the heterogeneity of corruption, predictable versus arbitrary, petty versus grand, and how these distinctions interact to shape financial outcomes. The role of emerging technologies, such as digital finance, blockchain, and AI-based monitoring, and their role in preventing corruption and reshaping financial management also needs to be examined. By advancing these directions, future research will provide more guidance for policymakers and institutions aiming to build transparent, efficient, and corruption-resilient financial systems.

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