



## Government Effectiveness and Ease of Doing Business: A South African Perspective

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**Abstract:** This study examined the long-run relationship between government effectiveness and the ease of doing business in South Africa, political instability, rule of law, and control for corruption were made controlled predictors. Using Transaction Cost Theory and Dynamic Ordinary Least Squares (DOLS), the study finds that government effectiveness and political stability significantly improve business conditions by reducing transaction costs. Conversely, rule of law and corruption control had no significant impact on the ease of doing business in the long term; the study provides unique, South Africa-specific insights, linking governance quality to operational constraints such as access to finance and regulatory burdens. Hence, the study recommends that policymakers should prioritize the improvement of government institutions, reducing political instability, and addressing bureaucratic inefficiencies to enhance a better business climate for SMEs. This research contributes to the literature by offering actionable insights for policy reforms aimed at improving business conditions, particularly in the context of South Africa.

**Keywords:** DOLS; Governance; Investment; South Africa

**JEL Codes:** C23, D73, H11, O17

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## 1. Introduction

Businesses of all sizes have become increasingly important to economic development in Africa over the past decade. Most importantly, SMEs account for approximately 80 per cent of employment in the region and play a significant role in promoting trade in goods and services (Dos Santos, 2015). Despite this high level of entrepreneurial activity, the majority of businesses in Africa remain small and informal, which constrains their productivity, income generation, and overall contribution to economic growth. This is not unconnected to the challenging business environment faced by businesses in the region. Challenges such as limited access to finance, poor electricity supply, and burdensome regulatory processes remain an obstacle to business growth and formalization (Thompson et al., 2017). These constraints are linked to weaknesses in government effectiveness, including inefficient public service delivery, weak policy implementation, and limited institutional capacity. As the importance of businesses in employment and economic activity cannot be overemphasized, it becomes necessary to improve government effectiveness in order to promote the ease of doing business in South Africa. More importantly, governance can reduce transaction costs, improve access to essential services, strengthen regulatory enforcement, and create a more predictable business environment, in turn enabling firms to formalize, expand, and contribute more meaningfully to sustainable economic development.

Furthermore, the extant literature on business environments in Africa most especially South Africa often aggregates multiple countries, which can obscure the unique institutional and governance challenges faced by country-specific, such works isolates its specific governance-to-business such as access to credit, infrastructure bottlenecks, and regulatory complexity in standalone empirical analyses (see Asah, 2019; Asah, Louw & Williams, 2020; Enaifoghe & Vezi-Magigaba, 2023; Daya, 2023; GEM, 2024). These studies could not integrate specific measures of the ease of doing business to government effectiveness.

Furthermore, the literature also points to persistent structural barriers such as infrastructure deficiencies and regulatory burdens that vary across the South African context (Basson & Omoruyi, 2025; Lose & Mapuranga, 2022), pointing out the need for more country-specific analyses of how governance performance shapes ease of doing business in South Africa. Studies on business constraints often examine them in isolation rather than integrating them to a broader government effectiveness measures. South African business climate, particularly SMEs highlight discrete

constraints which include limited access to finance, inadequate infrastructure, and regulatory hurdles, but often do not include these factors into a broader government effectiveness framework. As noted by Asah and Louw (2021), Mhlongo and Daya (2023), and the OECD (2020), fewer than 20% of new SMEs successfully obtain bank financing, rendering financial challenges a substantial impediment to SME expansion. Moreover, infrastructure challenges such as electricity shortages caused by load shedding and insufficient technological support have been shown to hinder operations and productivity, while elevated credit costs and inadequate financial products further constrain business growth (Lose & Mapuranga, 2022; Fowowe, 2017). Furthermore, Schwab (2017) and SEDA (2023) assert that inefficient regulatory processes and bureaucratic barriers remain significant impediments to corporate expansion. Therefore, it is crucial to correlate these operational constraints with broader indices of the efficacy of government policy implementation to understand the ease of conducting business in South Africa.

The structure of the remaining paper follows thus: Section 2 reviews relevant literature; Section 3 outlines the methodology; Section 4 presents the results and discussion; while Section 5 presents the conclusion and policy recommendations.

## 2. Literature Review

Small and medium-sized enterprises (SMEs) are essential to South Africa's economy which contributes significantly to employment and income generation, especially among youth and low-skilled workers (Rogerson, 2004; Fatoki & Garwe, 2010). Irrespective of this, SME growth remains low due to structural and institutional constraints (Herrington et al., 2017). High regulatory costs, compliance burdens, and policy uncertainty, particularly in the informal sector, hinder SME formalizations and productivity (De Koker & Jentzsch, 2013; Fourie, 2018). A strong link exists between ease of doing business and economic growth. Djankov et al. (2006) and Jayasuriya (2011) show that simpler business regulations foster higher growth and firm entry. World Bank's Doing Business reports highlighted that regulatory inefficiency such as licensing delay and contract enforcement issues are significant obstacles to business operations. Regulation uncertainty negatively influences private investment and growth (Fedderke & Luiz, 2008). Hence, the regulatory environment shapes firm dynamics, particularly through entry barriers, competition, and innovation. Klapper et al. (2004) and Aghion et al. (2008) found that high compliance cost and bureaucratic complexity can limit small firm's growth and

market dynamism in South Africa. This obstacle makes the markets more concentrated and discourage people from starting their own businesses. Consequently, the economic environment and FDI are affected by how possible it is to engage in business activities.

In South Africa, Private investment and investor trust has declined over time (see National Treasury, 2020). South Africa had a hard time attracting stable FDI because of policy uncertainty (Bhorat et al. 2016 & Green et al. 2010). Strong institutions are essential for economic performance. Hall and Jones (1999) and Fedderke et al. (2006) show that institutional quality is key to capital accumulation and productivity growth in South Africa. Poor government effectiveness, particularly in public service delivery, has negatively influenced business confidence and investment. Excessive regulation also fosters rent-seeking and corruption, increasing transaction costs and preventing expansion. Bernstein (2015) proves that unpredictable regulations contribute to informality, limiting the tax base and undermining business development. The interaction between governance failures and informality creates a self-reinforcing cycle. South African entrepreneurs, especially in youth and township-based businesses, avoid formal engagement due to concerns about bureaucratic delays and corruption (Herrington et al., 2017).

This dynamic hamper inclusive growth and business reform. Hosseini and Farsangi (2020) investigates how transaction costs influence the ease of doing business in emerging economies; they argue that government inefficiency, such as corruption and infrastructure gaps, increases transaction costs, impede business growth. Their study found that higher government effectiveness, characterized by better regulatory enforcement and reduced corruption, significantly lowers transaction costs, thereby improving the business environment. Kaufmann and Kraay (2020) examine the relationship between institutional quality, and transaction costs. Their result shows that weak governance structure raises transaction costs as a result of inefficiencies in property rights and the legal system. They added that improved governance reduces transaction costs, allowing business operations and promoting the ease of doing business. Bovens et al. (2022) examines the relationship between government effectiveness and firm behavior in emerging markets. Their results shows inefficiencies in government regulations, such as complex tax systems and slow permitting, increase transaction cost which all hinders business expansion. They argued that better regulatory techniques and strong enforcement mechanism reduces transactions costs and fosters business growth and innovation.

Qiu and Wei (2021), investigate the relationship between government effectiveness and transaction costs in international trade for developed nations. They found corruption, and inefficient legal systems to increase cross-border transaction costs, while countries with good governance in aspect like customs and taxation experience lower transaction costs, enables international trade and improves the ease of doing business globally. According to Rodrik and Subramanian (2004) strong institutions are required for effective reforms. Conversely, South Africa's regulatory reforms, weak implementation capacity and institutional inefficiency limit their impact (Fourie & Burger, 2020). Hence, this study examines the relationship between government effectiveness and the ease of doing business in South Africa, with a research question of how does government effectiveness; impact the ease of doing business in South Africa?

### 3. Methodology

Transaction Cost Theory (TCT), proposed by Coase (1937) and later developed by Williamson (1985), posits that economic transactions involve costs beyond the price of goods and services, including transaction costs. These costs arise from the need to negotiate, monitor, enforce contracts, and reduce uncertainty. TCT focuses on the role of institutions in minimizing these transaction costs, which directly impact the business environment. Furthermore, Transaction Cost Theory (TCT) has been widely applied in the literature to explore the relationship between government effectiveness, transaction costs, and the ease of doing business (See Hosseini & Farsangi, 2020; Kaufmann & Kraay, 2020; Bovens et al., 2022; Qiu & Wei, 2021). Hence, this study underpins the TCT Theory. In the context of ease of doing business, government effectiveness plays a critical role in reducing transaction costs. Governments that provide efficient regulations, clear legal frameworks, and administrative efficiency reduce the time, money, and uncertainty that businesses face when navigating regulatory requirements. Hence, government effectiveness directly influenced the ease of doing business by lowering transaction costs for firms. Thus:

$$TC = f(G_{eff}) \quad 1$$

Where TC decreases as  $G_{eff}$  increases. This implies that improved governance reduces bureaucracy, corruption, delays, and legal uncertainties, which in turn lowers transaction costs.

Ease of Doing Business ( $E\_Dbiz$ ) as a function of Transaction Costs (TC):

$$E\_Dbiz = g(TC) \quad 2$$

An increase in  $E\_Dbiz$  would inform TC to decrease. A more efficient and predictable business environment, facilitated by reduced transaction costs, makes it easier to start and run businesses.

$$E\_Dbiz = h(G\_eff) \quad 3$$

This shows that  $E\_Dbiz$  is positively related to government effectiveness through its mediating effect on transaction costs. Specifically, improvement in government effectiveness ( $G\_eff$ ) lead to reduced transaction costs (TC), which enhances the ease of doing business ( $E\_Dbiz$ ).

$$TC = \alpha - \beta \times G\_eff \quad 4$$

Where:

$\alpha$  means constant, implying the baseline transaction cost when government effectiveness is at its minimum.  $\beta$  is the coefficient representing the impacts of government effectiveness on transaction costs, which is expected to be negative (as government effectiveness reduces transaction costs). The negative sign of  $\beta$  indicates improvement in government effectiveness transaction costs.

Similarly, we can model the relationship between transaction costs and ease of doing business thus;

$$E\_Dbiz = \gamma - \delta \times TC \quad 5$$

$\gamma$  is a constant representing the baseline ease of doing business when transaction costs are at their highest.  $\delta$  implies the coefficient, representing the impact of transaction costs on the ease of doing business, which is expected to be positive (as lower transaction costs improve the ease of doing business). The positive sign of  $\delta$  shows that as transaction cost drops, the ease of doing business increases.

Substituting the equation for TC into the equation for  $E\_Dbiz$ ; in eq 5

$$E\_Dbiz = \gamma - \delta \times (\alpha - \beta \times G\_eff) \quad 6$$

Simplifying: eq 6

$$E\_Dbiz = \gamma - \delta \times \alpha + \delta \times \beta \times G\_eff \quad 7$$

This equation shows that  $E\_Dbiz$  is a linear function of government effectiveness ( $G\_eff$ ) with a positive relationship. The coefficient  $\delta \times \beta$  indicates how much ease of doing business improves for each unit increase in government effectiveness.

### 3.1. A Priori Expectation

Item	Po_Sb	Con_Cur	Ru_Law	G_eff
Model : Impact of Government effectiveness on Ease of doing Business in South Africa				
E Dbiz	+/-	+/-	+/-	+/-

### 3.2. Model Specification

The main estimation technique for this study is the dynamic Ordinary Least Square (DOLS) developed by Stock and Watson (1993); this technique allows for heterogeneous long-run dynamics and eliminates the challenge of endogeneity in the co-integrating equation estimates. Hence, the model is specified as;

$$y_t = \alpha_i + \beta X_t + \varphi T_t + \epsilon_t^+ \tag{8}$$

$\epsilon_t$  is a correlate of  $P_i$  and the lags of  $R_t = \Delta Z_t$ , where the correlation controls for  $\epsilon_t$ , assumes;

$$\epsilon_t = \sum_{r=-P_i}^{P_i} \lambda_r^{(i)} R_{t-r} + \epsilon_t^+ = \sum_{r=-P_i}^{P_i} \lambda_i^{(i)} \Delta Z_{t-r} + \epsilon_t^+ = \lambda_i T_t^+ \epsilon_t^+ \tag{9}$$

Where  $\delta_i = (\delta_{-P_i}^i, \delta_0^i, \dots, \delta_{P_i}^i)^t$  implies  $(2P_i + 1)k$  dimensional projection coefficients and  $T_t = (\Delta Z_{t-P_i}, \dots, \Delta Z_t, \dots, \Delta Z_{t+P_i})$ , is  $(2P_i + 1)k$  dimensional form of the lead and the lag first differences of the variables  $Z_t$ . Hence, the dynamic OLS is adopted to estimate the long-run impacts between Government effectiveness and the ease of doing business in South Africa.

Thus:

The functional relationship among the variables is specified as follows

$$E\_Dbiz_t = \alpha + \beta_1 G\_eff_t + \beta_2 Po\_Sb_t + \beta_3 Ru\_Law_t + \beta_4 Con\_Cur_t + W_t \tag{10}$$

Where:

$E\_Dbiz$  = Ease of doing business

$G\_eff$  = Government effectiveness

$Po\_Sb$  = Political Instability

$Ru\_Law$  = Rule of Law

$Con\_Cur$  = Control for corruption

$\alpha$  = Intercept coefficient

$\beta_1 \dots \beta_4$  = Slope coefficient

$W_t$  = Disturbance term

**Table 2. Measurement Variables and Sources**

<b>Code</b>	<b>Measurement</b>	<b>Source of Data</b>
$G\_eff$	Index measuring quality of public services, civil service independence, policy formulation, and implementation. Measured on a scale of $-2.5$ (weak) to $+2.5$ (strong governance).	World Bank Worldwide Governance Indicators (WGI); also in World Development Indicators (WDI) and EIU.
$Po\_Sb$	Index capturing perceptions of political instability and likelihood of violence/terrorism, measured from $-2.5$ to $+2.5$ .	World Bank Worldwide Governance Indicators (WGI)
$Ru\_Law$	Index measuring the adherence to societal rules and the strength of the judiciary and law enforcement. $-2.5$ to $+2.5$ scales.	World Bank Worldwide Governance Indicators (WGI)
$Con\_Cur$	Index reflecting the extent of public sector corruption, measured on a $-2.5$ to $+2.5$ scales. Sometimes reported alongside Corruption Perceptions Index (CPI) (0–100 scale).	World Bank Worldwide Governance Indicators (WGI); Transparency International CPI

<i>E_Dbiz</i>	This measured the number of procedures, time, cost, and paid-in minimum capital requirement for a small to medium-size limited liability company to start up and formally operate in each economy.	World Bank World Development Indicators (WDI) (derived from Doing Business reports)
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*Source: Author's Compilation, 2026*

*Note: Ease of doing business is proxied using regulatory burden indicators that capture the costs, time, and procedures associated with starting and operating a firm (See Djankov et al. 2002; Klapper et al., 2006; Hallward-Driemeier, 2003).*

The data used in the study are secondary data spanning from 1997 through 2024 which are derived from World Bank Development Indicators (WDI), Transparency International – Corruption Perceptions Index (CPI), The Economist Intelligence Unit (EIU) and World Governance Indicators (WGI) of various issues up to 2024.

#### 4. Empirical Results and Discussion

**Table 3. Descriptive Statistics**

	<b>E_Dbiz</b>	<b>G_eff</b>	<b>Po_Sb</b>	<b>Ru_Law</b>	<b>Con_Cur</b>
Mean	0.279221	0.220798	-0.272519	0.034057	-2059.996
Median	0.389572	0.180909	-0.232706	0.063835	-0.017757
Maximum	0.819586	1.020496	0.215347	0.181310	0.732927
Minimum	-0.543860	-0.384740	-0.750981	-0.243994	-21631.61
Std. Dev.	0.371269	0.326472	0.269055	0.111546	6161.246
Skewness	-0.402070	0.260299	-0.414777	-1.227689	-2.687040
Kurtosis	2.119419	2.866506	2.173854	3.809728	8.455145
Jarque-Bera	1.659075	0.336983	1.599125	7.798634	68.41256
Probability	0.436251	0.844939	0.449526	0.020256	0.000000
Sum	7.818176	6.182340	-7.630521	0.953597	-57679.89
Sum Sq. Dev.	3.721692	2.877775	1.954541	0.335946	1.02E+09
Observations	28	28	28	28	28

*Source: Author's computation, 2026*

Table 2 shows the statistics on South Africa's ease of doing business (*E\_Dbiz*), with a mean of 0.28 and a median of 0.39, indicating some heterogeneity in business conditions. Government effectiveness (*G\_eff*) is moderate with the mean of 0.22 and a little rightward tilt, indicating more low scores. Political instability (*Po\_Sb*)

indicates moderate instability, while the rule of law (*Ru\_Law*) is weak, as evidenced by a low mean of 0.03 and a negative skew. However, Control for Corruption (*Con\_Cur*) is the most worrying, with a dramatically low mean of -2059.99, excessive variability, and a heavily skewed distribution, indicating significant corruption control difficulties. Hence, South Africa faces challenges with political instability, weak rule of law, and especially severe corruption, despite moderate levels of ease in doing business and government effectiveness.

**Table 4. Variance Inflation Factor**

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
G_eff	0.016805	2.543153	1.843933
Po_Sb	0.021815	2.764170	1.670656
Ru_Law	0.093663	1.163516	1.122944
Con_Cur	4.74E-11	2.043317	1.941774
C	0.003236	3.348437	NA

*Source: Author's computation, 2026*

The VIFs in Table 3 show that the model does not display significant collinearity. With centered VIF values under 5, hence, multicollinearity does not appear to be a substantial concern.

**Table 5. Augmented Dickey-Fuller Test (ADF)**

Variable	Level T-Stat	Critical Value @ 5%	First Diff T-Stat	Critical Value @ 5%	Order of Integr
G_eff	-1.542	-2.323	-4.522	-4.625	I(1)
Po_Sb	-1.631	-5.425	-4.682	-2.962	I(0)
Ru_Law	-3.452	-2.756	-6.249	-2.673	I(1)
Con_Cur	-4.141	-2.538	-5.611	-1.743	I(0)

*Source: Authors computation, 2026*

*Note: The unit root test determines the order of integration. I (0) series are used without differencing, while I (1) series are differenced. Probabilities assume asymptotic normality.*

Table 4 presents the results of the unit root tests for the four variables: G\_eff, Po\_Sb, Ru\_Law, and Con\_Cur. The findings indicate that G\_eff and Ru\_Law are integrated of order one, I (1), implying that they are non-stationary at levels but become stationary after first differencing. In contrast, Po\_Sb and Con\_Cur are stationary at levels, indicating that they are integrated of order zero, I (0).

**Table 6. Empirical results of Dynamic Least Squares (DOLS) are presented as:**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
G_eff	0.935121	0.129635	7.213519	0.0000
Po_Sb	0.537162	0.147698	3.636896	0.0019
Ru_Law	0.355884	0.306045	1.162849	0.2601
Con_Cur	-1.94E-06	6.88E-06	-0.281456	0.7816
C	0.201824	0.056882	3.548140	0.0023

*Source: Author's computation, 2026*

Table 5 results of the Dynamic Least Squares (DOLS) estimate highlight the importance of government effectiveness and political stability on the ease of doing business in South Africa. The positive and statistically significant coefficient of G\_eff (Government Effectiveness) ( $\varphi = 0.935$ ;  $p = 0.0000$ ), implies that improvement in government efficiency strongly promote the business environment. This relationship is highly significant, which implies that as the government becomes more effective whether through better regulations, infrastructure, or overall governance; it directly contributes to a more favorable environment for business operations. This finding aligns with global studies that emphasize the importance of competent governance in fostering a thriving business climate. Similarly, the positive coefficient of Po\_Sb (Political Instability) ( $\omega = 0.537$ ;  $p = 0.0019$ ), implies that when political instability reduces, the ease of doing business improves.

A stable political environment is critical for fostering business confidence and long-term investments; on the other hand, Ru\_Law (Rule of Law), ( $\vartheta = 0.356$ ;  $p = 0.2601$ ) does not appear to have a statistically significant impact on the ease of doing business in South Africa. However, the effect of the rule of law on business in South Africa is not as impactful as government effectiveness and political stability. Furthermore, Control for Corruption does not exhibit a significant relationship with ease of doing business, ( $\partial = -1.94E-06$ ;  $p = 0.7816$ ). This suggests that, in the long run, efforts to control corruption have not had a measurable effect on improving the ease of doing business in South Africa. The result reflects the persistence of corruption, despite the anti-corruption policies or a possible disconnect between legal reforms and actual implementation. This can hinder the anticipated positive impact of corruption control on business climate. The findings are in tandem with the studies of (Bovens et al., 2022; Lose & Mapuranga, 2022; Fowowe, 2017), they argued that, inefficiencies in government effectiveness, like complicated tax systems and delayed permitting processes, raises transaction costs and hinder business growth. Furthermore, the results suggest that while structural improvements in governance and political

stability are key drivers of a favorable business environment in South Africa, addressing corruption and rule of law may require more focus and long-term strategies.

## 5. Conclusion and Recommendations

The study highlights the important role of government effectiveness in promoting the ease of doing business in South Africa. The result shows stronger government influence, through better regulatory frameworks, infrastructure, and public service delivery, to reduce transaction costs and fosters a more predictable business climate. On the other hand political stability also exerted positive influence; lower political instability improves business confidence. However, rule of law and corruption control do not have a significant effect on the ease of doing business, suggesting long-run reforms and effective enforcement to be impactful. This study empirically examines the relationship between governance and business operations in South Africa, by linking government effectiveness directly to operational constraints such as finance access and regulatory burdens, to provide empirical credence for understanding governance's role in shaping the business climate. Therefore, the study recommends the strengthening of government institutions; reduce political instability, and addressing bureaucratic inefficiencies. Efforts to enhance anti-corruption measures and the rule of law should continue, although their direct impact may take longer to materialize.

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