Is There a Local Culture of Corruption in the U.S.?*

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Keywords: Corruption, Corporate Governance
JEL Codes: *D73, G34*

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Abstract

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1. Introduction

Several recent papers underscore the importance of culture in explaining the behavior of individuals and firms. The general finding is that certain societal norms, such as attitudes toward corruption, endure even when individuals relocate to a very different legal and social milieu. A challenge the literature faces is the difficulty of isolating the effect of culture from the legal and economic environment in which it develops. An approach that addresses these concerns is to examine the behavior of individuals from different cultural backgrounds in a common socioeconomic and legal setting, such as in the U.S.A. (Fisman and Miguel, 2007). Studies using this approach show, for instance, that individuals with cultural ties to highly corrupt countries exhibit a greater prosperity to engage in unethical behavior.[1] This includes illegal parking by U.N. diplomats (Fisman and Miguel, 2007), corporate tax evasion (DeBacker, Heim, and Tran, 2015), and accounting fraud (Liu, 2016).

In this paper we examine whether there is a local, cultural component to the predisposition of some U.S. public corporations to engage in corrupt behavior. The notion is that there could be cultures, that are local in the sense of being common to the population in a particular geographic area, and in which corruption is more or less the norm. A corporate culture of corruption in these environments could be manifest in terms of firm managers' willingness to act in unethical ways to maximize firm profits. For instance, these managers may be willing to offer bribes in order to win government bids. In this case, corrupt behavior could actually create value for shareholders. In other instances, it could be manifest as self-serving behavior by corporate managers to the detriment of their shareholders. Our results indicate that there is a significant regional or state-level variation in terms of 'corruption culture' in the U.S. In particular, state-level measures of corruption by public officials and surveys on corruption perception, appear to reflect a local 'culture of corruption'. Public firms that are headquartered in more corrupt states exhibit a greater propensity for corrupt

[1] Similarly, several studies use local geographic culture measures such as religiosity around a firm's headquarters to explain corporate behavior (e.g., Hilary and Hui, (2009), Grullon, Kanatas, and Weston (2010), McGuire, Omer, and Sharp (2012)), and Parsons, Sulaeman, and Titman (2016), among others.

behavior. These results are fairly surprising, at least to us. After all, it is by no means obvious that state-level variation in public corruption would tend to be internalized by public firms in the area. First, the overall level of public corruption in the U.S. is relatively low, at least in comparison with the staggering degree of corruption in countries that rank high on corruption indices.[2] Second, many of the regulations and institutions that govern corporate behavior, such as the national stock exchanges, the SEC and other federal regulators, and institutional investors, are not typically restricted to the states. Despite this, our finding is that the local culture of corruption has economically meaningful effects.

To test whether firms participate in a common culture of corruption, the challenge is to separate effects that can be reliably attributed to local culture – and not to the effect of various other local economic and institutional factors. For instance, firm policies could be affected by unobserved factors that affect both the level of public corruption in a state and the policies of firms located in the area. Further, even if firms are not corrupt as such, they may choose firm policies, such as weak disclosure, in response to the threat of expropriation from corrupt officials.[3] Hence, as with some of the existing literature on the effect of corruption, we fashion a test in which corrupt activities occur strictly outside the local area and the direct influence of states and local authorities. However, in a way, our test runs in the opposite direction to much of the literature: we examine firms that, despite differences in the levels of local public corruption, are all based in a relatively low corruption environment in the U.S., with some also operating in highly corrupt foreign environments. The question is whether these relatively small differences in corruption across states result in economically significant effects in firm behavior when these firms operate outside of their local environment.

Our primary test for the effects of local corruption is based on the passage of the Foreign Corrupt Practices Act (FCPA) of 1977. The FCPA was passed to curb the corrupt practices of U.S.

[2]In part, this is due to long-standing effort by the federal government to target corrupt public officials.

[3]Smith (2016), for instance, provides evidence suggesting that firms in more corrupt states adjust cash policies to protect shareholder value from possible expropriation.

firms when conducting business in foreign countries. We test for whether FCPA had a differential impact on firms located in states with more public corruption. The rationale is that if corruption is part of a common regional culture, we would expect it to also influence managers' actions in a foreign country, i.e., even when these actions are outside the purview of local public officials. Our approach is somewhat similar to the argument made in studies that examine whether immigrants (and expatriates) retain cultural values of their countries of origin, such as a predisposition toward corruption, when they move to or operate in a different environment (e.g., Fisman and Miguel 2007). If state-level public corruption reflects a common local culture, we would expect firms from these states to be more willing to engage in corrupt practices such as bribing foreign officials to acquire government business and/or to receive favorable treatment. In this case, passage of FCPA, by limiting firms' ability to bribe in foreign countries, would more adversely affect firms in states with more public corruption.

For our measure of state-level public corruption we use the Department of Justice's data on corruption-related convictions of public officials that has been used in some recent literature (e.g., Glaeser and Saks, 2006; and Butler, Fauver, and Mortal, 2009). Using data on publicly-listed firms, we estimate a difference-in-differences ("diff-in-diff") model to test for the effects of the passage of FCPA on firm value (measured by *Tobin's Q*) over a seven-year window around the passage of FCPA in 1977. We find that the passage of FCPA hurts firm value if the firm is headquartered in a corrupt state. These results are not only statistically significant but also economically meaningful. For example, our estimates indicate that, in three years following the passage of FCPA, firms in more corrupt states saw a 10% or greater drop in their value relative to other firms.[4] Out results also show that firms located in corrupt states experienced a significantly greater decline in operating performance and firm growth after the passage of FCPA.

We conduct additional tests to ensure that the decline in firm value is driven by FCPA rather

[4]Our results are consistent with those reported by Zeume (2014), where the passage of the UK Bribery Act in 2010 adversely affected the value for UK firms operating in high-corruption regions of the world. However, the important difference is that we examine the differential effects of local corruption, and our findings support the claim that public corruption is symptomatic of a local culture of corruption that also induces corrupt behavior by private individuals such as firm managers outside the local area.

than other confounding events. First, we perform a placebo test to ensure that the parallel-trend assumption prior to FCPA is not violated and that it is indeed the passage of FCPA that results in the drop in firm value. Second, we show that these value effects are also evident in the short term after the passage of FCPA. The cumulative abnormal return (CAR) over a 120-day window after the passage of FCPA is significantly more negative for firms located in corrupt states, suggesting that the market may have taken some time to understand the extent to which certain firms engaged in corrupt activities abroad.

Third, since FCPA curbs the bribing of foreign officials, we contend that firms that are in more export-oriented industries should experience a greater decline in firm value. Further, if it is the ability of managers to bribe abroad that is arrested by the passage of FCPA, then the relative ease of bribery in that foreign country should have a bearing on the effects of FCPA-passage on the value of U.S. firms. Hence, we estimate the differential effects of FCPA on firms in different industries. We identify industries that export to foreign countries in the two years prior to the passage of FCPA and the list of countries to which these industries exports. Using LaPorta, Lopez-de-Silanes, Shleifer, and Vishny's (1998) corruption index as a proxy for the ease of bribery in a foreign country, we calculate the average corruption index of these "destination" countries, weighted by the proportion of the given industry's exports to the respective country. Our regression estimates suggest that the negative effects of FCPA-passage on firm value are greater among firms that are headquartered in more corrupt states and operating in more export-oriented industries, and the effects are even greater if the destination countries are more corrupt. For example, we find that firms from more corrupt states and in exporting industries experienced a 12% drop in firm value after the passage of FCPA; firms that export to more corrupt foreign countries (with the average corruption level of the export destination countries in the top decile) experienced an additional 6.5% drop in their value, when compared with firms whose industries export to less corrupt foreign countries. These results show that it is the enforcement of FCPA, rather that other confounding events during that period, that caused a decline in value for firms located in corrupt states.

We also perform further tests to show that the differential effects of FCPA reflect the local culture of corruption. First, the diff-in-diff estimates are robust to the inclusion of industry × year fixed effects. Thus, even within the same industry (e.g., an export-oriented industry), firms located in corrupt states are more affected by the legal ban on foreign bribery activities. Second, our main results are also robust to alternative measures of corruption that are derived from surveys that ask about state level corruption (e.g., Boylan and Long, 2003; Dincer and Johnston, 2013). Overall, the above results support our hypothesis that public corruption is symptomatic of a local culture of corruption, which is reflected in the actions of private citizens such as public firm managers.

The loss in firm value following FCPA suggests that foreign corrupt practices appear to have benefited shareholders. In other contexts, however, a culture of corruption may correspond to greater agency problems and self-dealing among firm managers and hurt shareholder value. We provide evidence by again utilizing a diff-in-diff approach that exploits an exogenous variation in the level of agency problems. Specifically, following existing literature, we use the passage of antitakeover laws by states and analyze its effect on firms' operating performance depending on whether they are located in more or less corrupt states.

It has been argued in the literature (e.g., Bertrand and Mullainathan, 2003) that the Business Combination (BC) Law is the most restrictive of all antitakeover laws. Therefore, we first conduct our tests using the passage of BC laws, which weaken external governance mechanisms by limiting the ability of the market for corporate control to facilitate beneficial changes at firms. Thus, the passage of BC Law will be more detrimental for shareholders if managers in corrupt states are more agency prone. We follow the literature (e.g., Bertrand and Mullainathan, 2003; Giroud and Mueller, 2010) to examine the effect of BC Law on operating performance for firms in corrupt states using the diff-in-diff approach. The results reveal that firms located in corrupt states were more adversely affected by the passage of BC Law in the state they were incorporated. For example, firms located in states with above-median level of corruption experienced a 10.6% greater drop in ROA after the passage of BC Law in the state of incorporation compared with other firms.

We also examine other indicators of agency issues being more severe in states with more public corruption. First, we find that firms located in corrupt states tend to engage more in earnings management through discretionary accruals. Second, among firms with higher size and age, we find that firms located in corrupt states are more likely to be subject to a securities class action. These results show that the local culture of corruption manifest in managers' opportunistic behaviors in financial reporting, which results in erroneous statements and increased litigation risk. Overall, our evidence shows that local corrupt culture is also associated with greater agency problems and self-dealing among firm managers, which is detrimental to shareholders' value.

Our paper contributes to the literature that highlights the implication of corruption as a social norm (see, e.g., Manski, 1993; Guiso, Sapienza, and Zingales, 2006; and Fisman and Miguel, 2007). Unlike public corruption which poses social cost only to economic activities in the local area, the culture of corruption originated from, e.g., the public sector, may form a social norm and shape individuals' behavior which can be carried over to other aspects of economic activity or other geographical area. For example, Fisman and Miguel (2007) study the parking behavior of United Nations officials and find that diplomats from high-corruption countries had more unpaid parking violations in Manhattan, where they are protected from parking enforcement actions. We provide additional insight to the role of corrupt social norms by showing that firms located in high-corruption states also tend to engage in bribery activities in foreign countries. Another related paper is Parsons, Sulaeman, and Titman (2016), which shows that a firm's likelihood of engaging in financial misconduct is related to other unethical behaviors in the same locale. Unlike the Parson's et al (2016) paper, we rely on the passage of an exogenous federal law. Since FCPA affects firm activities outside the purview of their local environment, the test provides evidence that can be more reliably tied to cultural, rather than other local social and economic effects.

Our paper also contributes to the literature by highlighting the role of corporate governance mechanisms when the surrounding economic environment is rife with corruption. We find that stronger governance mechanisms are especially beneficial for the firm when there is more corruption

in the local area. The choice of superior corporate governance can help firms distinguish themselves from other firms in more corrupt areas. This suggests that corporate governance mechanisms can at least partially overcome the problems of corrupt corporate culture. This is also consistent with other findings in the international finance literature whereby firms cross-list on foreign exchanges in order to signal their superior corporate governance (e.g., Stulz, 1999; Coffee, 2002).

2. Hypotheses

As the studies of corruption suggest, it is not straightforward to explain why some societies have high levels of public corruption, while others do not. However, there are some generally accepted facts about corruption patterns. First, corruption tends to be persistent, i.e., history is important in explaining current levels of corruption. Tirole (1996) argues that generations that are born into corrupt environments will learn to be corrupt and cause it to persist. It is also argued that there may be a "tipping point" in terms of corruption. Hence, once the level of corruption is sufficiently high, even individuals who would have preferred to not be corrupt may have little choice since, for instance, their careers may be jeopardized if they are unwilling to accept bribes and share them with co-workers or superiors (Bardhan, 1997). Therefore, even if it is not apparent as to where corruption may take root, once it does, it tends to persist.

Second is that corrupt behavior can be shaped by social norms and curtailed by stronger legal enforcement. Culture, which has been defined as a "social control system based on shared norms and values" (O'Reilly and Chatman, 1996), influences individuals' behavior in a way common to the population in a particular geographic area. We hypothesize that there is a culture of corruption in certain regions of the U.S., where local individuals in public and private sectors share a common belief about whether it is acceptable to engage in unethical behaviors for private benefits. Under this hypothesis, "private corruption" may exist alongside public corruption in these regions. What we term private corruption is the notion that corporate managers engage in corrupt behavior to acquire business for the firm and/or extract private benefits. Admittedly, it is not obvious that

state-level variation in corrupt culture would have an economically meaningful impact on firm managers' behaviors and firm value, especially with the federal regulations and institutions that are uniformly strong across states. However, private corrupt behavior, as a manifestation of local culture, can be carried over outside of the local areas. The relatively small differences of corruption across states can be significantly amplified if these firms operate in foreign countries with weaker institutions and law enforcement. Hence we expect legislations that aim to restrict foreign corrupt activities would have a more significant impact on firms located in states rife with corruption.

An example of corrupt cultural norms affecting people's behavior in far-off places is the finding in Fisman and Miguel (2007) that instances of parking violations by U.N. diplomats in New York City are strongly correlated with the level of corruption in the diplomats' home nations. Fisman and Miguel (2007) also show that improvements in legal enforcement are effective and may be necessary in curtailing corrupt behavior. Our setting is similar – we analyze the effect of legal enforcement (as reflected in the passage of the Foreign Corrupt Practices Act, or FCPA, of 1977) on the behavior of firms with different cultural norms about corruption. Our main prediction is that the effect of legal enforcement would be stronger for firms that are more deeply embedded in the culture of corruption. If public corruption is symptomatic of a broader culture of corruption, then managers of firms that are located in more corrupt states will also tend to engage in corrupt practices such as bribing officials in foreign countries, and thus, these firms should be more affected by the passage of FCPA.

Hypothesis 1 (H1): *Legal bans of foreign corrupt activities will more adversely affect firms located in states with high public corruption.*

The propensity of managers to engage in corrupt practices abroad could enhance firm value and benefit shareholders. In general, however, a culture of corruption is also likely to be associated with greater agency problems and self-dealing among firm managers – leading to a more significant loss in firm value. Consistent with this idea, Liu (2016) finds that firm managers with corrupt cultural background are more likely to engage in accounting fraud and option backdating. Under

this hypothesis, stronger corporate governance may be especially valuable in corrupt environments, by restricting agency problems and diversion of resources by corrupt managers. Specifically, an exogenous improvement (deterioration) in governance of all firms will benefit (harm) the investors more if these firms are located in more corrupt states. Therefore, we hypothesize:

Hypothesis 2 (H2): *Exogenous (legislative) changes in corporate governance will more strongly affect firms located in states with high public corruption.*

3. Data and Description of Variables

We start with all U.S. public firms covered in the CRSP/COMPUSTAT Merged Database and listed on the NYSE, NASDAQ, and AMEX. We gather accounting information from *Compustat*. We exclude firms operating in regulated industries (SIC 4900-4999 and SIC 6000-6999). We also exclude firms with total assets less than $1 million and firms with zero or negative reported sales. For the analysis based on FCPA, we use a seven-year window around the passage of FCPA in 1977; this sample includes 3,668 firms and 17,288 firm-year observations. For the analysis on state antitakeover laws, we follow Bertrand and Mullainathan (2003) and include observations from 1976 to 1995. This sample includes 7,749 firms and 60,935 firm-year observations. We use data over 1990–2011 to examine the relation between state public corruption and corporate misconduct. Historical data on firms' (headquarter) location are only available from 1991 onwards; therefore, we use the headquarter location in 1991 for prior years.

3.1. Measures of Local Corruption

We collect the number of corruption-related convictions by each local United States Attorney's Office district from 1990 to 2011; these data are available from the U.S. Department of Justice's (DoJ's) Public Integrity Section Reports. The Public Integrity Section focuses on "crimes involving abuses of the public trust by government officials" (Public Integrity Section, 2007). These data provide an ex post measure of local public corruption and have been used in the literature on political economy (e.g., Fisman and Gatti, 2002; Glaeser and Saks, 2006) and finance

(e.g., Butler, Fauver, and Mortal, 2009). Glaeser and Saks (2006) provide a detailed discussion for these conviction data; as they point out, an advantage of using these data is that, unlike the survey-based data or data on peoples'/firms' *perception* of corruption that have been used in earlier studies, the convictions-based data provide an *objective* measure of public corruption.[5] Because these data are based on *convictions* of public officials, they serve as a lower benchmark for the actual level of corruption.

For each state-year, we first calculate the ratio of the number of corruption-related convictions to state population in millions. We then take the time-series average of the state-level corruption from 1990 to 2011 and use the rank of the average state-level corruption as the main measure for our empirical analysis. Due to data limitation, the sample period used for constructing the corruption measure does not match with the sample period of the data analysis. For this reason, we conduct the analysis using the rank of corruption instead of the actual number of convictions to minimize the effect of measurement error. The relative level of corruption has been argued to be stable over time (Tirole, 1996). For example, Glaeser and Saks find that historical factors such Congregationalism in 1890 can explain the heterogeneity of corruption across states. Johnson, LaFountain, and Yamarik (2011) also find that state political characteristics in 1970 are correlated with the relative level of corruption in recent years. Thus, the rank of state corruption based on recent corruption cases is arguably a reliable measure for analysis in earlier period. As an alternative measure of corruption in our empirical analysis, we also use a binary variable – *High Corruption* – that equals one if the time-series average number of convictions in the state is ranked above the median.

One concern with this measure is that the number of convictions might reflect variation in the level of law enforcement across states. However, as previous studies point out (e.g., Fisman and Gatti, 2002; Butler, Fauver, and Mortal, 2009), the DoJ data cover cases that involve federal prosecutions. Thus, there should be no significant variation in the level of enforcement across states. In support of this argument, Fisman and Gatti (2002) show that there is no significant relation

[5]See Svensson (2005) for a description of various measures of corruption that have been used in the literature.

between these conviction data and cross-state variation in law enforcement. Further, if higher number of convictions indicate stronger enforcement and, hence, lower levels of corruption, then it should bias the estimates against our proposed hypotheses. Finally, we show that our empirical results are robust to using alternative measures of corruption based on surveys, such as those by Boylan and Long (2003) and Dincer and Johnston (2014).

3.2. Dependent Variables

The main dependent variable in our study is firm's market value and operating performance. We measure firm's market value using *Tobin's Q*, which is defined as the sum of total assets and the difference between market value and book value of common equity, divided by total assets. Operating performance is measured by *ROA*, which is the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to lagged assets. In addition, we use firms' discretionary accruals as the dependent variable when studying the relation between state public corruption and earnings management. We estimate firms' discretionary accruals using the Modified Jone's Model (see Dechow, Sloan, and Sweeney, 1995, for details). Finally, *Securities Class Action* is a binary variable that equals one if the firm is subject to a securities class action lawsuit in a given fiscal year. We report detailed definitions of all these variables in the Appendix.

3.3. Other Independent Variables

Besides the level of public corruption, we control for a number of firm characteristics that are known to affect firm value; these control variables are defined as follows. *Ln(Assets)* is the natural logarithm of total assets; *Firm Age* is the age of the firm in years based on CRSP; *Leverage* is defined as the sum of long term debt and debt in current liabilities divided by total assets; *Tangibility* is the total value of net property, plant, and equipment, divided by total assets; *HHI* is the Hirfindahl-Hirschman Index of the 3-digit SIC industry. In addition to firm and industry characteristics, in the regressions we also control for current economic condition of the state, as proxied by *State GDP Growth*.

3.4. Summary Statistics

In Table 1, we provide summary statistics of variables used in the empirical analysis. All the firm and industry characteristics are winsorized at the 1st and 99th percentiles. In Table 2, we report each state's number of public-corruption related convictions per million population, averaged over 1990 to 2011. There is substantial variation in the level of corruption across states. As per these figures in Table 2, the least corrupt state (on average) is Oregon (with 0.931 convictions per million population), whereas the most corrupt state (excluding Washington D.C.) is Louisiana (with 7.818 convictions per million population). Washington D.C. is an outlier, with an average of 70.081 convictions per million population. However, our empirical results are not affected by outliers because we use the convictions-based ranking of each state (ranging between 1 and 51) as an alternative measure in our empirical analyses. We also present state-level corruption in Figure 1, which again shows that there is a significant variation in corruption across the United States and there are no obvious geographic clusters that may bias our interpretation.

4. Is Public Corruption Reflective of a Broader Culture of Corruption?

4.1. FCPA, Local Public Corruption, and Firm Value

We start with a graphical representation of the effects that we hypothesize. Specifically, in Figure 2, we plot the industry-adjusted Tobin's Q for firms located in states with high vs. low local public corruption over the sever-year period around the passage of FCPA. The graph shows that the firm value of the two groups started to diverge in the year of passage. After the passage of FCPA, the value of firms in less corrupt states started to increase relative to the industry mean while that of the firms in more corrupt states decreased. This graph suggests that within an industry, firms located is less corrupt states tend to benefit from the legal ban of foreign bribery by FCPA, while firms located in more corrupt states suffered from this restriction and lost value.

Next, we analyze this relation with a more thorough empirical test of our hypothesis that

higher public corruption in a state is reflective of a broader culture of corruption, which will also encompass private corruption at firms that are located in that state. The underlying premise is that "culture" within a group is a set of norms and values that are shared by members of that group. As such, a state's culture would extend to both public officials as well as private individuals (including local firms' managers). We test this hypothesis by exploiting the passage of FCPA in 1977, which made it illegal for U.S. companies and individuals (among others) to bribe foreign officials. As per our hypothesis, firms rooted in a culture of corruption are more likely to engage in bribery overseas, and the enactment of strong legal enforcement in the form of FCPA will hurt their value more negatively, when compared with firms from a relatively less corrupt culture. To test our prediction, we estimate the following difference-in-differences (diff-in-diff) model in a seven-year window around the passage of FCPA in 1977:

$$\begin{aligned}\text{Tobin's Q}_{i,t} = \alpha + \beta_1 \text{FCPA}_t \times \text{Corruption}_s + \gamma_1 FIRM_{i,t-1} \\ + \beta_2 \text{State GDP Growth}_{s,t} + FirmFE + YearFE + \epsilon, \end{aligned} \tag{1}$$

where FCPA_t is a binary variable that equals one for observations after the passage of FCPA, and zero otherwise. $FIRM_{i,t-1}$ denotes a vector of lagged firm characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*. Corruption_s denotes the level of public corruption for state s, which is measured either by the rank of state corruption or a binary variable that equals one for states with average corruption above the median (i.e., states whose rank by average corruption is above 25). As discussed earlier, we measure state corruption based on the number of public corruption convictions since 1990. Firm's location is proxied by the location of its headquarters, and the data on headquarter location go as far back as 1991. Therefore, there is no time-series variation either in headquarter location or state corruption in the test window spanning 1974–1980. Corruption_s is thus a time-invariant factor that is absorbed by firm fixed effects and is dropped from the regression. Similarly, FCPA_t is constant within years and is thus absorbed by year fixed effects. We cluster standard errors by the headquarter-state to prevent serial correlation and within-state correlation of the outcome variable from inflating the

statistical significance of the diff-in-diff estimates (Bertrand, Duflo, and Mullainathan, 2004).

Table 3 reports the estimates of Model (1). The coefficient for $\text{FCPA}_t \times \text{Corruption}_s$ in both columns is negative and significant at least at 5% level. In column 2, the estimates show that the change in Tobin's Q after the passage of FCPA is significantly lower for firms located in states with above-median level of public corruption. The coefficient magnitude (–0.095) suggests that, relative to firms located in low-corruption states, those located in high-corruption states experienced a 10% greater loss in firm value, when measured against the median firm's Tobin's Q (0.951). This result indicates that the restrictions on foreign bribery had an economically significant impact on firms located in states with more severe public corruption. The finding is consistent with our hypothesis that firms rooted in a *local* culture of corruption will also tend to engage in *foreign* bribery activities, and these firms are more hurt by the introduction of a strong enforcement device that deters foreign bribery.

We argue that the strongly significant estimate of β_1 in Table 3 is evidence of corruption being a cultural norm. This is because our measure of corruption reflects corruption among *local* public officials, which should not really be related to firms' tendency to bribe *foreign* officials, unless both the local public corruption and the firms' corrupt activities originate from shared beliefs and norms, or a common "culture of corruption". The fact that the passage of FCPA negatively affected the market value of firms located in more corrupt states suggests that these firms were likely to be benefitting from foreign bribery, and clampdown due to FCPA eliminated those benefits.

We also examine changes in firm performance and policies after FCPA. First, we ask whether FCPA more negatively affected firms in high-public-corruption states in terms of operating performance. We estimate a model similar to Model (1), but replace the dependent variable with *ROA*. The results in columns 1 and 2 of Table 4 show that firms in corrupt states tend to have more negative changes in operating performance relative to those in less corrupt states after the passage of FCPA. The estimated coefficient is negative for $\text{FCPA}_t \times \text{Corruption}$ but is statistically significant only when using the binary variable of corruption.

Next, we examine whether firms in corrupt states experienced lower growth after the legal ban on foreign bribery. In columns 3 to 6 of Table 4, we present the estimated effect of FCPA on firm growth for firms in corrupt states. The estimates show that firms in corrupt states experienced lower growth, both in terms of assets growth and sales growth. This result suggests that, as FCPA restrict firms in corrupt states from getting business through bribery, they tend to cut investment in fixed assets and experience lower growth in revenue.

4.2. Alternative Explanations and Robustness

In this subsection, we address a number alternative explanations to the documented effect of FCPA and check the robustness of the main results.

4.2.1. Confounding Events

It is possible that some confounding events around 1977, rather than FCPA, drive the observed value reduction for firms located in high-public-corruption states. To address this concern, we look further into the timing and the cross-sectional variation of the effect. First, an important assumption for the diff-in-diff estimate is that the treated group and the control group followed a parallel trend prior to the treatment (FCPA). The pattern shown in Figure 2 appears to be consistent with the assumption, as the firm value of the two groups did not diverge until the passage of FCPA. To formally test the parallel trend assumption, we conduct a placebo test by estimating a DID model over a four-year window *prior to* the passage of FCPA, with a pseudo shock that took place two years before FCPA (1974). Table 5 reports the estimates of the placebo test. It shows that the diff-in-diff estimator is not significant in the pre-FCPA period, suggesting that there is no significant difference in the trend of value between firms in less/more corrupt states until the passage of FCPA. This result confirms the parallel-trend assumption and the validity of our empirical setting.

We also examine the short-term market reaction to FCPA. We compute the market-adjusted cumulative abnormal return (CAR) over different windows around May 5, 1977, when FCPA passed

the senate, and regress CARs on measures of state corruption. Table 6 reports the estimates of the CAR regressions. As columns 1 and 2 show, there is no significant difference in stock return between firms in more/less corrupt states over a 30-day window prior to the passage of FCPA. This again confirms the parallel-trend assumption. Importantly, we find that firms in states with above-median level of public corruption received a more negative market reaction in 10, 60, and 120 trading days after FCPA. This is consistent with our main result that FCPA significantly reduced firm value for firms located in corrupt states. Thus, our results on short-term and long-term market reaction show that the value decline took place precisely after the passage after FCPA.

Further, we ask what industries are more likely affected by FCPA. If firms in corrupt states experienced a decline in value after the passage of FCPA because of the restriction on foreign bribery, then we expect the effect to be stronger for firms in export-oriented industries, particularly when they sell to corrupt countries.[6] We therefore examine the heterogeneity across industries based on whether and where they export.

We collect the U.S. export value at the 4-digit SIC industry level in 1974 and 1975, and define export-oriented industries as those with non-zero value of export in the 1974-1975 period.[7] Further, among the export-oriented industries, we measure the average level of corruption for the export destinations. Specifically, we use the corruption index from La Porta, Lopez-de-Silane, Shleifer, and Vishny (1998, LLSV hereafter) to compute the average level of corruption for the export destination countries, weighted by export value, for each 4-digit SIC industry. We then define a industry as exporting to corrupt countries if the average corruption score of the destination countries is in the bottom decile of the sample.[8]

Based on the information on industry export value and export-destination corruption, we split the diff-in-diff estimator $\text{FCPA}_t \times \text{Corruption}_s$ in Model 1 into three groups: firms in non-export

[6]However, we do not argue that only firms that export are affected by FCPA. For example, a firm that does not export products or services can still be constrained by FCPA if they have foreign subsidiaries where they directly produce and sell products in the local market. Our underlying assumption is that, ceteris paribus, firms that export to corrupt countries are more subject to the legal ban on foreign bribery activities by FCPA.

[7]Data is available at `http://faculty.som.yale.edu/peterschott/sub_international.htm`. The underlying data is collected from the U.S. Census Bureau. Thanks to Peter Schott for making the data available.

[8]A lower corruption score in LLSV indicates higher corruption.

industries, firms in industries exporting to low-corruption countries, and firms in industries exporting to high-corruption countries. Our prediction is that if firms in high-public-corruption states experienced a decline in market value around 1977 because of the legal ban on foreign bribery activities, then the effect should be stronger in export-oriented industries. Further, firms located in corrupt states and in industries that export to corrupt countries should be the most vulnerable to the legal ban of foreign bribery imposed by FCPA.

In Table 7 we present the new diff-in-diff estimates. Note that the binary variables for the industry groups are again dropped from the regression because we fix the definition in 1974 and hence it is not time variant over the sample period. The result shows that the diff-in-diff estimator is significantly negative for firms in export industries, but less so other firms. Moreover, those export to corrupt countries were more adversely affected by the enactment of FCPA. The coefficient estimates in column 2 suggests that while firms in the export-oriented industries and located in states with above-median level of corruption has a 12% decrease in firm value from the sample median after the passage of FCPA, the value of firms in industries exporting to the most corrupt countries decreased by another 6.5%. This is consistent with our conjecture that firms in corrupt states are affected by FCPA due to the constraint imposed on their foreign bribery activities. Thus, this finding reflects the link between local public corruption and corporate private corruption. While one may still concern about confounding events around 1977 that drive the decline in market value for firms in corrupt states, we believe that this is unlikely to be the case. Given the evidence in Table 7, any omitted confound event should also have a greater negative effect on industries that export to corrupt countries.

4.2.2. Industry Effects

Another concern that arises, particularly with the evidence in Table 7, is that the result may be entirely driven by certain industries. Specifically, industries that are more prone to soliciting business through bribery may be more concentrated in states with higher public corruption, as well as bribing more in foreign countries. However, our hypothesis predicts that, even within industry,

firms located in corrupt states should be more affected by FCPA because they are more likely to bribe in foreign countries due to local corrupt culture. To distinguish the local cultural effect from the industry effect, we re-estimate Model (1) controlling for industry $\times$ year fixed effects. The results in Table 8 show that the diff-in-diff estimator remains significantly negative after controlling for industry $\times$ year fixed effects. This result suggests that, among firms in the same industry (e.g. an export-oriented industry), those located in corrupt states are more likely to benefit from foreign bribery activities prior to the passage of FCPA. Thus, our main finding is consistent with the culture hypothesis ($H1$), where firms' behavior overseas is shaped by local corrupt culture, and cannot be explained merely by industry effect.

4.2.3. Imperfect Measure of Local Public Corruption

Finally, we acknowledge that our conviction-based measure of corruption is inherently a noisy proxy of state public corruption, because of the mismatch in timing between the construction of the measure (1990-2011) and the empirical test (1977). Hence, we check the robustness of our main result to alternative measures of corruption.

We adopt two alternative measures based on surveys. The first one is based on Boylan and Long (2003), who surveyed State House reporters to compare the level of corruption across states. In Question 6 of the survey, the authors asked: " Suppose you were to rank all states in terms of level of corruption of their government employees (including elected officials, political appointees, and civil servants). Where would your state rank?". 293 reporters from 47 states responded to this question. We use the ranking based on the responses to Question 6 to measure the level of corruption.[9]

The second measure is based on another survey conducted by Dincer and Johnston in 2013.[10] They surveyed news reporters covering state politics as well as investigative reporters covering issues related to corruption. Further, they construct two survey-based indices to measure two

[9]There was no response for Massachusetts, New Hampshire, and New Jersey, and thus these three states are not included in Boylan and Long's measure.

[10]The survey results are available at: `http://ethics.harvard.edu/blog/measuring-illegal-and-legal-corruption-american-states-some-results-safra`.

different forms of corruption in American states: *Legal corruption* refers to "political gains in the form of campaign contributions or endorsements by a government official, in exchange for providing specific benefits to private individuals or groups, be it by explicit or implicit understanding"; *Illegal corruption* refers to "private gains in the form of cash or gifts by a government official, in exchange for providing specific benefits to private individuals or groups." Their survey identifies states that are most subject to legal or illegal corruption.[11] We follow their survey result and use two binary variables to indicate states that are perceived as legally or illegally corrupt. Note that, similar to our conviction-based measure, these surveys were conducted after the sample period of our empirical test and hence they may not properly reflect the relative level of corruption during the period around FCPA. However, the resultant measurement error should bias against finding any result consistent with our hypothesis.

We repeat the estimation of Model (1) using the survey-based measures and report the estimates in Table 9. When using Boylan and Long's measure or the legal corruption measure by Dincer and Johnston, we find consistent result that firms located in corrupt states suffered from greater value reduction after the passage of FCPA. Hence our main finding is not driven by any specific way of measuring state public corruption.

5. Is Culture of Corruption Associated with Agency Problem?

5.1. State Antitakeover Law and Firm Performance

The previous section shows that a legal ban of foreign bribery activities more negatively affect firms located in states with high public corruption, suggesting that firms in corrupt environments also tend to practice corruptly elsewhere and that public corruption is symptomatic of a local culture of corruption. Managers may engage in bribery activities to solicit business, with the purpose of maximizing shareholders' value. This is consistent with the value reduction after the

[11] The most legally corrupt states include Kentucky, Illinois, Nevada, Mississippi, New Jersey, Alabama, New Mexico, New York, Georgia, Pennsylvania, and Wisconsin; The most illegally corrupt states include Arizona, California, Kentucky, Alabama, Illinois, New Jersey, Georgia, New Mexico, Pennsylvania, Florida, Indiana, Rhode Island, and Texas.

legal ban of foreign bribery activities. On the other hand, for a company embedded in a corrupt culture, managers may have the tendency to pursue personal interests at the cost of shareholders. Therefore, we examine whether local corrupt culture is related to more severe agency problem. For this purpose, we look at how exogenous changes in the strength of corporate governance affect performance more for firms in corrupt environments. If managers' corrupt activities are purely driven by the intention to maximize shareholders' value, then a weaker governance mechanism should not reduce firm value; However, if corrupt culture is reflective of agency problem, weakening corporate governance may exacerbate the problem and impede firm performance more relative to firms without a corrupt culture.

We test the above conjecture by exploiting exogenous changes in the state-level antitakeover laws. State antitakeover laws that protect firms from becoming a takeover target weaken the role of market for corporate control in curbing the agency problem. The extant literature suggests that passage of state antitakeover laws resulted in lower operating performance, lower investment, and lower technological innovation (Bertrand and Mullainathan, 2003; Giroud and Mueller, 2010; Atanassov; 2013). Under our hypothesis, if firms in corrupt environments are subject to more severe agency problem, then these firms should be more negatively affected by the adoption of state antitakeover protection. We test our prediction using the following model:

$$\begin{aligned}\text{ROA}_{i,t} = \alpha + \beta_1 \text{Antitakeover Law}_{c,t} + \beta_2 \text{Antitakeover Law}_{c,t} \times \text{Corruption}_s + \beta_3 \text{Corruption}_s \\ + \gamma_1 FIRM_{i,t-1} + \beta_4 \text{State GDP Growth}_{s,t} + FirmFE + YearFE + \epsilon. \end{aligned} \quad (2)$$

Antitakeover $\text{Law}_{c,t} \times \text{Corruption}_s$ is the interaction between a binary variable indicating the passage of an antitakeover law in state c, where the firm is incorporated, and the level of public corruption for state s, where firm headquarter is located.[12] Note that firms are affected by the antitakeover legislation of the state of incorporation rather than the state of headquarter location, which may be correlated with the local economic condition. To take into account the correlation

[12]When interacting *Antitakeover Law* with the state rank of corruption, we subtract the median rank (25) from the corruption measure so that the stand-alone variable *Antitakeover Law* captures the effect of antitakeover law on an average firm in a state with the median level of corruption.

in firm performance within state of incorporation, we follow the literature and estimate the standard errors with state of incorporation clustering (Bertrand and Mullainathan, 2003; Giroud and Mueller, 2010). We use the same set of control variables, including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, *HHI*, and *State GDP Growth*. Because we have the historical headquarter location from 1991 onwards but this regression sample consists of observations from 1976 to 1995, some firms have changes in headquarter location during the sample period and thus the standa-lone variable *Corruption* is estimated in the model. The binary variable *Antitakeover Law* can also be estimated because these laws are passed in a staggered fashion across states and thus the variable is not perfectly collinear with time effects.

We first focus on one specific antitakeover law – the Business Combination Law (BC Law), which is considered one of the most restrictive type of antitakeover laws. The BC Law imposes a three to five year moratorium on transactions such as mergers and asset sales between the firm and a large shareholder that obtains more than a specified percentage of the shares. This moratorium hinders a potential acquirer from using the target's assets to repay the acquisition debt, making acquisition more costly. Therefore, BC Law reduces the threat of hostile takeover as a form of corporate governance and thus induces managerial slack (Bertrand and Mullainathan, 2003; Giroud and Mueller, 2010). We argue that takeover threat as a corporate governance mechanism is particularly important for firms in corrupt environments, if corrupt corporate culture is associated with more severe agency problem.

Table 10 reports the estimates of Model 2. The results show that $\text{BC}_{c,t} \times \text{Corruption}_s$ is significantly negative, suggesting that firms in corrupt states had a greater decrease in operating performance than those in less corrupt states after the passage of BC Law in the state of incorporation. Giroud and Mueller (2010) find that, on average, there is a 0.60 percentage point drop in ROA after the passage of BC Law. We find that while there is no significant change in ROA for firms located in states with below-median level of local public corruption, firms located in the state with above-median level of local public corruption had a 1.19 percentage point

decrease in ROA after the passage of BC Law. The results suggest that weaker corporate governance due to antitakeover defenses reduces operating performance mainly for firms in corrupt states.

To mitigate the concern of a systematic trend in firm performance prior to the passage of antitakeover law and reverse causality, we show the dynamics of the effect of BC Law on firm performance. We follow Bertrand and Mullainathan (2003) and split the BC dummy into four dummies: BC^{-1} for observations in the year prior to the passage of BC laws, BC^{0} for years when BC law was passed, BC^{1} for observations where the BC law was passed one year ago, and BC^{2+} for observations where BC law was passed two or more years ago. We interact all the BC dummies with the state corruption measure to test whether the decrease in operating performance for firms in corrupt states took place after the passage of the laws. In columns 3 and 4 of Table 10, we show that firms in corrupt states have similar level of operating performance as the other firms until one year after the passage of BC laws, when their operating performance started to deteriorate. Thus, reverse causality is unlikely to drive our result.

Bertrand and Mullainathan (1999) argue that BC Law is the most restrictive type of antitakeover law. Since then, a large number of studies follow Bertrand and Mullainathan and focus on BC Law in examining the implication of firm governance to other firm policies. In a recent study, Karpoff and Wittry (2014) argue that the use of BC Law in empirical studies is complicated by the confounding effects from other antitakeover laws, such as the coverage by first-generation state antitakeover laws, other second-generation state antitakeover laws, and pre-existing firm-level takeover defenses. For this reason, simply focusing on BC Law can lead to misspecified tests. To address this concern, we control for the effect from other state antitakeover laws in the regression model. In Table 11, we present estimates from regression models where we include dummy variables indicating other antitakeover laws enacted in the state of incorporation, including the First-generation Law (FG), the Poison Pill Law (PP), the Control Share Acquisition Law (CS), the Directors' Duties Law (DD), and the Fair Price Law (FP), and their interaction

with headquarter state corruption measures.[13] Our estimate shows that among all the interactions between corruption and anti-takeover laws, only the interaction term $BC \times Corruption$ has a significantly negative coefficient, suggesting that the negative effect documented earlier is driven by the passage of BC Laws rather than other existing state antitakeover provisions.

Finally, in Table 13, we also show that the stronger negative effect of antitakeover laws on operating performance for firms located in corrupt states is robust to using survey-based measures of corruption. Specifically, firms in states that are identified as legally or illegally corrupt by Dincer and Johnston (2014) had a greater decline in ROA after the passage of BC Law in their state of incorporation. Overall, our analysis shows that weaker corporate governance due to the passage of state antitakeover laws has an adverse impact mainly on firms located in areas with higher public corruption. As we show in Section 4, local public corruption is reflective of a local culture of corruption. This analysis thus implies that local corrupt culture is also manifested in greater agency problem among local firms.

5.2. Local Culture of Corruption and Corporate Misconduct

Next, we show further evidence that managers in states with greater public corruption also tend to practice corruptly. We examine two forms of corporate corrupt practices. The first one is earnings management. Financial reports convey information about a firm's performance and prospects to investors. Given the nature of auditing and accounting standards, managers have leeway in their reporting of information that is relevant to the investors (see, e.g., Healy and Wahlen, 1999). However, the flexibility offered by the accounting standards can also lead to opportunistic earnings management such that the financial reporting does not fully or accurately convey the firm's true state of affairs. Managers can "manage" earnings by taking seemingly innocuous steps, such as recognizing revenue prematurely or deferring R&D/advertising expenses; these steps ultimately affect the accrual of earnings. Managers who are prone to greater agency problems and extraction

[13]Karpoff and Wittry (2014) provide the years in which various state anti-takeover laws are enacted.

of private benefits would favor opaqueness over informational transparency to better conceal their activities. To the extent that local corrupt culture is part of the driving force of corporate corrupt practices, we would expect actions such as earnings management to be more widespread in states with greater corruption. To test our prediction, we examine the variation in earnings management activities across firms with different levels of local corruption using the following model:

$$\text{Discetionary Accurals}_{i,t} = \alpha + \beta_1 \text{Corruption}_s + \gamma_1 FIRM_{i,t-1} + \beta_2 \text{State GDP Growth}_{s,t} + IndustryFE + YearFE + \epsilon. \quad (3)$$

Although finding clear evidence of earnings management is difficult, it is widely believed in the accounting literature that abnormal accrual of earnings is a sign of earnings management. We estimate firms' discretionary accruals using the Modified Jone's Model (Dechow, Sloan, and Sweeney, 1995) and we take the absolute value to examine the magnitude of earnings management.[14] In addition to firm characteristics included in the previous analysis, we also include the value of total current accruals in the regression following the literature on earnings management (Frankel, Johnson and Nelson, 2002). Since there is no time-series variation in our corruption measure, we focus on the cross-sectional variation in this test and control for industry fixed effects at the Fama-French 48 industry level. We predict β_1 to be significantly positive if firms in corrupt states are more likely to manipulate accounting earnings.

Table 14 reports the estimates of Model (3) for firm-year observations from 1990 to 2011. The estimates show that firms located in corrupt state tend to have significantly greater discretionary accruals, indicating these firms are more engaged in earnings management activities on average.

Second, we examine corporate misconduct reflected by securities class actions. A securities class action is a lawsuit filed by a group of shareholders who suffer from economic losses due to the firm's violations of securities laws. Under our hypothesis, managers who behave corruptly to pursue personal interests may be more prone to making erroneous statements and increasing litigation risk.

[14]We report the detailed description of the variable construction in the Appendix.

Hence we test whether firms located in corrupt states are more likely to be subject to a securities class action.

We use the data on securities class actions from 1995 to 2011 from the Stanford Securities Class Action Clearing House (SCAC). We estimate a probit model similar to Model (3), where the dependent variable is a binary variable that equals one if the firm is subject to a securities class action in that year, and zero otherwise. Again, we aim to capture the cross-sectional variation in litigation risk across firms in different states, and thus we include industry and year fixed effects in the model.

In columns 1 and 2 of Table 15, where we estimate the model among all firms from 1995 to 2011, we do not find a significant relation between local state corruption and the likelihood of a securities class action. However, we notice that the likelihood of a securities class action is correlated with certain firm characteristics, such as firm size and age. As state corruption is an endogenous variable and firms in different states may vary significantly in terms of various characteristics, we perform the estimation in subsamples based on firm size and age. In columns 3 and 4, we report the estimates among firms with above-median level of total assets and age. In this sample, we find that higher state corruption is correlated with higher likelihood of a securities class action. Our results suggest that, at least among well-establish firms in terms of greater size and age, those located in corrupt states are more likely to be subject to a securities class action. Hence, the evidence supports the idea that local corrupt culture, as manifested by public corruption cases, induces greater agency problems and corporate misconduct.

6. Conclusion

In this paper, we study the implication of the culture of corruption to public firms in the U.S. We argue that local corruption can influence (and be influenced by) economic activity through channels other than bribery alone. For instance, public corruption may exist alongside and reinforce a broader "culture of corruption" that impinges on different aspects of economic activity in the

local area. This culture of corruption can also encourage "private corruption" on the part of firms' managers.

We test whether our hypothesis about a "culture of corruption" – as opposed to rent-extraction by public officials – is supported empirically. Consistent with the "culture" argument, we find evidence that firms located in states rife with public corruption are more affected by legislations that curb foreign bribery activities, suggesting that firms in corrupt environments tend to engage in corrupt practices elsewhere.

In addition, we find that the culture of corruption also coincides with greater agency problems at firms located in corrupt environments, and that stronger corporate governance is especially beneficial to firms in more corrupt states. This is because when the external environment is weak, stronger internal governance mechanisms may ensure that the cash flow and control rights of the investors are protected. Further, we find that firms in high-corruption states tend to engage in more earnings management and that legislations that aim to enhance the quality of financial reporting are more effective among these firms. This evidence points to the fact that governance mechanisms may work in conjunction with the external economic and cultural environment.

We believe that our findings have significant implications for both research as well as policy-making. Our results indicate that the local cultural environment (including attitudes toward corruption) can have a greater impact, than has been recognized, on the value-implications of corporate governance and informational transparency. What is surprising is that, despite the strong judicial/political systems and relatively low levels of corruption in the U.S., the value effects of the variation in state-level corruption are economically important. We believe that the link between public corruption and corporate governance is a fruitful avenue for future research.

The findings in this paper have useful policy implications. First, at least in the context of the U.S. where expropriation by public officials is small, regulation that requires greater information disclosure and adoption of stronger governance standards could help overcome some of the ill-effects of corruption. Second, it is important to curb the "culture" of corruption. In that vein, it is

plausible that conviction of corrupt public officials has a parallel to the "broken-window" view of crime: strictly limiting public corruption could signal that private corruption is also unacceptable.

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Appendix: Variable Definitions

- *Corruption* is the rank of the average number of corruption convictions per million population of the state from 1990 to 2011.
- *High Corruption* is a binary variable that equals one if the average number of corruption convictions per million population of the state is above the median.
- *Tobin's Q* is the sum of total assets and the difference between market value and book value of total common equity, divided by total assets.
- *Ln(Assets)* is the natural logarithm of total assets.
- *Firm Age* is the age of the firm in years based on CRSP.
- *Leverage* is the sum of long term debt and debt in current liabilities divided by total assets.
- *Tangibility* is the net total value of property, plant, and equipment, divided by total assets.
- *ROA* is equal to earnings before interest, taxes, depreciation and amortization (EBITDA) to lagged asset ratio.
- *HHI* is the Hirfindahl-Hirschman Index of the 3-digit SIC industry.
- *Discretionary Accruals*: is the discretionary accruals estimated from the Modified Jone's Model (Dechow, Sloan, and Sweeney, 1995). We first estimate the following model in each 2-SIC industry and year:
  $Total\ Accurals = \alpha_0 + \alpha_1 \frac{1}{Assets_{t-1}} + \alpha_2 \frac{\Delta Rev}{Assets_{t-1}} + \alpha_3 \frac{PPE_{t-1}}{Assets_{t-1}} + \epsilon,$
  where current accruals $TotalAccurals$ is the difference between net income and net cash flow divided by lagged assets, ΔRev is the change in net sales. PPE is the gross property, plant and equipment. The coefficient estimates are used to predict the non-discretionary accruals in the following model:
  $Nondiscretionary\ Accurals = \hat{\alpha_0} + \hat{\alpha_1} \frac{1}{Assets_{t-1}} + \hat{\alpha_2} \frac{\Delta Rev - \Delta AR}{Assets_{t-1}} + \hat{\alpha_3} \frac{PPE_{t-1}}{Assets_{t-1}} + \epsilon,$
  where ΔAR is the change in accounts receivables. The discretionary accruals is computed as the absolute value of the difference between the total accruals and nondiscretionary accruals. We multiply the discretionary accruals by 100 when using it in the regressions.
- *Total Accruals*: is the difference between net income and net cash flow divided by lagged assets.
- *Export Industry*: is a dummy variable that equals 1 if the 4-digit SIC industry has non-zero value of export in year 1974.
- *Corrupt Destination*: is a dummy variable that equals 1 if the export-value-weighted average of the export destination countries' corruption score (La Porta, Lopez-de-Silane, Shleifer, and Vishny, 1998) is in the bottom decile of the sample.

Table 1: Summary Statistics.

This table presents summary statistics of the main variables used in our analyses. We winsorize all the variables at the 1st and 99th percentiles. All the variables are defined in the Appendix.

	N	Mean	Std. Dev.	25th	Median	75th
FCPA Sample						
Q	17,288	1.175	0.893	0.805	0.951	1.227
Ln(Assets)	17,288	4.179	1.736	2.955	4.020	5.214
Firm Age	17,288	12.363	13.376	4.211	7.049	14.342
Leverage	17,288	0.270	0.186	0.137	0.253	0.373
Tangibility	17,288	0.336	0.202	0.189	0.298	0.452
ROA	17,288	0.184	0.135	0.109	0.176	0.250
HHI	17,288	0.124	0.180	0.012	0.058	0.155
Export Industry	16,152	0.445	0.497	0.000	0.000	1.000
BC Sample						
Q	60,935	1.761	1.602	0.960	1.246	1.880
Ln(Assets)	60,935	4.178	2.006	2.723	4.008	5.427
Firm Age	60,935	12.489	13.448	3.329	8.145	16.510
Leverage	60,935	0.248	0.208	0.079	0.220	0.367
Tangibility	60,935	0.322	0.218	0.153	0.276	0.447
ROA	60,935	0.112	0.214	0.051	0.137	0.215
HHI	60,935	0.142	0.200	0.012	0.062	0.188

Table 2: Corruption by State.

This table presents average number of corruption-related convictions per million population from 1990 to 2011. All the variables are defined in the Appendix.

State	Average Number of Corruption-related Convictions per Million Population (1990-2011)
Oregon	0.931
New Hampshire	0.955
Nebraska	1.045
Utah	1.178
Minnesota	1.292
Kansas	1.428
Washington	1.481
Colorado	1.497
Iowa	1.554
Nevada	1.678
Wisconsin	1.696
North Carolina	1.812
Indiana	2.029
Michigan	2.175
South Carolina	2.204
Idaho	2.237
Arizona	2.309
New Mexico	2.316
Arkansas	2.379
Vermont	2.386
Connecticut	2.389
California	2.42
Texas	2.602
Rhode Island	2.887
Massachusetts	2.943
Maine	3.022
Georgia	3.1
Maryland	3.158
Oklahoma	3.187
Missouri	3.239
West Virginia	3.398
Hawaii	3.557
Delaware	3.644
Wyoming	3.703
Pennsylvania	3.764
New York	3.84
New Jersey	4.021
Tennessee	4.204
Alabama	4.211
Florida	4.245
Ohio	4.328
Virginia	4.667
Illinois	4.762
Kentucky	5.536
Montana	5.544
Alaska	5.679
Mississippi	6.445
South Dakota	6.446
North Dakota	7.235
Louisiana	7.818
District Of Columbia	70.081

Table 3: Foreign Corrupt Practices Act, State Corruption, and Firm Value.

In this table, we show that the enactment of the Foreign Corrupt Practices Act (FCPA) more adversely affected firms located in states with high public corruption. We present estimates from regressions in a seven-year window around the enactment of FCPA in 1977. The dependent variable is *Tobin's Q* and the independent variables of interest are interactions between *FCPA*, a binary variable that equals one after the enactment of FCPA, and measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. The standalone variable *FCPA* (*Corruption*) is not estimated, because it does not vary across firms (over time in this sample). We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q	
	(1)	(2)
FCPA × Corruption	-0.003**	
	(-2.41)	
FCPA × High Corruption		-0.095***
		(-2.91)
Ln(Assets)	-0.130*	-0.134**
	(-1.95)	(-2.03)
Firm Age	-0.046**	-0.042**
	(-2.41)	(-2.16)
Leverage	0.333	0.337*
	(1.65)	(1.68)
Tangibility	-0.451*	-0.457*
	(-1.85)	(-1.89)
ROA	0.401***	0.399***
	(3.06)	(3.04)
HHI	-0.073*	-0.072*
	(-1.82)	(-1.77)
GDP Growth	1.569***	1.599***
	(4.20)	(4.28)
Constant	2.513***	2.440***
	(5.45)	(5.41)
Adjusted R^2	0.791	0.791
Observations	17,288	17,288
Year FE	YES	YES
Firm FE	YES	YES

Table 4: Foreign Corrupt Practices Act, State Corruption, and Firm Performance.

In this table, we show that the enactment of FCPA more adversely affected firms located in states with high public corruption in terms of operating performance and firm growth. We present estimates from regressions in a seven-year window around the enactment of FCPA in 1977. The dependent variables are *ROA* (columns 1 and 2), *Assets Growth* (columns 3 and 4) and *Sales Growth* (columns 5 and 6). The independent variables of interest are interactions between *FCPA*, a binary variable that equals one after the enactment of FCPA, and measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *Q*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. The standalone variable *FCPA* (*Corruption*) is not estimated, because it does not vary across firms (over time in this sample). We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	ROA		Assets Growth		Sales Growth	
	(1)	(2)	(3)	(4)	(5)	(6)
FCPA × Corruption	-0.0003		-0.0015***		-0.0008*	
	(-1.32)		(-3.50)		(-1.78)	
FCPA × High Corruption		-0.0094**		-0.0435***		-0.0260**
		(-2.28)		(-4.43)		(-2.15)
Ln(Assets)	-0.0711***	-0.0715***	-0.2348***	-0.2363***	-0.2241***	-0.2253***
	(-14.49)	(-14.49)	(-9.45)	(-9.54)	(-7.80)	(-7.85)
Firm Age	-0.0182***	-0.0178***	-0.0565***	-0.0547***	-0.0482***	-0.0470***
	(-3.38)	(-3.30)	(-4.07)	(-3.88)	(-3.64)	(-3.54)
Leverage	-0.0913***	-0.0910***	-0.5353***	-0.5343***	0.1248	0.1256
	(-4.55)	(-4.51)	(-11.30)	(-11.20)	(1.52)	(1.53)
Tangibility	0.0247	0.0241	0.1924**	0.1901**	-0.0106	-0.0121
	(1.23)	(1.21)	(2.41)	(2.37)	(-0.10)	(-0.12)
Q	0.0254***	0.0252***	0.0896***	0.0892***	0.0186	0.0183
	(3.91)	(3.90)	(5.00)	(4.96)	(1.50)	(1.48)
HHI	-0.0039	-0.0039	-0.0132	-0.0133	-0.0242	-0.0243
	(-0.77)	(-0.78)	(-1.27)	(-1.26)	(-1.08)	(-1.08)
GDP Growth	0.1729***	0.1754***	0.2335**	0.2417**	0.4701***	0.4770***
	(4.41)	(4.44)	(2.46)	(2.57)	(4.09)	(4.11)
Constant	0.7442***	0.7378***	2.0432***	2.0039***	1.7986***	1.7789***
	(10.22)	(10.06)	(8.06)	(7.93)	(9.26)	(9.15)
Adjusted R^2	0.647	0.647	0.396	0.397	0.326	0.326
Observations	19,881	19,881	19,900	19,900	19,867	19,867
Year FE	YES	YES	YES	YES	YES	YES
Firm FE	YES	YES	YES	YES	YES	YES

Table 5: Robustness: Placebo Test for FCPA

In this table, we present diff-in-diff estimates in the 1973-1976 period around a pseudo shock in the end of 1974, to test the parallel trend prior to FCPA. The dependent variable is *Tobin's Q* and the independent variables of interest are interactions between *Post 1974*, a binary variable that equals one after 1974, and measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *Q*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. The standalone variable *FCPA* (*Corruption*) is not estimated, because it does not vary across firms (over time in this sample). We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q	
	(1)	(2)
Post 1974 × Corruption	-0.000	
	(-0.32)	
Post 1974 × High Corruption		-0.011
		(-0.64)
Ln(Assets)	-0.319***	-0.320***
	(-5.76)	(-5.76)
Firm Age	0.048	0.049
	(0.32)	(0.32)
Leverage	0.249***	0.250***
	(2.99)	(2.99)
Tangibility	-0.191	-0.192
	(-1.37)	(-1.38)
ROA	0.372***	0.373***
	(3.91)	(3.92)
HHI	0.060*	0.060*
	(2.00)	(2.00)
GDP Growth	-0.077	-0.084
	(-0.43)	(-0.49)
Constant	1.782	1.774
	(0.90)	(0.90)
Adjusted R^2	0.796	0.796
Observations	10,208	10,208
Year FE	YES	YES
Firm FE	YES	YES

Table 6: Robustness: Short Term Market Reaction to FCPA.

The dependent variable is the cumulative abnormal return (CAR) adjusted by value-weighted market return over different windows around May 5, 1977, when FCPA passed the senate. The independent variables of interest are measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. We present t-statistics using robust standard errors in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variables:	CAR[-30,-1]		CAR[0,+10]		CAR[0,+60]		CAR[0,+120]	
	(1)	(2)	(3)					
Corruption	-0.000		-0.000		-0.000		-0.001**	
	(-0.11)		(-1.43)		(-1.00)		(-2.16)	
High Corruption		-0.000		-0.006*		-0.015**		-0.025***
		(-0.02)		(-1.88)		(-2.28)		(-2.79)
Constant	0.016***	0.016***	0.014***	0.012***	0.049***	0.049***	0.088***	0.078***
	(2.64)	(4.32)	(3.60)	(5.10)	(5.89)	(9.98)	(7.70)	(11.70)
Adjusted R^2	-0.000	-0.000	0.000	0.001	-0.000	0.002	0.001	0.003
Observations	2,692	2,692	2,689	2,689	2,690	2,690	2,693	2,693

Table 7: Foreign Corrupt Practices Act, State Corruption, Export Industries, Corruption in Destination Countries, and Firm Value.

In this table, we show that the enactment of FCPA more adversely affected firms located in states with high public corruption, particularly for firms in industries export to corrupt countries. We present estimates from regressions in a seven-year window around the enactment of FCPA in 1977. The dependent variable is *Tobin's Q*. The independent variables of interest are interactions between *FCPA*, measures of state corruption, and binary variables indicating firms in *Non-Export Industry*, industries that *Export to Low-Corruption Destinations*, and industries that *Export to High-Corruption Destinations*. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q	
	(1)	(2)
FCPA × Corruption (Non-Export Industry)	-0.002	
	(-1.58)	
FCPA × Corruption (Export to Low-Corruption Destinations)	-0.004***	
	(-3.05)	
FCPA × Corruption (Export to High-Corruption Destinations)	-0.006***	
	(-3.62)	
FCPA × High Corruption (Non-Export Industry)		-0.064*
		(-1.86)
FCPA × High Corruption (Export to Low-Corruption Destinations)		-0.114***
		(-3.34)
FCPA × High Corruption (Export to High-Corruption Destinations)		-0.176***
		(-4.34)
Adjusted R^2	0.689	0.689
Observations	16,152	16,152
Control Variables	YES	YES
Year FE	YES	YES
Firm FE	YES	YES

Table 8: Controlling for Industry × Year Fixed Effects.

In this table, we show that our diff-in-diff estimate around FCPA is robust to controlling for industry × year fixed effects. The dependent variable is *Tobin's Q* and the independent variables of interest are interactions between *FCPA*, a binary variable that equals one after the enactment of FCPA, and measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*, as well as *State GDP Growth*. We also include both firm and industry × year fixed effects in the regressions. We use three different industry classifications: two-digit SIC (columns 1 and 2), three-digit SIC (columns 3 and 4), and Fama-French 48 industries (columns 5 and 6). The standalone variable *FCPA* (*Corruption*) is not estimated, because it does not vary across firms (over time in this sample). We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q					
	(1)	(2)	(3)	(4)	(5)	(6)
FCPA × Corruption	-0.002**		-0.002***		-0.002**	
	(-2.52)		(-2.76)		(-2.57)	
FCPA × High Corruption		-0.062**		-0.063**		-0.055**
		(-2.65)		(-2.66)		(-2.66)
Ln(Assets)	-0.207***	-0.209***	-0.221***	-0.223***	-0.202***	-0.203***
	(-3.79)	(-3.82)	(-4.28)	(-4.31)	(-4.27)	(-4.30)
Firm Age	-0.027	-0.024	-0.020	-0.018	-0.029	-0.028
	(-0.95)	(-0.87)	(-0.67)	(-0.60)	(-1.26)	(-1.17)
Leverage	0.348**	0.350**	0.353**	0.353**	0.362***	0.363***
	(2.11)	(2.12)	(2.46)	(2.46)	(2.88)	(2.89)
Tangibility	-0.359*	-0.363*	-0.321*	-0.325*	-0.360*	-0.364*
	(-1.76)	(-1.79)	(-1.70)	(-1.74)	(-1.91)	(-1.94)
ROA	0.437***	0.436***	0.446***	0.445***	0.415***	0.415***
	(3.51)	(3.50)	(3.22)	(3.21)	(3.41)	(3.40)
HHI	0.021	0.022	-0.012	-0.011	0.042	0.043
	(0.49)	(0.51)	(-0.21)	(-0.20)	(0.96)	(0.97)
GDP Growth	1.019***	1.038***	0.938***	0.956***	1.055***	1.069***
	(4.38)	(4.40)	(3.70)	(3.73)	(4.94)	(4.93)
Adjusted R^2	0.757	0.758	0.757	0.757	0.761	0.761
Observations	17,288	17,288	17,288	17,288	17,288	17,288
Industry × Year FE	YES	YES	YES	YES	YES	YES
Industry Definition	SIC2	SIC2	SIC3	SIC3	FF48	FF48
Firm FE	YES	YES	YES	YES	YES	YES

Table 9: Robustness: Alternative Measures of Corruption.

In this table, we show that our main result is robust to alternative measures of corruption. In column 1, we rank state corruption based on Question 6 of the survey by Boylan and Long (2003). In columns 2 and 3, we use binary variables indicating states that are considered legally or illegally corrupt, based on the survey by Dincer and Johnston (2014). In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q		
Corruption Measures:	Boylan-Long Q6	Dincer-Johnston	
		Legal Corruption	Illegal Corruption
	(1)	(2)	(3)
FCPA × Corruption	-0.004***	-0.079**	0.024
	(-2.86)	(-2.67)	(0.60)
Ln(Assets)	-0.130*	-0.131*	-0.125*
	(-1.78)	(-1.99)	(-1.89)
Firm Age	-0.033	-0.045**	-0.049**
	(-0.22)	(-2.36)	(-2.65)
Leverage	0.378*	0.332	0.329
	(1.71)	(1.65)	(1.62)
Tangibility	-0.498*	-0.458*	-0.448*
	(-1.95)	(-1.89)	(-1.83)
ROA	0.328**	0.399***	0.402***
	(2.57)	(3.05)	(3.06)
HHI	-0.080*	-0.071*	-0.071*
	(-1.80)	(-1.73)	(-1.72)
GDP Growth	1.615***	1.523***	1.462***
	(4.31)	(4.27)	(3.97)
Constant	2.378	2.456***	2.454***
	(1.11)	(5.45)	(5.42)
Adjusted R^2	0.788	0.791	0.790
Observations	15,503	17,288	17,288
Year FE	YES	YES	YES
Firm FE	YES	YES	YES

Table 10: State Antitakeover Laws, Local State Corruption, and Performance.

In this table, we show that the enactment of state antitakeover laws more negatively affected operating performance for firms located in states with high public corruption. We present regression estimates for firm-year observations from 1976 to 1995, where the dependent variable is *ROA*. In columns 1 and 2, and the independent variables of interest are interactions between measures of headquarter state corruption and a binary variable, *BC*, that equals one if a Business Combination Law is passed in the state of incorporation. In columns 3 and 4, we decompose *BC* into four binary variables indicating observations before/after the passage of BC law (BC^{-1}, BC^{0}, BC^{1}, and BC^{2+}). We use the rank of headquarter state corruption in columns 1 and 3 and a binary variable indicating firms with above-median level of headquarter state corruption in columns 2 and 4. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *Q*, and *HHI*, as well as the *State GDP Growth*. We also include firm and year fixed effects in the regressions. We present *t*-statistics using standard errors clustered by state of incorporation in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:			ROA	
Corruption Measure:	Rank	Above-median	Rank	Above-median
	(1)	(2)	(3)	(4)
BC	-0.0038	0.0012		
	(-0.91)	(0.27)		
BC × Corruption	-0.0006***	-0.0119***		
	(-4.58)	(-3.57)		
BC^{-1}			0.0010	-0.0006
			(0.22)	(-0.13)
BC^{0}			-0.0049	-0.0060
			(-0.96)	(-1.08)
BC^{1}			-0.0026	0.0014
			(-0.37)	(0.20)
BC^{2+}			-0.0013	0.0051
			(-0.21)	(0.83)
BC^{-1} × Corruption			0.0002	0.0032
			(1.19)	(0.88)
BC^{0} × Corruption			-0.0001	0.0013
			(-0.46)	(0.48)
BC^{1} × Corruption			-0.0005***	-0.0107***
			(-3.27)	(-3.51)
BC^{2} × Corruption			-0.0006***	-0.0152***
			(-4.30)	(-3.93)
Corruption	0.0016*	0.0203	0.0016*	0.0217
	(1.77)	(0.84)	(1.82)	(0.91)
Ln(Assets)	-0.0139***	-0.0139***	-0.0140***	-0.0139***
	(-3.74)	(-3.73)	(-3.73)	(-3.72)
Firm Age	-0.0008***	-0.0008***	-0.0008***	-0.0008***
	(-6.28)	(-6.54)	(-6.20)	(-6.55)
Leverage	-0.0398***	-0.0398***	-0.0397***	-0.0397***
	(-4.93)	(-4.93)	(-4.89)	(-4.87)
Tangibility	-0.0104	-0.0105	-0.0101	-0.0103
	(-0.94)	(-0.94)	(-0.90)	(-0.91)
Q	-0.0014	-0.0014	-0.0014	-0.0014
	(-0.63)	(-0.62)	(-0.63)	(-0.62)
HHI	0.0056**	0.0057**	0.0056**	0.0058**
	(2.17)	(2.23)	(2.20)	(2.27)
GDP Growth	0.2646***	0.2674***	0.2597***	0.2623***
	(6.64)	(6.70)	(6.39)	(6.58)
Constant	0.1437***	0.1748***	0.1412***	0.1726***
	(5.95)	(15.13)	(5.60)	(13.68)
Adjusted R^2	0.620	0.620	0.620	0.620
Observations	60,935	60,935	60,935	60,935
Year FE	YES	YES	YES	YES
Firm FE	YES	YES	YES	YES

Table 11: Robustness: Controlling for other Antitakeover Laws.

In this table, we present regression estimates where we include state antitakeover laws other than the Business Combination Law, including the First-generation Law (FG), the Poison Pill Law (PP), the Control Share Acquisition Law (CS), the Directors' Duties Law (DD), and the Fair Price Law (FP). The dependent variable is *ROA* and the independent variables of interest are interactions between measures of headquarter state corruption and binary variables indicating the passage of antitakeover laws. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *Q*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. We present *t*-statistics using standard errors clustered by state of incorporation in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	ROA	
Corruption Measure:	Rank	Above-median
	(1)	(2)
BC	-0.0045	-0.0013
	(-1.23)	(-0.31)
FG	-0.0004	-0.0002
	(-0.11)	(-0.04)
PP	-0.0057	-0.0127
	(-1.15)	(-1.37)
CS	0.0019	0.0039
	(0.47)	(0.62)
DD	-0.0018	0.0087
	(-0.31)	(0.93)
FP	-0.0040	-0.0093
	(-1.02)	(-1.46)
BC × Corruption	-0.0005*	-0.0100***
	(-1.96)	(-2.88)
FG × Corruption	0.0000	-0.0001
	(0.16)	(-0.03)
PP × Corruption	0.0003	0.0120
	(0.61)	(0.96)
CS × Corruption	-0.0003	-0.0039
	(-0.88)	(-0.58)
DD × Corruption	-0.0003	-0.0189
	(-0.71)	(-1.60)
FP × Corruption	0.0004	0.0115
	(1.16)	(1.48)
Corruption	0.0015	0.0184
	(1.67)	(0.79)
Adjusted R^2	0.620	0.620
Observations	60,935	60,935
Control Variables	YES	YES
Year FE	YES	YES
Firm FE	YES	YES

Table 12: Robustness: Controlling for Industry × Year Fixed Effects.

In this table, we show that the negative effect of state antitakeover laws on operating performance for firms in corrupt states is robust to controlling for industry × year fixed effects. The dependent variable is *ROA*, and the independent variables of interest are interactions between measures of headquarter state corruption and a binary variable, *BC*, that equals one if a Business Combination Law is passed in the state of incorporation. We use the rank of headquarter state corruption in columns 1, 3, and 5, and a binary variable indicating firms with above-median level of headquarter state corruption in columns 2, 4, and 6. In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *Q*, and *HHI*, as well as *State GDP Growth*. We also include both firm and industry × year fixed effects in the regressions. We use three different industry classifications: two-digit SIC (columns 1 and 2), three-digit SIC (columns 3 and 4), and Fama-French 48 industries (columns 5 and 6). We present *t*-statistics using standard errors clustered by state of incorporation in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	ROA					
	(1)	(2)	(3)	(4)	(5)	(6)
BC	-0.0038	0.0022	-0.0024	0.0050	-0.0028	0.0036
	(-0.99)	(0.60)	(-0.63)	(1.34)	(-0.78)	(1.08)
BC × Corruption	-0.0007***		-0.0008***		-0.0006***	
	(-4.72)		(-4.35)		(-4.29)	
BC × High Corruption		-0.0145***		-0.0176***		-0.0149***
		(-3.93)		(-4.95)		(-4.04)
Corruption	0.0018**		0.0018**		0.0018**	
	(2.12)		(2.55)		(2.30)	
High Corruption		0.0245		0.0229		0.0269
		(1.13)		(1.14)		(1.25)
Ln(Assets)	-0.0150***	-0.0150***	-0.0147***	-0.0146***	-0.0154***	-0.0153***
	(-4.46)	(-4.46)	(-4.32)	(-4.34)	(-4.58)	(-4.57)
Firm Age	-0.0008***	-0.0008***	-0.0007***	-0.0007***	-0.0010***	-0.0010***
	(-5.81)	(-5.95)	(-5.22)	(-5.10)	(-6.55)	(-6.81)
Leverage	-0.0365***	-0.0366***	-0.0358***	-0.0358***	-0.0378***	-0.0379***
	(-5.04)	(-5.04)	(-4.39)	(-4.37)	(-4.65)	(-4.64)
Tangibility	-0.0022	-0.0025	-0.0074	-0.0077	0.0006	0.0004
	(-0.21)	(-0.23)	(-0.64)	(-0.66)	(0.06)	(0.04)
Q	-0.0027	-0.0027	-0.0041*	-0.0041*	-0.0029	-0.0030
	(-1.21)	(-1.21)	(-1.90)	(-1.90)	(-1.32)	(-1.33)
HHI	0.0080*	0.0081*	0.0074	0.0076	0.0058	0.0060
	(1.88)	(1.92)	(1.56)	(1.60)	(1.53)	(1.58)
GDP Growth	0.1798***	0.1834***	0.1791***	0.1834***	0.1839***	0.1874***
	(4.60)	(4.62)	(4.17)	(4.21)	(4.78)	(4.82)
Adjusted R^2	0.604	0.604	0.604	0.604	0.606	0.606
Observations	60,935	60,935	60,935	60,935	60,935	60,935
Industry × Year FE	YES	YES	YES	YES	YES	YES
Industry Definition	SIC2	SIC2	SIC3	SIC3	FF48	FF48
Firm FE	YES	YES	YES	YES	YES	YES

Table 13: Robustness: Alternative Measures of Corruption.

In this table, we show that our main results are robust to alternative measures of corruption. In column 1, we rank state corruption based on Question 6 of the survey by Boylan and Long (2003). In columns 2 and 3, we use binary variables indicating states that are considered legally or illegally corrupt, based on the survey by Dincer and Johnston (2014). In addition, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, and *HHI*, as well as *State GDP Growth*. We also include firm and year fixed effects in the regressions. We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	Tobin's Q		
Corruption Measures:	Boylan-Long Q6	Dincer-Johnston	
		Legal Corruption	Illegal Corruption
	(1)	(2)	(3)
BC	-0.0004	0.0006	-0.0009
	(-0.07)	(0.14)	(-0.20)
BC × Corruption	-0.0002	-0.0150***	-0.0100***
	(-1.24)	(-5.45)	(-3.53)
Corruption	0.0009		
	(0.84)		
Ln(Assets)	-0.0137***	-0.0138***	-0.0139***
	(-3.68)	(-3.76)	(-3.82)
Firm Age	-0.0008***	-0.0007***	-0.0008***
	(-6.12)	(-6.36)	(-6.70)
Leverage	-0.0418***	-0.0400***	-0.0400***
	(-5.55)	(-4.98)	(-5.01)
Tangibility	-0.0048	-0.0104	-0.0107
	(-0.50)	(-0.94)	(-0.98)
Q	-0.0012	-0.0014	-0.0015
	(-0.67)	(-0.63)	(-0.65)
HHI	0.0039	0.0056**	0.0056**
	(1.51)	(2.22)	(2.21)
GDP Growth	0.2839***	0.2686***	0.2644***
	(6.43)	(6.71)	(6.57)
Constant	0.1640***	0.1779***	0.1736***
	(5.22)	(16.98)	(10.51)
Adjusted R^2	0.622	0.620	0.620
Observations	54,367	60,935	60,935
Year FE	YES	YES	YES
Firm FE	YES	YES	YES

Table 14: State Corruption and Earnings Management.

This table presents regression estimates for firm-year observations from 1990 to 2011. The dependent variable is *Discretionary Accruals* and the independent variables of interest are measures of headquarter state public corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. We control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, *Q*, *HHI*, *Current Accruals*, as well as *State GDP Growth*. We also control for Fama-French 48 industry fixed effects and year fixed effects in these regressions. We present *t*-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	*Discretionary Accruals*	
	(1)	(2)
Corruption	0.026***	
	(4.52)	
High Corruption		0.360**
		(2.02)
Ln(Assets)	-1.324***	-1.319***
	(-21.73)	(-21.24)
Firm Age	0.009	0.010
	(1.60)	(1.61)
Leverage	3.057***	3.079***
	(8.08)	(8.13)
Tangibility	-3.469***	-3.522***
	(-6.59)	(-6.62)
ROA	-0.783***	-0.788***
	(-3.01)	(-3.02)
Q	0.588***	0.589***
	(9.21)	(9.25)
HHI	-0.203	-0.201
	(-0.76)	(-0.74)
Current Accruals	-20.655***	-20.658***
	(-10.42)	(-10.42)
GDP Growth	9.847***	8.427***
	(3.79)	(3.37)
Constant	14.148***	14.775***
	(20.25)	(21.42)
Adjusted R^2	0.229	0.229
Observations	74,424	74,424
Year FE	YES	YES
Industry FE	YES	YES

Table 15: State Corruption and Securities Class Action.

This table presents probit regression estimates where the dependent variable is *Securities Class Action*, a binary variable that equals one if the firm is subject to a securities class action in year t. The independent variables of interest are measures of headquarter state corruption. *Corruption* is the rank of headquarter state corruption based on the average number of corruption convictions per million population. *High Corruption* is a binary variable that equals one if the headquarter state has above-median level of *Corruption*. In columns 1 and 2, the sample consists of all firm-year observations from 1995 to 2011. In columns 3 and 4, the sample consists of firm-year observations with total assets and firm age above the sample median. In all the regressions, we control for lagged firm and industry characteristics including *Ln(Assets)*, *Firm Age*, *Leverage*, *Tangibility*, *ROA*, *Q*, *HHI*, as well as *State GDP Growth*. We also control for Fama-French 48 industry fixed effects and year fixed effects in these regressions. We present t-statistics using standard errors clustered by headquarter state in brackets. *, ** and *** indicate significance better than 10%, 5%, and 1% respectively.

Dependent Variable:	*Securities Class Action*			
Sample:	Full		Size and age above median	
	(1)	(2)	(3)	(4)
Corruption	0.001		0.005***	
	(0.74)		(2.78)	
High Corruption		-0.021		0.074*
		(-0.64)		(1.74)
Ln(Assets)	0.189***	0.189***	0.220***	0.221***
	(17.16)	(17.19)	(7.99)	(7.83)
Firm Age	-0.009***	-0.009***	-0.006***	-0.005**
	(-6.58)	(-6.62)	(-2.61)	(-2.48)
Leverage	-0.090	-0.085	0.234***	0.228**
	(-1.64)	(-1.52)	(2.59)	(2.56)
Tangibility	-0.553***	-0.556***	-0.729***	-0.734***
	(-4.54)	(-4.57)	(-2.67)	(-2.69)
ROA	-0.011	-0.011	0.188	0.180
	(-0.40)	(-0.38)	(1.10)	(1.05)
Q	0.057***	0.057***	0.100***	0.099***
	(9.81)	(9.72)	(4.77)	(4.69)
HHI	-0.096	-0.095	-0.247	-0.249
	(-0.94)	(-0.92)	(-1.60)	(-1.61)
GDP Growth	1.689***	1.517**	1.390*	1.383*
	(2.70)	(2.24)	(1.74)	(1.67)
Constant	-3.364***	-3.318***	-3.707***	-3.610***
	(-9.43)	(-9.08)	(-8.36)	(-8.20)
Pseudo R^2	0.114	0.114	0.138	0.137
Observations	52,157	52,157	16,952	16,952
Year FE	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES

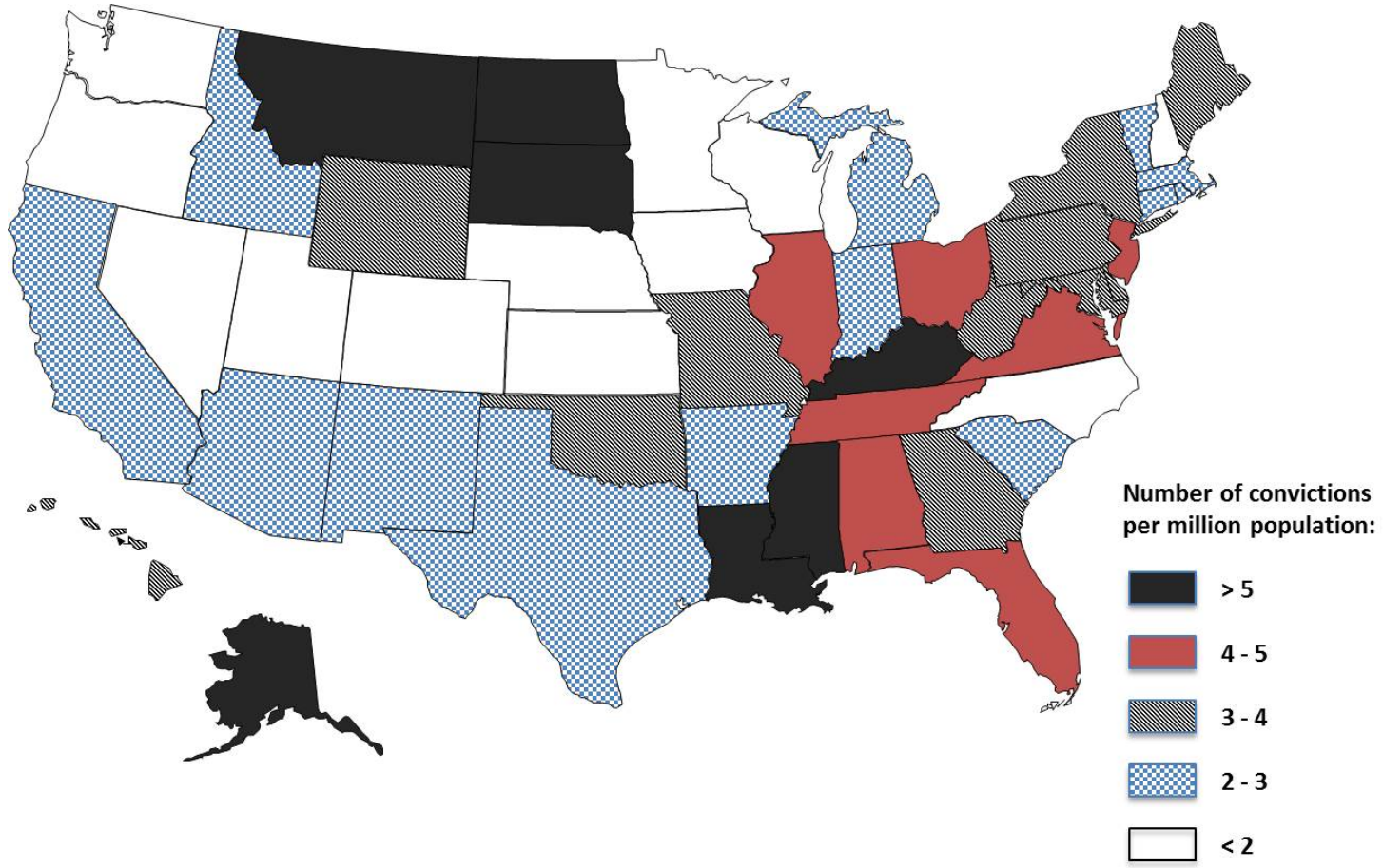

Figure 1: Map showing variation in the average corruption across the United States

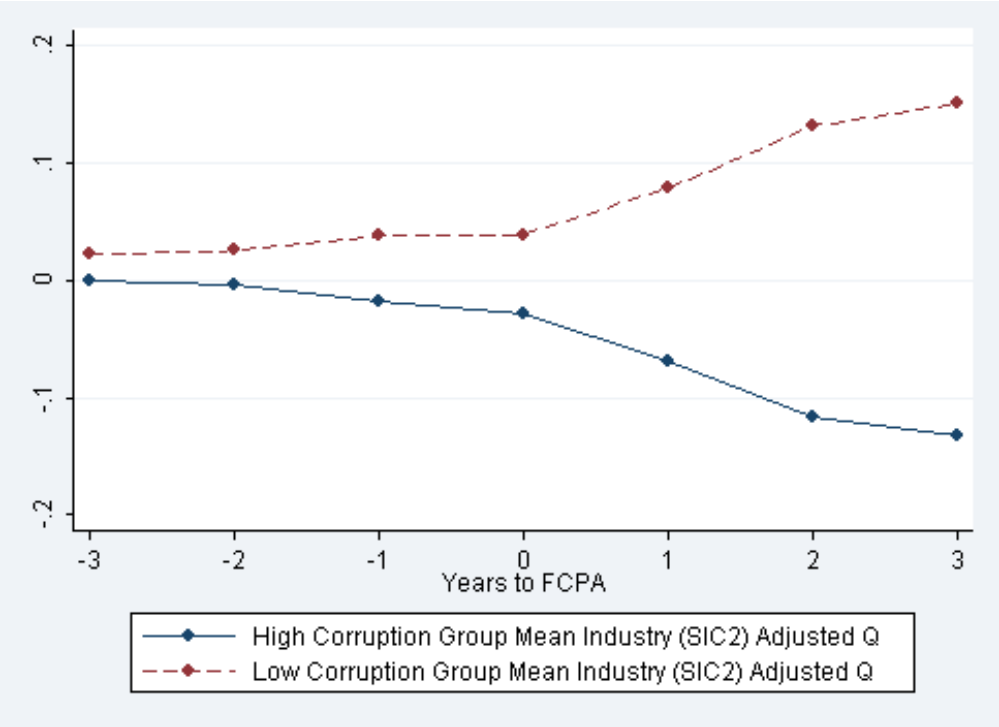

Figure 2: Industry-adjusted Q around FCPA