Neighbor's Corruption and Corporate Social Responsibility

Erdem Ucar[a], Arsenio Staer[b]

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ABSTRACT: This paper introduces a new impact of corruption on corporate social responsibility (CSR) by examining how corruption affects CSR) via peer reciprocity. We show that firms located in states surrounded by neighboring states with high corruption rates have lower levels of CSR score. This finding is not driven by the firm's own local area corruption and holds after accounting for local corruption. Furthermore, this result is not captured by corporate governance differences across firms. The neighbor corruption-CSR association remains significant after corporate relocation and alternative corruption tests. Neighboring corruption is also negatively associated with individual CSR components. Our findings remain robust after a series of robustness checks. This paper introduces a novel role of spatial corruption in the firms' CSR outcomes.

Keywords: *Corruption, Corporate social responsibility, Neighbor effects, Local effects, Peer reciprocity.*

[a] California State University Fullerton, Mihaylo College of Business and Economics. Department of Finance, 800 N. State College Blvd., Fullerton, CA 92831. Email:erucar@fullerton.edu.

[b] California State University Fullerton, Mihaylo College of Business and Economics. Department of Finance, 800 N. State College Blvd., Fullerton, CA 92831. Email:astaer@fullerton.edu.

1. Introduction

"*A bad neighbor is a misfortune, as much as a good one is a great blessing.*"

Hesiod

Corruption has been present since time immemorial and is a major challenge for the modern society according to the famous speech by World Bank President James Wolfensohn in 1996[1]. Existing economic theory and evidence suggest that corruption is costly because it imposes frictions, obstructs trade and impedes financial and economic developments (Shleifer and Vishny (1993), LaPorta et al. (1999) and Aidt (2003)). In this paper, we examine whether corruption has another cost to society via its influence on corporate behavior. We investigate how the geography of corruption affects the firm's corporate policies oriented towards social good represented by corporate social responsibility (CSR)[2] for a large sample of U.S. firms. We find that firms located in areas surrounded by neighboring states with a more corrupt environment have lower levels of corporate social responsibility. Our findings uncover a strong effect of the geographically close but *non-local* corruption on the local firm's CSR while controlling for the *local* corruption and examine it in the context of the corruption contagion and peer reciprocity effects (Dong, Dulleck, and Torgler (2012)).

Following the related literature (e.g., Butler, Fauver, and Mortal (2009)), we use state-level federal corruption convictions per capita in measuring local and neighboring corruption culture

[1] See https://www.un.org/press/en/1997/19970905.SGSM6318.html.

[2] Corporate social responsibility (CSR) is defined as the ''actions that appear to further some social good, beyond the interests of the firm and that which is required by law" (McWilliams and Siegel (2001)).

and environment. We find that a one-standard-deviation increase in corruption in firm's neighboring states leads to an almost 0.0571 standard deviation decrease in total CSR score of the firm. This economically strong finding underlines the extent of the influence of the surrounding environment on an important corporate policy like corporate social responsibility. When we examine the impact of the firm's own local corruption, we find that a one-standard-deviation increase in local corruption in a firm's state is associated with a 0.033 standard deviation decrease in total CSR score of the firm in our sample. When we examine the *Neighbor Corruption* after controlling for the *Local Corruption*, the findings still demonstrate a stronger effect of the *Neighbor Corruption* compared to the *Local Corruption*. The negative impact of local corruption on CSR is somewhat expected because firms located in corrupt areas are expected to do less social good due to the direct influence of local culture. This paper introduces an economically important, and statistically stronger, impact of the corruption culture of the surrounding environment of a firm on its CSR. Our findings present a novel channel through which geography and corruption influence corporate policies.

It is well known that social influence and interactions affect criminality and corruption (Glaeser, Sacerdote, and Scheinkman (1996) and Glaeser and Saks (2006)). Furthermore, an individual tends to exhibit susceptibility to corruption if there is a sufficient number of corrupt peers around him (Miller (2006)). From a psychological standpoint, Dong, Dulleck, and Torgler (2012) introduce the concept of reciprocity that implies, that if the corruption is endemic, members of the society suffer from less remorse and are more likely to engage in illegal activities. For instance, Bikhchandani, Hirshleifer, and Welch (1998) document contagion-like behavior in kidnapping, assassinations and tax evasion driven in large part by observing the behavior of others.

More recently, Parsons, Sulaeman, and Titman (2018) study the influence of the local unethical behavior like spousal infidelity and medical malpractice on financial advisor misconduct. Liu (2016) look at the link between corporate executives' home culture and incidences of earnings management and accounting fraud. On a macro level, Goel and Nelson (2007) find that there is significant corruption contagion across states in the U.S. However, few studies have focused on the effects of corruption and in particular of corruption contagion on the corporate policies.

We focus on the corporate social responsibility (CSR) policies as the best proxy for the relevant corporate policies for a number of reasons. First, this is the most appropriate, comprehensive well-studied indicator of the firm's policies for the social good. Quoting McWilliams and Siegel (2001), CSR policies are aimed to "further some social good, beyond the interests of the firm and that which is required by law." These policies comprise several dimensions such as *Humanitarian*, *Community*, *Employee*, *Diversity,* and *Product* with the objective to cover the major social consequences of the firm's policies[3]. Each dimension has a comprehensive variety of performance indicators categorized as a strength or a concern (e.g., Community Engagement is classified as *Community – Strength*).

Furthermore, several studies have documented that the CSR policies seem to provide substantial benefits to the firm after CSR adoption. Higher CSR leads to lower cost of equity and debt (El Ghoul et al. (2011) and Goss and Roberts (2011)), better access to political connections (Lin et al. (2015)), easier access to financing (Cheng, Ioannou, and Serafeim (2014)), less bad

[3] See MSCI ESG Research Inc, 2015, "MSCI ESG KLD STATS: 1991-2014 Data Sets" at WRDS.

news hoarding and low price crash risk (Kim, Li, and Li (2014)), higher Tobin's Q and earnings persistence (Gao and Zhang (2015)) and higher post-merger returns and lower failure rates for CSR acquirers (Deng, Kang, and Low (2013)). Investors assign a value to CSR adoption as well: According to a 2016 report on the trend in socially responsible investing, $8.1 trillion out of $40.3 trillion of the professionally managed U.S. assets were connected to socially responsible investing (SRI).[4]

Second, CSR policies carry a significant discretionary component subject to managerial decisions and local factors. For instance, Di Giuli and Kostovetsky (2014) find that Democratic-leaning companies exhibit higher CSR but lower posterior ROA while Jha and Cox (2015) show that higher local social capital is associated with higher CSR. Looking at the international markets, Cai, Pan, and Statman (2016) study the influence of country factors on aggregate CSR scores, and Boubakri et al. (2016) examine foreign companies and find that their CSR score increase after the cross-listing on the U.S. markets.

From a theoretical perspective, Bénabou and Tirole (2010) present three main reasons for CSR adoption: strategic, altruism and greenwashing. Strategic approach relates to implementing CSR to strengthen market position and increase future long-term profits. Altruism implies that the firm conducts CSR activities for their own sake (Baron (2004)). Greenwashing conveys implementing image-oriented CSR policies while not changing the way the business operates. Interestingly, a major enforcement mechanism in the CSR model in Bénabou and Tirole (2010) is the stigma of deviating from the socially beneficial strategy. Goel and Nelson (2007) and Dong,

[4] Report available at https://www.ussif.org/files/Trends/US%20SIF%202016%20Trends%20Overview.pdf

Dulleck, and Torgler (2012) submit that the intensity and prominence of that stigma are driven in part by the level of corruption perceived by the individual in their environment. In our case, this means that when the surrounding corruption is infrequent, managers tend to engage in less anti-social behavior since the cost of violating social norm and hence being stigmatized is very high. When the surrounding corruption is perceived more prevalent, managers tend to engage in more anti-social behavior since the cost to transgress the norm diminishes.

In our paper, we document a substantial link between corruption, both local *and* neighbor, with local firms' corporate social responsibility (CSR) policies. Specifically, firm's tendency to do social good is influenced by the exposure to a variety of factors including the geographically determined ones (Jha and Cox (2015) and Di Giuli and Kostovetsky (2014)); we find that exposure to local corruption is associated with lower disposition of the firm to do social good. However, we find that not only the local corruption, but even to a greater degree the neighboring corruption are important in determining the firm's predisposition to do social good via a peer reciprocity effect (Dong, Dulleck, and Torgler (2012)) as conditional cooperation decreases. Kahan (1998) argues that people overestimate the likelihood of escaping punishment and underestimate the stigma of misconduct when observing that many of their peers commit the misconduct or the crime. Hence not only the higher concentration of corruption in an area but also the higher concentration in *surrounding* areas induces the "when in Rome" attitude (Kahan (1998)) towards social good reducing the propensity to engage in CSR-related policies (Glaeser, Sacerdote, and Scheinkman (1996)).

This paper shows the role of the geographically close but *non-local* corruption in determining local firm's CSR outcomes. We demonstrate that both local corruption and neighboring corruption have a negative impact on CSR. Our findings suggest a stronger effect of neighboring corruption compared to local corruption. We also run a series of robustness checks and additional tests and examine the strength of neighboring corruption effect. We examine the neighboring corruption effect after controlling for a firm's own local corruption and show that the neighboring corruption effect is not driven by the local corruption effect. Our findings also hold after controlling for local demographic, economic and cultural factors. We also show that the neighbor corruption effect is not a proxy for corporate governance issues. The empirical findings remain strong after controlling for different measures of corporate governance such as G-Index, Takeover index, etc.

One might suggest that the influence of corruption on corporate behavior can be different between firms with weak and strong corporate governance. We conjecture that the relation between *Neighbor Corruption* and CSR should be stronger in the firms more susceptible to governance issues and find that the negative impact of *Neighbor Corruption* on CSR is more pronounced for the firms with weak corporate governance. As an additional robustness test, we examine the persistence of the *Neighbor Corruption* effect and find that the lagged *Neighbor Corruption* exerts significant influence on CSR. Finally, we look at the relationship between individual CSR components and *Neighbor Corruption* and find that supporting evidence in the individual CSR tests.

This paper makes several important contributions to the literature. First, we introduce a novel channel of the role of geography in finance. There is a growing body of literature that highlights the link between geography and finance that focuses on the impact of a firm's own location or local factors on financial outcomes (e.g., Di Giuli and Kostovetsky (2014)). In this paper, we show that not only a firm's own location but the surrounding areas affect corporate behavior. Next, the cost of corruption to society has been investigated by many studies in economics and other social sciences[5]. We contribute to this body of literature by presenting another cost of corruption to society by showing the negative impact of corruption environment in neighboring states surrounding a firm on the firm's tendency to participate in socially good behavior. Last, the recent literature shows the impact of geography on CSR by highlighting the role of local factors on CSR (e.g., Jha and Cox (2015)). We contribute to this literature by underlining the negative effect of local corruption on CSR. More importantly, we introduce a strong negative impact of corruption in neighboring areas on CSR.

2. Data, Sample Selection, and Summary Statistics

We follow a sample selection method consistent with the related literature. Our final sample has US firms with available firm and accounting information from COMPUSTAT for the period 1991-2013. We use the firm location information provided by COMPUSTAT. The final sample excludes the firms in the utility and financial industry categories (SIC codes 4900-4999 and SIC 6000-6999), and it has 22,968 firm-year observations for the sample period.

We use the corporate social responsibility (CSR) data from Kinder, Lydenberg, and Domini (KLD) provided via WRDS to construct our CSR measures. We employ the following

[5] For a survey see Svensson (2005).

individual social and environmental dimensions in constructing our CSR variable: community activities, diversity, employee relations, environmental record, human rights, and product quality. We follow the related literature in constructing the individual CSR dimension scores and the total CSR score. For each dimension, we calculate the individual dimension score by subtracting the number of weaknesses from the number of strengths. Our total CSR score variable is the sum of the individual CSR scores.

To measure corruption, we use the local number of DOJ-prosecuted federal corruption convictions for each state by following the related literature (Butler, Fauver, and Mortal (2009))[6]. We define *Local Corruption* as the number of convictions per capita for a firm's headquarter state.[7] *Neighbor Corruption* is defined as the average corruption convictions per capita of all neighboring states, while *National Corruption* is the average corruption conviction per capita for all states.

We use the following main control variables consistent with the related literature (e.g., Di Giuli and Kostovetsky (2014) and Jha and Cox (2015)): *LnMV, Cash, M/B, Debt, Dividend, KZ Index*[8], *EBITDA* and *Inst Own.* We winsorize all accounting variables at the 1st and 99th percentiles. We also employ several demographic, economic, and cultural factors as control variables in our tests. These local variables are as follows: *LogPop, Education, Local Income, CPRatio, Local Seniors,* and *Republican*. These variables represent the county-level local

[6] We thank Alex Butler for providing the updated state-year corruption conviction data used in Butler, Fauver, and Mortal (2009) on his website (http://butler.rice.edu/corruption.htm).

[7] We multiply the corruption per capita numbers by 1,000 in constructing all our corruption variables to better display the results in our empirical tests.

[8] *KZ Index* is the index of financial constraints (Kaplan and Zingales (1997)) and calculated using the formula in Di Giuli and Kostovetsky (2014).

population, education, income, religion, the fraction of seniors, and political affiliation, respectively. We present the detailed variable definitions of the main controls, as well the local controls and other variables in the appendix.

We present the summary statistics for the sample in Table 1. The mean and the standard deviation values of *CSR* are about -0.07 and 2.35, respectively, while the neighbor corruption has a mean and standard deviation of 0.0037 and 0.0027, respectively. The main control variables—*LnMV, Cash, M/B, Debt, Dividend, KZ Index, EBITDA* and *Inst Own* have summary statistics consistent with the related studies (e.g., Liang and Renneboog (2017) and Jha and Cox (2015)). Table 1 also reports summary statistics of local variables which are again in line with the previous studies.

[Insert Table 1 about here]

3. Empirical Results

3.1. Baseline Tests

We present the baseline tests in Table 2. We follow an empirical model following the prior studies and present the baseline tests in Table 2. The dependent variable is *CSR* which measures the total CSR for a sample firm in a given year. In our empirical model, we use the following main controls (*LnMV, Cash, M/B, Debt, Dividend, KZ Index, EBITDA* and *Inst Own*) consistent with the related literature. We also control for year and industry[9] fixed effects. We employ robust standard errors clustered at the firm level. Our main variable of interest is *Neighbor Corruption*,

[9] We use the Fama-French 12 industry categories.

which shows the average corruption per capita in neighboring states surrounding a firm's location.

[Insert Table 2 about here]

Our baseline results show that *Neighbor Corruption* has a negative and statistically significant coefficient suggesting a negative impact of neighboring corruption environment surrounding a firm's location on the firm's corporate social responsibility. This finding is also economically significant. A one-standard-deviation increase in neighbor corruption leads to about a 0.0571 standard deviation[10] decrease in CSR. This finding suggests that corruption environment in neighboring areas hinders the firm's involvement in socially responsible actions.

3.2. Robustness Checks and Additional Tests

3.2.1. Tests with Local Corruption

Next, we examine the effect of local corruption in the firm's location. One may argue that the neighbor corruption effect is a proxy for or is driven by the local corruption effect. To investigate the validity of this argument, we re-run our baseline test and re-examine the neighbor corruption effect after controlling for the local corruption effect in Table 3. Our results show that both the neighbor and local corruption effects are negative and statistically significant in line with the previous results and suggest that neighbor corruption is robust to local corruption. Moreover, the neighbor corruption effect has a much larger coefficient magnitude compared to the local corruption effect indicating a more pronounced neighbor corruption effect. The economic impacts

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[10] The standardize coefficient effect is presented to highlight the economic effect in a better way. This standardized coefficient effect is computed as follows: The coefficient value of neighbor corruption effect in is -51.08257. The standard deviation of neighbor corruption is about 0.002627 whereas the standard deviation of CSR is about 2.3506. (These summary statistics are presented in Table 1). Hence, the standardized effect is calculated as (-51.08257x 0.002627)/2.350598=-0.0571.

also support this hypothesis. A one standard deviation increase in the neighbor corruption effect leads to almost a 0.055 standard deviation decrease in CSR whereas the same increase in the local corruption effect is associated with approximately a 0.024 standard deviation decrease in CSR. This result suggests that the neighbor corruption effect is more than two times stronger than the local corruption effect. A more pronounced neighbor corruption effect after controlling for local corruption indicates that the neighbor corruption effect is not driven by the local corruption effect.

[Insert Table 3 about here]

We suggest that *Neighbor Corruption* captures an additional negative effect on CSR linked with corruption influence (Goel and Nelson (2007)) and conditional corruption (Dong, Dulleck, and Torgler (2012)). Specifically, firm's predisposition to do social good is influenced by the exposure to a variety of factors including the geographically determined ones (Jha and Cox (2015) and Di Giuli and Kostovetsky (2014)); we find that exposure to local corruption is associated with the lower propensity of doing social good. However, if the local corruption is high, but the neighbor corruption is also high then the exposure to the local and neighbor corruption effects reduces the firm's tendency to do social good even more via a peer reciprocity effect (Dong, Dulleck, and Torgler (2012)) as conditional cooperation falters. Kahan (1998) suggests that individuals upgrade the likelihood of escaping punishment and downgrade the stigma of misconduct when they see a crime or misconduct is more prevalent among their peers. In geographic terms, a higher concentration of corruption not only in the locality but also *surrounding* the local area leads to "when in Rome" attitude towards social good reducing the propensity to engage in CSR-related policies (Glaeser, Sacerdote, and Scheinkman (1996)).

One can argue that neighbor corruption shocks are associated with the decrease in CSR only via local corruption; however, the correlation between neighbor and local corruption is relatively low, and more importantly, *Neighbor Corruption*'s association with CSR is strongly negative even when *Local Corruption* is present. The evidence presented in Table 3 sheds light on a novel channel of the effect of corruption on society via a decrease in the corporate disposition to engage in socially responsible policies (CSR). Furthermore, the evidence shows that this effect of corruption on CSR tends to be exacerbated when the firm is located in geographical proximity to high corruption areas as well.

3.2.2. Tests with Local Controls, Location, and Firm Effects

In this section, we present a series of robustness checks and additional tests to underline the strength of the neighbor corruption effect. First, we focus on the tests with local controls. One might argue that the corruption effect we show earlier is driven by local factors. The same can be argued about the negative association between a firm's propensity to engage in socially responsible policies (CSR) and *Neighbor Corruption*.

In order to test the robustness of the relation between neighbor corruption and CSR, we re-examine the baseline results after controlling for a set of local demographic, economic, and political effects described in the related literature (e.g., Jha and Cox (2015) and Di Giuli and Kostovetsky (2014)). These local control variables capture local population, income, education, religion, the fraction of seniors, and political affiliation. Column 1 of Table 4 shows that *Neighbor Corruption* has a more pronounced negative impact on CSR even after controlling for local factors. A one standard deviation increase in *Neighbor Corruption* is associated with a 0.067 standard deviation decrease in CSR and is on par with the effect of the local political affiliation documented in Di Giuli and Kostovetsky (2014). The effect of neighbor corruption becomes stronger after controlling for local variables compared to the baseline results in Table 2. This analysis demonstrates that the neighbor corruption effect is not driven by local factors and provides additional evidence underlining the strength of the effect.

[Insert Table 4 about here]

Next, we investigate whether our results are robust to any location effects. In Column 2 of Table 4, we continue our analysis by including state fixed effects into our tests and examining whether our results are driven by any location effects. Column 2 demonstrates a negative and statistically significant *Neighbor Corruption* coefficient. This result underlines the strength of the effect of corruption in neighboring states on CSR and shows that the effect is not driven by any state effects. Furthermore, we examine whether our results remain after controlling for firm effects. In Column 3, we include firm fixed effects in our analysis and re-run the regressions. Column 3 reports a negative and statistically significant *Neighbor Corruption* effect after controlling for firm fixed effects. This finding demonstrates that the empirical results are not driven by any firm fixed effects. Overall, this table shows that the neighbor corruption effect remains robust after controlling for local factors, state, and firm fixed effects.

3.2.3. Corporate Relocations

Our previous results show that the neighbor corruption is not a proxy for local corruption. When we include local corruption in our tests, the neighbor corruption effect remains robust. Therefore, one may also expect local factors to be uncorrelated with neighbor corruption, and the results do not arise from omitted factors like local level variables. Furthermore, the previous results also show that the empirical findings remain robust after controlling for location effects and the findings are not driven by local controls as well as location fixed effects. To provide additional support for the identification of the neighbor corruption effect and to furnish additional evidence addressing endogeneity, we examine corporate relocations. Following the prior literature, (e.g., Pirinsky and Wang (2006)) we examine change in CSR for a subsample of firms with corporate relocations. We use historical firm locations and identify the firms that move headquarters to another state during our sample period.[11] To identify whether the neighbor corruption effect on CSR changes is in line with the change of location, we examine the pre-move and post-move[12] separately following the prior literature (e.g., Pirinsky and Wang (2006)). We include both old and new locations' neighbor corruption in the tests in Table 5. If our results are driven by the neighbor corruption effect, then one can expect the old neighbor corruption effect to have a stronger effect in the pre-move subsample whereas the new neighbor corruption effect to have a stronger effect in the post-move subsample.

[Insert Table 5 about here]

Column 1 of Table 5 reports the results for the pre-move subsample whereas Column 2 presents the findings for the post-move subsample. Although we have a small subsample of firms with corporate relocations, Table 5 demonstrates findings in the corporate relocation tests in line

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[11] We use the Compact Disclosure Dataset as well as the historical firm location information from Bill McDonald's website (https://sraf.nd.edu/data/augmented-10-x-header-data/). To clearly identify the impact of headquarter moves, we only focus on the firms that have one corporate relocation during our sample period. We also require at least one year of observations before and after the headquarter move.

[12] The pre-move subsample uses the one year prior the moving year and the earlier years whereas the post-move subsample uses the one year after the moving year and the later years in our sample period.

with our conjecture. Column 1 indicates that the neighbor corruption effect from the old location has a much stronger coefficient value for the pre-move test than the new neighbor corruption effect. Moreover, the old neighbor effect has a negative and statistically significant coefficient as expected whereas the new neighbor corruption is statistically insignificant in the pre-move period. Similarly, Column 2 shows that that the neighbor corruption effect from the new location has a more pronounced coefficient value for the post-move test than the old neighbor corruption effect. Also, the new neighbor effect has a negative and statistically significant coefficient as expected whereas the old neighbor corruption is statistically insignificant for the post-move period. Table 5 provides important evidence in identifying the neighbor corruption effect. The results show that there is a change in CSR in line with the change in neighbor corruption effect when firms move their headquarters. The corporate relocation tests also help address any endogeneity concern and underline the fact that our empirical findings are driven by the neighbor corruption effect.

3.2.4. Neighbor Corruption and Corporate Governance

One may suggest that neighbor corruption captures corporate governance issues and our results are driven by the corporate governance of a firm. To investigate whether neighbor corruption is a proxy for the corporate governance problems, we re-examine the baseline results after controlling for corporate governance. To measure corporate governance quality, we employ several corporate governance indexes which are widely used to measure corporate governance problems (e.g., Cain, McKeon, and Solomon (2017)). First, we re-run the baseline regression after controlling for the *Takeover Index* used by Cain, McKeon, and Solomon (2017) in Column 1 of Table 6. We also control for the *G-Index*[13] from Gompers, Ishii, and Metrick (2003) and the *E-Index*[14] from Bebchuk, Cohen, and Ferrell (2009) in Column 2 and Column 3, respectively.

[Insert Table 6 about here]

Table 6 demonstrates that *Neighbor Corruption* displays significantly negative coefficients in all three columns suggesting that neighbor corruption is negatively related to local firm's CSR even after controlling for the corporate governance issues. The economic significance of the neighbor corruption effect remains strong after controlling for all these corporate indexes. For example, in Column 1, a one standard deviation increase in neighbor corruption leads to approximately 0.0588 standard deviation decrease in CSR. Similarly, Column 2 (3) shows that a one standard deviation increase in neighbor corruption leads to approximately 0.0841 (0.0822) standard deviation decrease in CSR. Overall, this table demonstrates that *Neighbor Corruption* is not a proxy for corporate governance quality and our empirical findings do not arise from the corporate governance of a firm.

3.2.5. Tests for Different Levels of Corporate Governance

The previous section indicates that the neighbor corruption effect is not a proxy for corporate governance of a firm and the empirical results are not driven by corporate governance. Next, we re-examine the results for firms with different corporate governance quality. Intuitively, a company with more governance issues would be more vulnerable to the corruption peer effects

[13] The G-index dataset is available on Andrew Metrick's website (http://faculty.som.yale.edu/andrewmetrick/data.html).

[14] The E-Index dataset is available on Lucian Bebchuk's website (http://www.law.harvard.edu/faculty/bebchuk/data.shtml).

documented in Dong, Dulleck, and Torgler (2012). In order to test this conjecture, we divide the sample into low and high Takeover Index subsamples and estimate our main tests for these subsamples separately in Table 7. Low Takeover Index values represent firms with strong corporate governance whereas high Takeover Index values show firms with weak corporate governance. We present the low (high) Takeover Index subsample in Column 1 (2) of Table 7.

[Insert Table 7 about here]

Table 7 reports that *Neighbor Corruption* has negative coefficients for both low and high Takeover Index subsamples. However, *Neighbor Corruption* has a statistically insignificant coefficient for the strong corporate governance subsample in Column 1, as proxied by low Takeover Index values. On the other hand, *Neighbor Corruption* displays a highly significant and negative coefficient for the weak corporate governance subsample in Column 2, as proxied by high Takeover Index values. This finding is consistent with our earlier conjecture. The economic impact is also significant in Column 2. A one standard deviation increase in *Neighbor Corruption* in the companies with corporate governance issues— and hence more vulnerable to conditional corruption (Dong, Dulleck, and Torgler (2012))—is related to almost a 0.085 standard deviation decrease in CSR. This table provides additional evidence highlighting the strength of the neighbor corruption effect. This table also shows that the negative impact of corrupt culture environments in neighbor areas surrounding a firm on CSR is more pronounced for the firms with corporate governance issues which are expected to be more vulnerable to the influence of corruption on corporate culture and decisions.

3.2.6. Tests with Lagged Neighbor Corruption

Corporate policies usually exhibit delays in implementation, and substantial policy changes often take longer than a year to be enacted. If *Neighbor Corruption* has an important impact on CSR policies, then one might expect it to have a somewhat long-lasting effect. Therefore, one would expect the previous year's *Neighbor Corruption* to display a significant association with current CSR policies as well. We test for this conjecture by re-examining the baseline test after including a lagged *Neighbor Corruption* in Table 8.

[Insert Table 8 about here]

Table 7 reports the results of the CSR regression on lagged *Neighbor Corruption*. Lagged *Neighbor Corruption* coefficient is highly significant and negative. The lagged neighbor corruption has some important economic significance, and the economic impact is close to the baseline results. A one standard deviation increase in lagged *Neighbor Corruption* is associated with almost a 0.05 standard deviation decrease in CSR. These findings support our conjecture that *Neighbor Corruption* is associated not only with the current CSR policies but with the 1-year leading CSR policies as well, suggesting that neighbor corruption effect has a long-lasting influence on CSR. These results also indicate that corruption environments in areas surrounding firm locations have a persistent negative impact on corporate policies.

3.2.7. Tests with an Alternative Corruption Measure

To provide additional evidence on the strength of the neighbor corruption effect, we re-examine our baseline analysis by using an alternative corruption measure. One may argue that conviction per capita does not capture the corruption effect well. To investigate whether our results remain robust when we use an alternative corruption measure, we employ Corruption Reflections Index (CRI) introduced by Dincer and Johnston (2017). The CRI state-level index is calculated as the share of Associated Press (AP) news stories about political corruption in a particular state[15]. There are several differences between CRI and Corruption Convictions Index (CCI). The CRI measure covers not only convictions but also allegations, trials, and appeals which may not directly correspond to the actual annual conviction number. Furthermore, CRI not only covers corruption stories about federal officials but also about city and state level officials. Dincer and Johnston (2017) however caution against using CRI as the main measure of corruption as it gauges only the frequency of corruption-related mentions in the media and not the proven incidences of corruption itself.

Similar to our main corruption measure, we construct a neighbor corruption measure based on CRI and use this measure, *Neighbor CRI*, as an alternative corruption measure in Table 9. We use *Neighbor CRI* and re-examine whether the neighbor corruption remains robust when we examine our baseline results when we employ an alternative corruption measure.

[Insert Table 9 about here]

Neighbor CRI has a negative and statistically significant coefficient suggesting a negative impact of neighboring corruption on CSR, consistent with our previous results. This finding is also

[15] To construct CRI, Dincer and Johnston (2017) search for the words ”corrupt”, ”fraud” and “bribe” (and variants such as “corruption” or “fraudulent") and count the appearance of news articles (or pages) containing those words (similar to Gentzkow, Glaeser, and Goldin (2004)). This count gives a measure of the amount of space newspapers give to stories related to corruption or fraud. They then deflate these counts by the number of articles (or pages) containing the word “political” (and its variants) which measures the amount of space given to politically relevant stories. This deflation by the overall news stories about politics implicitly adjusts for the size of the government and hence the state.

economically significant similar to the *Neighbor Corruption* measure. A one-standard-deviation increase in neighbor corruption leads to about a 0.06 standard deviation decrease in CSR. This finding suggests that our corruption results remain robust when we use an alternative corruption measure and underlines the strength of the negative impact of neighbor corruption on CSR.

3.2.8. Neighbor Corruption and CSR components

Motivated by the evidence in the previous sections, we now examine the strength of the impact of the *Neighbor Corruption* on CSR across the CSR components. Our CSR score is composed of the following six individual CSR components: *Humanitarian*, *Community*, *Diversity*, *Employees*, *Environment,* and *Product*. We implement our baseline regression for the individual CSR components separately.

Table 10 reports the results of regressions of CSR components on *Neighbor Corruption*. Based on the sign, *Neighbor Corruption* is negatively associated with the majority of the components of the CSR score. This result suggests that the relationship between *Neighbor Corruption* and CSR is reflected to an extent in a majority of individual CSR components. The neighbor corruption is also statistically significant for a majority of the individual CSR components. The negative impact of the neighbor corruption effect is especially pronounced for the *Community*, *Diversity*, *Environment*, and *Product* components with statistically significant coefficients. This table shows that the negative impact of *Neighbor Corruption* is more observable and stronger on the community, diversity, environment, and product-related CSR practices and policies.

4. Conclusions

In this paper, we document a first look at the relationship between corruption and corporate social responsibility (CSR) of the firm. Neighboring state corruption surrounding a firm's location displays strong negative impact on CSR policies indicating a new and unexplored channel of corruption contagion – through conditional corruption and peer reciprocity effects (Dong, Dulleck, and Torgler (2012) and Glaeser, Sacerdote, and Scheinkman (1996)).

The association between *Neighbor Corruption* and CSR is significant even in the presence of Local Corruption with similar economic effects. Furthermore, we show that the neighbor corruption effect remains strong after controlling for a variety of corporate governance measures suggesting that the neighbor corruption effect is not a proxy for corporate governance issues and is not driven by corporate governance. We also find that the negative relationship between CSR and neighboring state corruption is more prominent in companies with corporate governance issues consistent with the notion that those firms are expected to be vulnerable to the negative influence of corruption.

To address possible endogeneity, we follow the prior literature and employ corporate relocation tests that show that the effect of the post-move neighboring states corruption on the firm's CSR is insignificant before and becomes highly significant after the move. The pre-move neighboring states corruption displays the opposite pattern indicating that our empirical findings are indeed driven by the neighbor corruption effect.

We also employ an alternative measure of corruption, Corruption Reflections Index (Dincer and Johnston (2017), that measures the frequency of corruption-related stories in the media and find similar results. In additional robustness checks, we report that neighboring corruption's impact on CSR is persistent over time as corporate policies usually take time to be enacted furnishing ancillary evidence of the CSR – neighbor corruption relationship. Finally, we demonstrate that neighboring corruption is negatively associated with all CSR components with Community, Diversity, and Environment being the most prominent ones. In sum, we shed light on a novel channel of spatial corruption contagion through peer reciprocity (Dong, Dulleck, and Torgler (2012)) on the local corporate policies resulting in a reduction of corporate social responsibility scores.

Appendix- Appendix - Variable Definitions

CSR Variables

CSR is measured by using the Kinder, Lydenberg, and Domini (KLD) score provided on the WRDS. *CSR* is the total corporate social responsibility score in a year and calculated as the sum of the individual CSR score of the following CSR components: *Human Rights*, *Community*, *Diversity*, *Employee Relations*, *Environment*, and *Product.* For each individual component, the individual component score is calculated by subtracting the number of weaknesses from the number of strengths.

Corruption Variables

Neighbor Corruption is measured as the average federal corruption convictions per capita multiplied by 1000 of the neighboring states.

Local Corruption is measured as the number of federal corruption convictions per capita multiplied by 1000 in the state

Neighbor CRI is the Corruption Reflections Index from Dincer and Johnston (2017) averaged over the neighboring states. CRI indicates the relative frequency of fraud and corruption-related stories in the news about politics published by Associated Press (AP).

Firm Variables

LnMV is the market value which is calculated by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items.

Cash is CHE divided by lag AT using COMPUSTAT items.

EBITDA is EBITDA divided by AT using COMPUSTAT items.

M/B is the market-to-book ratio which is calculated as (PRCC_C*CSHO) divided by CEQ using COMPUSTAT items.

Debt is calculated as LT divided by AT using COMPUSTAT items.

KZ Index comes from the prior literature (e.g. Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)) and is measured as -1.002 x *CashFlow* + 0.283 x *Q* + 3.139 x *Leverage* – 39.368 x *Dividends* -1.315 x *Cash Holdings,* where *CashFlow* is (IB+DP)/lag(PPENT), *Q* is (AT-CEQ-TXDB+(PRCC_F*CSHO))/AT, *Leverage* is (DLC+DLTT)/(DLC+DLTT+SEQ), *Dividends* is (DVC+DVP)/lag(PPENT), and Cash Holdings is CHE over lag(PPENT) by using Compustat data items.

Inst Own Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings).

Dividend is a calculated as (DVC+DVP) divided by Lag AT using COMPUSTAT items.

Corporate Governance Variables

G-index is the takeover index developed by Gompers, Ishii, and Metrick (2003)

Takeover Index is the hostile takeover index developed by Cain, McKeon, and Solomon (2017), which is constructed based on the passage of 12 different types of state takeover laws, one federal statute, and three state standards of review, with higher values indicating higher hostile takeover hazard.

E-Index is the managerial entrenchment index developed by Bebchuk, Cohen, and Ferrell (2009)

Local Variables

LogPop is the log of the population for a given county

Education (%) is the fraction of individuals 25 years and over having a bachelor's, graduate, professional, or some college degree.

Local Income is the median household income for a given county.

CPRatio is the ratio of Catholics to Protestants in the firm's county sourced from the ARDA dataset with the missing years interpolated.

Republican (%) is the percentage of Republican voters in the county.

Local Seniors is the fraction of residents who are 65 years old or older within a county where a firm is headquartered.

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Table 1. Summary Statistics

This table presents summary statistics of the all main variables that are used in the empirical tests. *CSR* is measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the index of financial constraints as described in the prior literature (e.g. Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)) and is measured as -1.002 x *CashFlow* + 0.283 x *Q* + 3.139 x *Leverage* – 39.368 x *Dividends* -1.315 x *Cash Holdings*, where *CashFlow* is (IB+DP)/lag(PPENT), *Q* is (AT-CEQ-TXDB+(PRCC_F*CSHO))/AT, *Leverage* is (DLC+DLTT)/(DLC+DLTT+SEQ), *Dividends* is (DVC+DVP)/lag(PPENT), and Cash Holdings is CHE over lag(PPENT) by using Compustat data items. *Inst Own* Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *LogPop* is the log of the population for a given county. *Education (%)* is the fraction of individuals 25 years and over having a bachelor's, graduate, professional, or some college degree. *Local Income* is the median household income for a given county. *CPRatio* is the ratio of Catholics to Protestants in the firm's county sourced from the ARDA dataset with the missing years interpolated. *Local Seniors* is the fraction of residents who are 65 years old or older within a county where a firm is headquartered. *Republican* is the percentage of Republican voters in the county.

Variable	Mean	Std. Dev.	p25	Median	p75	N
CSR	-0.068	2.351	-1	0	1	22,968
Neighbor Corruption	0.004	0.003	0.002	0.003	0.004	22,968
LnMV	7.239	1.575	6.087	7.067	8.217	22,968
Cash	0.227	0.284	0.038	0.120	0.308	22,968
EBITDA	0.120	0.137	0.082	0.131	0.186	22,968
Debt	0.496	0.236	0.319	0.491	0.639	22,968
M/B	3.292	4.109	1.522	2.390	3.934	22,968
KZ Index	-9.159	32.572	-6.825	-1.782	0.414	22,968
Inst Own	0.700	0.217	0.566	0.738	0.864	22,968
Dividend	0.013	0.025	0	0	0.0174438	22,968
LogPop	13.721	1.065	13.181	13.744	14.353	22,968
Education (%)	36.105	10.446	28.280	34.939	43.929	22,968
Local Income	56,140.09	15,160.12	44,704.0	52,595	66,697	22,968
CPRatio	1.937	1.785	0.586	1.349	2.762	22,968
Local Seniors	0.118	0.026	0.102	0.116	0.132	22,968
Republican (%)	39.096	13.795	30.2	38.7	48.3	22,968

Table 2. Baseline Test

This table presents the baseline tests for the effect of neighbor corruption on CSR. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita multiplied by 1000 of the neighboring states. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)).). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own* Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year and industry dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dep. Var.	CSR
Neighbor Corruption	-51.083***
	(-3.73)
LnMV	0.444***
	(10.90)
Cash	0.030
	(0.30)
EBITDA	0.379*
	(1.94)
Debt	-0.094
	(-0.64)
M/B	0.005
	(0.77)
KZ Index	0.002***
	(3.37)
Dividend	4.302***
	(3.00)
Inst Own	-0.372**
	(-2.08)
Constant	-2.399***
	(-6.92)
Year Fixed Effects	Yes
Industry Fixed Effects	Yes
Observations	22,968
R-squared	0.166

Table 3. Test with Local Corruption

This table presents the tests for the effect of neighbor corruption on CSR with *Local Corruption* as controls. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Local Corruption* is measured as the number of federal convictions per capita in the state multiplied by 1000. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)).). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own* Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year and industry dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

Dep. Var.	CSR
Neighbor Corruption	-47.332***
	(-3.40)
Local Corruption	-13.799*
	(-1.94)
LnMV	0.444***
	(10.91)
Cash	0.030
	(0.29)
EBITDA	0.381*
	(1.95)
Debt	-0.092
	(-0.62)
M/B	0.005
	(0.80)
KZ Index	0.002***
	(3.35)
Dividend	4.272***
	(2.99)
Inst Own	-0.364**
	(-2.03)
Constant	-2.379***
	(-6.88)
Year Fixed Effects	Yes
Industry Fixed Effects	Yes
Observations	22,968
R-squared	0.167

Table 4. Test with Local Controls, State, and Firm Fixed Effects

This table presents the tests for the effect of neighbor corruption on CSR with local, state and firm fixed effects as controls. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)).). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own* Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). *Local Controls* comprise *LogPop, Education, Local Income, CPRatio, Local Seniors, Republican. LogPop* is the log of the population for a given county. *Education* is the fraction of individuals 25 years and over having a bachelor's, graduate, professional, or some college degree. *Local Income* is the median household income for a given county. *CPRatio* is the ratio of Catholics to Protestants in the firm's county sourced from the ARDA dataset with the missing years interpolated. *Local Seniors* is the fraction of residents who are 65 years old or older within a county where a firm is headquartered. *Republican* is the percentage of Republican voters in the county. Year, industry, state, and firm dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)	(3)
Dep. Var.	CSR	CSR	CSR
Neighbor Corruption	-59.476***	-24.817***	-18.871**
	(-4.18)	(-2.61)	(-2.16)
Main Controls	Yes	Yes	Yes
Local Controls	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes
State Fixed Effects	No	Yes	No
Firm Fixed Effects	No	No	Yes
Observations	22,968	22,968	22,968
R-squared	0.174	0.201	0.647

Table 5. Corporate Relocations

This table presents the tests for the effect of neighbor corruption on CSR using corporate relocations as a correction for possible endogeneity. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Old Neighbor Corruption* is measured as the average federal corruption convictions per capita of the states neighboring the state where the company was located before the move and multiplied by 1000. *New Neighbor Corruption* is measured as the average federal corruption convictions per capita of the states neighboring the state the company moved to and multiplied by 1000. *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own* Fraction of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). *Local Controls* comprise *LogPop, Education, Local Income, CPRatio, Local Seniors, Republican. LogPop* is the log of the population for a given county. *Education* is the fraction of individuals 25 years and over having a bachelor's, graduate, professional, or some college degree. *Local Income* is the median household income for a given county. *CPRatio* is the ratio of Catholics to Protestants in the firm's county sourced from the ARDA dataset with the missing years interpolated. *Local Seniors* is the fraction of residents who are 65 years old or older within a county where a firm is headquartered. *Republican* is the percentage of Republican voters in the county. Year, industry, state, and firm dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)
	Pre-Move	Post-Move
Dep. Var.	CSR	CSR
Old Neighbor Corruption	-126.458**	-25.817
	(-2.42)	(-0.44)
New Neighbor Corruption	-54.822	-89.073*
	(-1.36)	(-1.86)
Main Controls	Yes	Yes
Local Controls	Yes	Yes
Year Fixed Effects	Yes	Yes
Industry Fixed Effects	Yes	Yes
State Fixed Effects	Yes	Yes
Observations	723	704
R-squared	0.418	0.322

Table 6. Tests with Corporate Governance Measures

This table presents the tests for the effect of neighbor corruption on CSR with corporate governance controls. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Takeover Index* is the hostile takeover index developed by Cain, McKeon, and Solomon (2017). *G-index* is the takeover index developed by Gompers, Ishii, and Metrick (2003). *E-Index* is the managerial entrenchment index developed by Bebchuk, Cohen, and Ferrell (2009). *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own Fraction* of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year, industry and state dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)	(3)
Dep. Var.	CSR	CSR	CSR
Neighbor Corruption	-51.922***	-75.987***	-74.820**
	(-3.66)	(-2.59)	(-2.33)
Takeover Index	0.501		
	(1.05)		
G-Index		0.039	
		(1.27)	
E-Index			0.135**
			(2.04)
Main Controls	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes
Observations	22,501	3,170	2,823
R-squared	0.170	0.145	0.146

Table 7. Firms with Strong vs. Weak Corporate Governance

This table presents the tests for the effect of neighbor corruption on CSR in two subsamples: Strong and Weak Corporate Governance. Strong and Weak Corporate Governance correspond to *Low* and *High Takeover Indexes* measured as the values of the takeover index below and above the sample median respectively. *Takeover Index* is the hostile takeover index developed by Cain, McKeon, and Solomon (2017). The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Takeover Index* is the hostile takeover index developed by Cain, McKeon, and Solomon (2017). *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own Fraction* of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year, industry and state dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)
	Low Takeover Index	High Takeover Index
Dep. Var.	CSR	CSR
Neighbor Corruption	-18.822	-96.109***
	(-1.40)	(-4.12)
Main Controls	Yes	Yes
Year Fixed Effects	Yes	Yes
Industry Fixed Effects	Yes	Yes
Observations	11,289	11,212
R-squared	0.156	0.199

Table 8. Tests with Lagged Neighborhood Corruption

This table presents the tests for the effect of neighbor corruption on CSR with lagged neighbor corruption as controls. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Lag Neighbor Corruption* is measured as the lagged average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Takeover Index* is the hostile takeover index developed by Cain, McKeon, and Solomon (2017). *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own Fraction* of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year, industry and state dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)
Dep. Var.	CSR
Lag Neighbor Corruption	-41.498***
	(-3.14)
Main Controls	Yes
Year Fixed Effects	Yes
Industry Fixed Effects	Yes
Observations	22,968
R-squared	0.165

Table 9. Tests with an Alternative Corruption Measure

This table presents the tests for the effect of neighbor corruption on CSR using an alternative corruption measure. The dependent variable is *CSR* as measured via Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor CRI* is the Corruption Reflections Index from Dincer and Johnston (2017) averaged over the neighboring states. *CRI* indicates the relative frequency of fraud and corruption-related stories in the news about politics published by Associated Press (AP). *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own Fraction* of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year, industry and state dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)
Dep. Var.	CSR
Neighbor CRI	-1.099***
	(-3.62)
Main Controls	Yes
Year Fixed Effects	Yes
Industry Fixed Effects	Yes
Observations	22,968
R-squared	0.165

Table 10. Neighborhood Corruption and Individual CSR Components

This table presents the tests for the effect of neighbor corruption on the individual CSR components. The dependent variables are components of CSR: *Humn, Commun, Divty, Emply, Envrn, Produ* are Human Rights, Community, Diversity, Employee Relations, Environment, and Product respectively. *CSR Components* are part of the Kinder, Lydenberg, and Domini (KLD) score provided via WRDS. *Neighbor Corruption* is measured as the average federal corruption convictions per capita of the neighboring states multiplied by 1000. *Main Controls* comprise *LnMV, Cash, EBITDA, Debt, M/B, KZ Index, Dividend, Inst Own Fraction*. *LnMV* is the market value which is calculated as by taking the natural logarithm of PRCC_C*CSHO using COMPUSTAT items. *Cash* is CHE divided by lagged AT using COMPUSTAT items. *EBITDA* is EBITDA divided by AT using COMPUSTAT items. *Debt* is calculated as LT divided by AT using COMPUSTAT items. *M/B* is the market-to-book ratio which is calculated as (PRCC_C*CSHO) is divided by CEQ using COMPUSTAT items. *KZ Index* is the financial constraints index as described in the prior literature (e.g., Kaplan and Zingales (1997), Farre-Mensa and Ljungqvist (2016), and Ucar (2018)). *Dividend* is the ratio of total dividends (DVC+DVP) to lagged total assets (AT). *Inst Own Fraction* of firm stock held by institutional investors (Thomson Financial data on quarterly 13f filings). Year, industry and state dummies are not reported for brevity. Standard errors are adjusted for heteroskedasticity and clustered at the firm level. T-statistics are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively.

	(1)	(2)	(3)	(4)	(5)	(6)
Dep. Var.	Humn	Commun	Divsty	Emply	Envrn	Produ
Neighbor Corruption	0.207	-8.634***	-16.238**	-5.747	-13.611***	-7.060*
	(0.16)	(-3.55)	(-2.49)	(-1.25)	(-3.96)	(-1.77)
Main Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	22,968	22,968	22,968	22,968	22,968	22,968
R-squared	0.057	0.112	0.303	0.163	0.111	0.110