FRIENDS IN HIGH PLACES: AN EMPIRICAL ANALYSIS OF POLITICAL CONNECTIONS, CORRUPTION, AND VOLUNTARY DISCLOSURE

A Dissertation

by

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ABSTRACT

I investigate whether political connections, defined as corporate lobbying and campaign contributions, moderate the adverse effects a firm faces from operating in a corrupt environment. A corrupt environment refers to a state in which there is a high public official corruption conviction rate per capita. In these environments, firms have incentives to decrease voluntary disclosure due to the threat of illegal expropriation by public officials. However, I find that the known negative relation between corruption and voluntary disclosure is moderated in the presence of political connections. This suggests that there is a weaker incentive for politically connected firms, compared to non-politically connected firms, to reduce voluntary disclosure. I find evidence indicating that this moderation is driven by greater investor demand for disclosure. My results show that firms operating in corrupt environments not only face greater demand for disclosure, in general, but face greater demand for political disclosure, in particular. I examine whether these findings are concentrated in politically connected firms (i.e., firms that publicly disclose a relation with a public official). I find that the demand for disclosure is significantly greater for firms that provide such public disclosure. Lastly, I also find evidence that the moderating effect of political connections extends to corporate policies other than disclosure (i.e., cash holdings and leverage policies).

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1. INTRODUCTION

Prior literature finds that firms operating within corrupt environments reduce voluntary disclosure in an effort to avoid adverse consequences resulting from an increased threat of illegal expropriation: consequences such as lower firm value, lower aggregate investment flows, and reduced investment efficiency (Durnev and Fauver 2008; Hakkala et al. 2008; O'Toole and Tarp 2014; Dass et al. 2016). However, as voluntary disclosure plays a significant role in the shaping of the corporate information environment (Beyer et al. 2010), the loss of such disclosure can also result in significant consequences (Healy and Palepu 2001; Lambert et al. 2007; Levi 2008). My study examines whether political connections, defined as corporate lobbying and campaign contributions, mitigate the incentive for firms in corrupt environments to decrease voluntary disclosure. I argue that this mitigation occurs because political connections both reduce the threat of illegal expropriation for firms and increase investor demand for disclosure from firms in corrupt environments. For the purposes of my study, a corrupt environment refers to one in which there are a large number of corruption convictions of public officials per capita (Smith 2016; Dass et al. 2016; Boland et al. 2018).

Consistent with my expectations, I find that political connections appear to successfully mitigate incentives for firms to decrease voluntary disclosure when operating in corrupt environments. I also find evidence indicating that this mitigation appears to be partially driven by greater investor demand for disclosure, which I proxy for using shareholder proposals made during the year. My results suggest that investors increase their demand from politically connected firms for disclosure in general, and for political disclosure in particular, when they operate in a corrupt environment. I also find evidence that the mitigating impact of political connections extends to corporate policies other than disclosure as well (i.e., firm cash holdings and leverage policies).

My study is important as corruption is a pervasive issue within the US. Between 2006 and 2016 federal prosecutors convicted more than 11,000 government officials for acts of official corruption.[1] Corruption includes a number of actions such as bribery, kickbacks, extortion, etc. These convictions relate to elected and appointed officials at all levels of government (i.e., state, federal, or local). The most recent data indicates that total federal and state level elected and appointed officials amount to about 19,000 and that 1,500 of these officials face either charges, convictions or upcoming trials for acts of official corruption.[2] This suggests that at least 8% of federal and state level elected and appointed officials are involved with or accused of corruption relating to their term. Non-governmental groups that observe the legislature report an increase in the general inclination toward corrupt acts and increases in specific and observable acts of corruption (Nichols 2011). This increasing prevalence of corruption within the US makes it important to understand methods that can be used to mitigate its adverse corporate effects. My study investigates one such method: political connections.

I argue that political connections reduce the incentive for firms operating in a corrupt environment to decrease voluntary disclosure for three primary reasons. First,

[1] See the Public Integrity Section's 2016 Report to Congress (https://www.justice.gov/criminal/pin).
[2] Data relating to public officials are provided by the Census Bureau at https://www.census.gov/govs/.

political connections provide a legal avenue through which public officials can openly connect with and gain support from a firm, without the negative consequences associated with illegal rent seeking (Harstad and Svensson 2011). This reduces the incentive for public officials to engage in illegal expropriation. Second, establishing this legal and public relationship incentivizes the connected official to protect the connected firm in order to ensure the continuation of the relationship. This means possible illegal rent seekers run the risk of conflicting with the connected official, which increases the overall cost of illegal expropriation. Third, politically connected firms (i.e., firms with a publicly disclosed relation with a politician) operating in a corrupt environment may face heightened investor concerns over reputation damage because the public *perceives* politicians to be corrupt on average.[3] This heightened concern increases investor demand for voluntary disclosure. Collectively, these reasons result in a weaker incentive for politically connected firms to reduce their voluntary disclosure levels when operating in a corrupt environment.

I first examine whether firms operating in a corrupt environment decrease their voluntary disclosure levels. To measure a corrupt environment, I use data from the Department of Justice (DOJ) Public Integrity Section (PIN). The DOJ PIN publishes a report to Congress every year that details the total number of corruption convictions of public officials by state. I scale convictions by state population to proxy for the overall

[3] In a national survey, more than 50% of respondents agreed that corruption in the federal government is “widespread” and an “extremely serious concern,” while fewer than 5% considered corruption to be “rare” or “not a concern” (Milyo 2014).

corruption in the environment (Glaeser and Saks 2006; Butler et al. 2009; Dass et al. 2016; Smith 2016; Boland et al. 2018): the higher the corruption conviction rate per capita, the more corrupt the environment. Firms are classified into different corruption environments depending on the location of their headquarters. Following prior literature, I use the frequency of management forecasts as my main disclosure metric (Guay et al. 2016; Nagar et al. 2019). I find that the more corrupt the environment, the less the amount of voluntary disclosure provided by firms. This is consistent with findings in prior literature (Dass et al. 2016) and suggests that firms operating in corrupt environments reduce their disclosure levels in an effort to avoid illegal expropriation.

Next, I examine whether or not the presence of political connections moderates the negative relation between operating in a corrupt environment and voluntary disclosure. I follow prior literature and use corporate lobbying and campaign contributions data from the Center for Responsive Politics to proxy for political connections (Correia 2014; Smith 2016; Boland et al. 2018). Full data is available for both lobbying expenditures and campaign contributions starting in 1998 due to the passage of the 1995 Lobbying Disclosure Act. Overall, my results suggest that political connections successfully reduce incentives for firms to avoid voluntary disclosure when operating in corrupt environments. As I use a non-random sample (i.e., politically connected firms) in my regression estimation, there is a potential concern that my coefficient estimates are biased due to a correlated omitted variable. Therefore, I rerun my main analyses using several approaches designed to address endogeneity: using a propensity score matched sample and comparing periods before and after the formation of political connections. I confirm that my results are robust to the use of these approaches.

One of the main arguments I make in my study is that investors are likely to demand a greater level of voluntary disclosure from politically connected firms that operate in a corrupt environment. To provide support for this argument, I examine shareholder proposals made to politically connected firms and non-politically connected firms across varying levels of corrupt environments. In general, I find that as corruption in the environment increases, so does the demand from investors for greater voluntary disclosure. However, I find that this positive relation between corruption in the environment and investor demand for disclosure is significantly greater for politically connected firms, compared to non-politically connected firms. My results confirm that investors appear to demand greater disclosure from politically connected firms located in corrupt environments.

In an additional analysis, I examine whether the mitigating effect of political connections extends to two other corporate policies: firm cash and leverage policies. Prior work documents that firms manage liquidity downward and debt obligations upward in response to the threat of expropriation by public officials. Specifically, prior studies find that firms both decrease their total cash holdings and increase their total amount of leverage when operating in a more corrupt area compared to a less corrupt area (Caprio et al. 2013; Dass et al. 2016). I find that politically connected firms operating in a corrupt environment hold more cash and less debt compared to non-politically connected firms operating in the same environment. This supports the argument that political connections appear to decrease the likelihood that a firm will face illegal expropriation and thus mitigate the effects of operating in a corrupt environment on firm policy decisions.

My paper makes several contributions to the existing literatures. First, I contribute to the corruption and disclosure literatures by providing evidence on how investor *demand* for disclosure changes depending on the level of corruption in the environment. Other existing studies largely focus on the supply of disclosure (Durnev and Fauver 2008; Dass et al. 2016). Second, I contribute to both the political connections and corruption literatures by jointly examining political connections and corruption in a US setting. Thus far, despite the fact that these two literatures are both concerned with public officials and their influence over firms, currently, most studies examine the effects of political connections and corruption independently (Warren 2004; Lessig 2013; Harstad and Svensson 2011). Third, I show that political connections moderate the adverse effects of corruption. I find that this occurs not only for voluntary disclosure policies, but also for other corporate policies. Lastly, I show that the effects of corruption (and the moderating effects of political connections) are concentrated in small-to-medium size firms. Arguably, this occurs because smaller firms are less costly targets for illegal expropriation compared to their larger counterparts, as they are both less influential and less significant to the overall economy. These findings suggest that smaller firms are more susceptible to the effects of corruption, and thus may benefit the most from political connections. My results are not only of interest to managers and investors concerned with the increasing level of corruption in the US, but also to policy-makers attempting to address the issue of corruption in the US.

2. RELEVANT LITERATURE

2.1. Corruption Literature

Rose-Ackerman (1975) identifies corruption as the illegal or unauthorized transfer of money (or a similar substitute). She describes corruption as illegal expropriation by the state, where public officials take actions for their own benefit that reduce the return on corporate investments. Other studies, building on Rose-Ackerman (1975), argue that corruption negatively impacts the economy. It distorts economic decisions and leads to a misallocation of resources which adversely affects aggregate investment and economic growth (Shleifer and Vishny 1993; Mauro 1995; Stulz 2005). At the firm-level, Hakkala et al. (2008) find that corruption results in less investment. More particularly, they find that corruption reduces the likelihood that a firm will invest in a country, while at the same time significantly reducing the likelihood of horizontal investments (i.e., sales to local affiliates). O'Toole and Tarp (2014) further examine the effects of corruption on investment. They examine the impact of corruption on investment efficiency, finding that corruption reduces that efficient allocation of capital by reducing the marginal return per unit investment. These analyses demonstrate the negative effects of corruption, both from an economy-wide and firm-specific perspective.

In an internationally-based study, Dong et al. (2012) find that the perceived corruption level of peers and other individuals in a society influences the willingness of an individual to engage in corrupt acts. They also find that once an individual participates in a corrupt act for the first time they are more likely to engage in corrupt acts in subsequent periods. Thus, based on this study, one can argue that operating in a corrupt environment increases the likelihood of illegal expropriation.[4]

To a large extent, current literature examines corruption from an international perspective (Wei 2000; Amore and Bennedsen 2013; Caprio et al. 2013; Liu 2016). Using a cross-country setting, Zhao et al. (2003) find a negative relation between corruption and foreign direct investment and Habib and Zurawicki (2002) find that investors appear to avoid more corrupt countries due to operational inefficiencies. Similarly, Rodriguez et al. (2005) argue that firms are less likely to establish a wholly owned subsidiary in corrupt countries due to increased expropriation risk. Caprio et al. (2013) find that increased expropriation risk in corrupt countries results in firms holding less cash. These firms instead use their resources to acquire fixed assets.

Existing literature focusing on within-country corruption, particularly within the US, is relatively scarce. In general, US-based studies find that corrupt environments result in negative impacts on firms and investors, such as a lower firm value, lower cash holdings and reduced levels of disclosure (Smith 2016; Dass et al. 2016; Boland et al. 2018). One study, conducted by Glaeser and Saks (2006), investigates the determinants of corruption within the US. They find that more educated states, and to a smaller degree richer states, have less corruption.[5] The Dass et al. (2016) study is relevant to my main analysis, as they

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[4] One potential concern for my main analysis is the level of corruption present within a firm could be driving the results. I control for this (untabulated) by including a series of variables relating to corporate governance: board size, independence, and CEO tenure. Arguably, a higher level of internal monitoring prevents within firm corruption (i.e., the unauthorized or illegal use of assets). My results hold consistent to the inclusion of these additional controls.

[5] Considering these findings, I include variables relating to state-level income and education as controls within my main analyses.

examine the relation between corruption in the US and firm-value and disclosure policies. In particular, the authors find that earnings-related disclosure (i.e., management earnings guidance) decreases when a firm operates in a more corrupt area. This supports the argument that firms decrease disclosure in an attempt to avoid illegal expropriation by public officials. Also examining the effects of corruption in a US setting, Smith (2016) finds that firms in more corrupt areas hold less cash and have greater leverage. The author argues that these findings indicate that firms in corrupt areas attempt to limit the potential for illegal expropriation by reducing firm liquidity (i.e., the ability of a firm to pay bribes).

2.2. Political Connections Literature

Corporate lobbying and campaign contributions are the most prominent ways that firms can directly and *legally* influence the development of new laws and regulations and the placement of public officials within the US. Most organizations that make campaign contributions also actively engage in lobbying; thus campaign contributions and lobbying frequently occur simultaneously within firms (Wright 1990). These activities result in connections with existing public officials, whether directly or indirectly. Firms can directly form a connection with a public official by making contributions to help fund said official's election (or re-election). Firms can indirectly form a connection with a public official through hiring lobbyists.[6] Lobbyists provide public officials with access to information, legislation expertise, and campaign contributions (Koger and Victor 2009).

[6] The majority of lobbyists have been employed as a public official at one point in time during their career. For example, 56% of the revenue generated by private lobbying firms between 1998 and 2008 can be attributed to individuals with some type of federal government experience (Vidal et al. 2012). Thus, it is likely that lobbyists retain a network of connections with existing public officials.

Although public officials are aware that lobbyists provide information that benefits their client base, they still view them as a reliable source of information. As a result, due to the complexities of legislation, public officials are frequently willing to cross party lines to receive lobbyists' expertise (Bertrand et al. 2014).

The existing political connections literature finds that these connections provide a wide variety of benefits to firms in the US, such as an increased likelihood of receiving government stimulus or government bailouts, an increased likelihood of obtaining external financing, a reduced likelihood of facing regulatory enforcement actions and improved future firm performance (Faccio et al. 2006; Claessens et al. 2008; Correia 2014; Adelino and Dinc 2014; Chen et al. 2015). Several industry-specific papers find that political connections also successfully help to shape both trade policies and legislation relating to particular markets (Schuler 1996; Glantz and Begay 1994; Igan and Mishra 2014). For example, Igan and Mishra (2014) find that spending on lobbying by the financial industry and network connections between lobbyists and legislators are positively associated with the probability of a legislator changing positions in favor of deregulation. That is, more intense lobbying on a bill, or lobbying using an individual who previously worked for a legislator, was linked to better odds that a legislator switched their vote in favor of deregulation. In general, these studies indicate that engaging in campaign contributions or corporate lobbying influence the behavior of public officials.

2.3. Combined Literature

There are a few studies that examine both political connections and corruption. Several existing international studies investigate the value of political connections in corrupt countries (Fisman 2002; Johnson and Mitton 2003; Li et al. 2008; Bunkanwanicha and Wiwattanakantang 2009; Cingano and Pinotti 2013). For example, Cingano and Pinotti (2013) examine the returns on political connections for a sample of Italian firms. They find that political connections result in a revenue premium of 5.7% to firms, and that this revenue premium increases when firms are located in corrupt areas.[7] However, given the strong legal enforcement and political institutions within the US, it is unclear if the conclusions from these studies apply to the US. One study by Amore and Bennedsen (2013) examines the effect of political connections on operating performance (i.e., operating return on assets) in a country with strong political institutions, Denmark. However, they do not examine how the influence of political connections changes given variation in corruption levels. My study contributes to both the existing political connections and corruption literatures by examining the impact of political connections on firms that operate within differing levels of corrupt environments in the US.

[7] Their corruption measure is based on judicial allegations for misbehavior made against the members of parliament elected in each region.

3. HYPOTHESIS DEVELOPMENT

3.1. Corrupt Environments and Voluntary Disclosure

Economic theory suggests that firms benefit from the voluntary revelation of information to the capital markets. If there is no cost to disclosure then firms should fully eliminate information asymmetry with the market (Jovanovic 1982; Jung and Kwon 1988). However, empirically there is great variation in disclosure quality across firms which suggests that there are costs to full disclosure. In a corrupt environment, in particular, the potential costs of voluntary disclosure are relatively high. After all, tacit claims grow only if public officials perceive that the benefits of expropriation exceed the costs associated with the expected penalties from being caught (Rose-Ackerman 1975; Smith 2016; Boland et al. 2018). Higher levels of voluntary disclosure allow public officials to more readily assess the costs and benefits of expropriation as they can better assess the economic reality of a firm (Kasznik and Lev 1995; Coller and Yohn 1997). Therefore, when a firm in a corrupt environment increases voluntary disclosure it also increases the likelihood that it faces illegal expropriation and its associated costs: the loss of profits through expropriation, potential reputational damage, and lower aggregate investment flows and investment efficiency,[8] all of which result in lower overall firm value (Dass et al. 2016). Given these findings, and consistent with arguments in prior

[8] Refer to Durnev and Fauver (2008), Hakkala et al. (2008) and O'Toole and Tarp (2014).

literature, I posit that firms in corrupt environments will reduce voluntary disclosure. I state my first hypothesis as follows:

H1: There is a negative relation between corruption in the environment and voluntary disclosure.

3.2. Politically Connected Firms and Voluntary Disclosure within a Corrupt Environment

While operating in a corrupt environment provides firms with incentives to decrease voluntary disclosure, I posit that these incentives are reduced in the presence of political connections for several reasons. First, political connections provide a legal avenue through which public officials can gain benefits, without the negative consequences associated with illegal rent seeking (Harstad and Svensson 2011). That is, political connections allow public officials to openly connect with and gain support from a firm without facing potential penalties for illegal activities. This reduces the incentive for public officials to engage in illegal expropriation in the first place. Second, establishing this legal and public relationship with a firm provides incentives for that official to protect the firm from possible illegal rent seekers to guarantee the continuation of the relationship. In turn, the chance for conflict with a powerful official increases costs for potential illegal rent seekers, which reduces the likelihood that a politically connected firm will face illegal rent seeking.[9] My arguments assume that possible illegal rent seekers are aware of firms' political connections.

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[9] Prior literature finds that firms form relations with "powerful" politicians, i.e. public officials that have an extensive network of connections and that can readily influence political outcomes (Vidal et al. 2012). Thus,

Third, political connections incentivize firms operating in corrupt environments to increase voluntary disclosure due to heightened investor concerns over corruption (i.e., the potential for damage to a firm's reputation). A good reputation is a strategic asset that can produce tangible benefits such as premium prices for products, lower cost of capital, and a cushion of goodwill in the event a crisis occurs (Fombrun 2001; Christensen 2016). However, reputations can be damaged very quickly when negative high-profile events occur (Skinner and Srinivasan 2012). If a firm connects to a corrupt official, the likelihood that a firm faces a negative high-profile event (i.e., a scandal) increases, which results in higher potential reputation costs to the firm.

Currently in the US, the public perception of politicians is that they are, on average, involved in some form of corruption (Nichols 2011; Milyo 2014). When a firm forms a political connection, either through campaign contributions or corporate lobbying, it is required to *publicly disclose* its connection with an existing politician, or with a well-connected lobbyist (CRP 2019).[10] Therefore, when firms operate in an area with historically high levels of corruption and choose to form a political connection, they can be perceived as being corrupt by association. This can heighten investor concerns over potential reputation costs to the firm, in turn, increasing investor demand for disclosure from politically connected firms. Increasing voluntary disclosure provides a form of

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the costs for conflict with these officials are relatively high and significantly increase the cost of illegal rent seeking for other less influential officials.

[10] A significant portion of lobbyists served as a public official at least once during their career. Nearly 25% of former House members and 29% of former Senators registered as lobbyists between 1976 and 2012 (Lazarus et al. 2016). Thus, while engaging in lobbying does not directly form a relation with an active public official, lobbying does suggest close ties to politicians.

assurance to investors that firm resources are not being illegally expropriated against, as higher voluntary disclosure levels allows investors and the general public to better assess the economic reality of a firm (Kasznik and Lev 1995; Coller and Yohn 1997). This leads to my second set of hypotheses:

H2a: There is a positive relation between corruption in the environment and investor demand for disclosure.

H2b: The positive relation between corruption in the environment and investor demand for disclosure is significantly greater for politically connected firms, compared to non-politically connected firms.

In sum, the incentives for politically connected firms to decrease voluntary disclosure when operating in a corrupt environment are weaker compared to non-politically connected firms in the same environment. Instead, politically connected firms have incentives to provide increased voluntary disclosure. There are three main reasons for this: 1) political connections provide a legal avenue through which public officials can gain benefits, which reduces their incentive to engage in illegal activities, 2) political connections increase costs for potential illegal rent seekers, reducing the threat of illegal expropriation, and 3) political connections increase investor demand for voluntary disclosure due to concerns with potential reputation costs to the firm. This leads to my third hypothesis:

H3: Political connections moderate the negative relation between corruption in the environment and voluntary disclosure.

Contrary to this, if political connections are indicative of corruption as suggested by national survey data (Nichols 2011; Milyo 2014), then the incentive to decrease voluntary disclosure may be greatest for politically connected firms that operate in a corrupt environment. Connected firms that are engaging in illegal behaviors and extracting private benefits have strong incentives to deliberately maintain information asymmetry with the market.

4. RESEARCH DESIGN

4.1. Corruption Data

Corruption data for my main analyses comes from the DOJ's Public Integrity Section (PIN). PIN was created in 1976 in order to pursue corruption cases within the US. PIN attorneys prosecute cases involving federal, state, or local officials. The Ethics in Government Act of 1978 mandates that the Attorney general report made annually to Congress includes the status of the DOJ's PIN. This status update both describes the activities of the PIN and provides statistics on public corruption (i.e., the number of convicted corruption cases against public officials per state). Most of the numbers in the report are crimes prosecuted by the US Attorney's Office in the originating district. Corruption investigations included in the PIN report cover illegal acts such as bribery, extortion, election crimes, criminal conflicts of interest, etc. (Smith 2016).

These data provide an ex post measure of corruption and have been used in the accounting, political economy and finance literatures (Glaeser and Saks 2006; Butler et al. 2009; Dass et al. 2016; Boland et al. 2018). One of the advantages to using the PIN corruption conviction data is that it is an objective measure of corruption faced by the firm. However, because PIN does not provide details of the cases from each district, it is not possible to count convictions that only affect the firm. This means that the corruption measurement will include offenses unlikely to directly impact the firm. My analysis assumes that the various types of corruption are positively correlated with each other.

Prior to using corruption conviction data, research was conducted mainly using survey-based data (Glaeser and Saks 2006). Although these survey measures contain useful information, they face significant issues involving potential measurement error because the data is subjective in nature and thus prone to bias and makes inferences difficult. For example, Olken (2009) compares perception-based measures of corruption (public survey responses on a project) to an objective measure of corruption (missing expenditures on the project) and finds only a weak correlation between the two measures. Due to the readily available nature of the data, and the potential issues with existing survey-based measures, I use the corruption conviction data in my study. [11]

I provide further detail on PIN state-level corruption data in Table 4.1. As shown in Table 4.1, total convictions average to about 1,000 cases per year. My corruption measure is calculated for each state-year and equals the ratio of the number of corruption convictions of public officials made per state to population of the state in millions.[12] I merge the state-level corruption data and firm-level financial data using the state location of firm headquarters to measure the overall level of corruption of a firm's operating environment. As Figure 4.1 shows, there is significant variation in the average level of corruption convictions across the United States.

[11] As a robustness test, I rerun my main analysis (equation (1)) using the survey-based measure of corruption developed by Boylan and Long (2003). In their survey, Boylan and Long (2003) requested that state house reporters rate their state's corruption on a scale from one (not corrupt) to seven (very corrupt). The average response by state was used to come up with a state's overall corruption score. I obtain similar results using this alternative measure of corruption (untabulated).

[12] State-level population data comes from the Census Bureau.

Figure 4.1 Average Convictions per 1,000,000 from 1998 to 2016

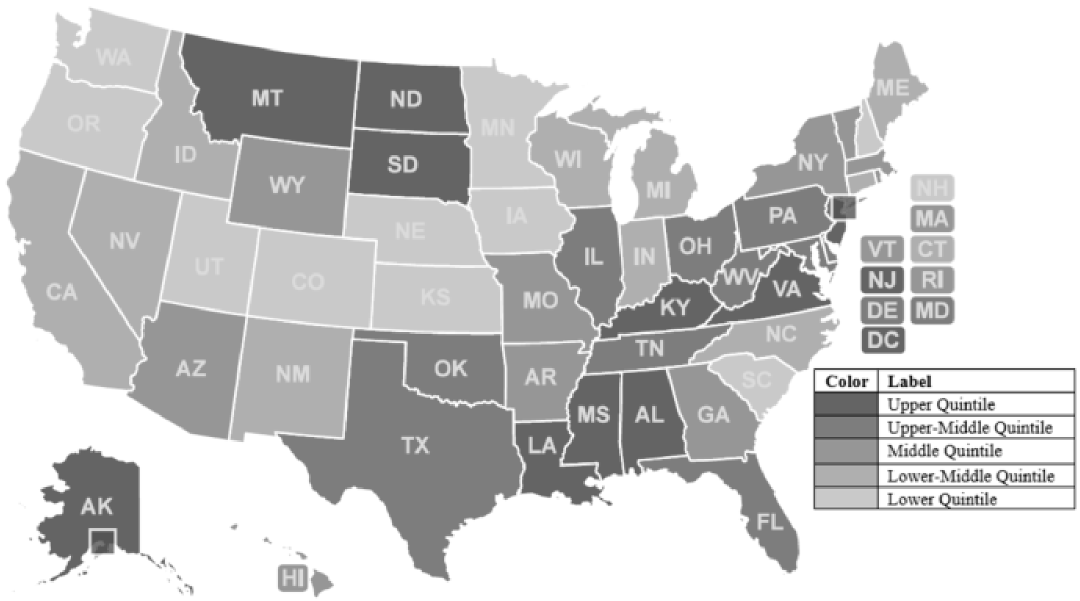

Table 4.1 Annual State-Level Corruption Conviction Data

Year	Annual Total	State Average	State Median	State S.D.	State Min	State Max
1998	990	19.41	7	27.07	0	100
1999	1,034	20.68	8.5	27.24	0	134
2000	903	17.71	8	23.08	0	107
2001	888	17.41	8	21.54	0	96
2002	891	17.47	8	19.68	0	82
2003	910	17.84	10	20.45	0	75
2004	973	19.08	10	21.82	0	90
2005	1,014	19.88	13	22.27	0	85
2006	1,000	19.61	9	21.08	0	83
2007	1,009	19.78	11	20.38	0	76
2008	1,087	21.31	11	23.46	0	112
2009	1,025	20.10	9	22.56	0	99
2010	1,009	19.78	11	20.10	0	71
2011	969	19.00	9	19.80	0	88
2012	1,029	20.18	9	22.94	0	101
2013	1,013	19.86	11	27.42	0	166
2014	937	18.37	10	21.95	0	102
2015	880	17.25	8	22.60	0	91
2016	844	16.55	8	20.09	0	86

This table provides information on state-level corruption conviction data. Corruption conviction data comes from the annual report to Congress provided by the Public Integrity Section of the Department of Justice.

4.2. Political Connections Data

Following existing literature, I classify firms as being politically connected if the firm made lobbying expenditures and campaign contributions during the fiscal year (Correia 2014; Kong et al. 2017; Heese et al. 2017). My political connections data comes from the Center for Responsive Politics (CRP), which aggregates the semi-annual lobbying disclosure reports filed with the Senate's Office of Public Records and the campaign contribution reports filed with the Federal Election Commission. CRP does not include company identifiers in their data, so I manually match public firm names to Compustat firm names. Due to the passage of the 1995 Lobbying Disclosure Act, data relating to corporate lobbying expenditures is only publicly available starting from 1998. Therefore, my sample includes data from the years 1998 to 2016.

4.3. Estimation Models

To examine the relation between corruption in the environment and voluntary disclosure (H1), I estimate the following model:

$$lnGuidance_t = \alpha_1 Corruption_t + \alpha_2 Controls_t + \varepsilon_t \qquad (1)$$

where *lnGuidance* is the natural logarithm of one plus the number of management guidance disclosures of earnings and sales issued during year t. I use management forecasts as my disclosure measure for three reasons. First, management forecasts are the voluntary disclosure mechanism that explains the highest fraction of stock return variance (Beyer et al. 2010). Second, according to a survey conducted by Brown et al. (2015), sell-side analysts recognize that management guidance is an important element in establishing their own earnings forecasts and stock recommendations. They note that management guidance is a more useful source of information than recent earnings performance and 10-K/Q filings. Lastly, management forecasts are the measure most commonly used in studies relating to corporate disclosure choices (Balakrishnan et al. 2014; Schoenfeld 2017; Bourveau et al. 2018).

I define *Corruption* as the corruption conviction rate of public officials per capita for the state the firm is headquartered in during year t; and *Controls* are equal to a list of variables intended to capture firm characteristics that prior literature finds as determinants of firm disclosure levels (Dass et al. 2016; Huang et al. 2017). These controls include *Size, MTB, Leverage, Litigation, lnAnalyst, GeoCount, BusCount, ROA, MktShare,* and

Distress.[13] Controls relating to firm size (*Size*), market-to-book ratio (*MTB*), debt obligations (*Leverage*), litigation risk (*Litigation*), analyst following (*lnAnalyst*) and business and geographic segment counts (*GeoCount* and *BusCount*) are meant to control for the demand for information for a particular firm. *Size* is the logarithm of total assets for firm i in year t; *MTB* is the market-to-book ratio for firm i in year t; *Leverage* is the sum of long-term and short-term debt, scaled by total assets for firm i in year t; *Litigation* is an indicator variable, equal to 1 if the firm is in a highly litigious industry in year t, 0 otherwise; *lnAnalyst* is the logarithm of the number of analysts following firm i in year t; *GeoCount* is the number of geographic segments for firm i in year t; and *BusCount* is the number of business segments for firm i in year t.

Separately, controls relating to return on assets (*ROA*), market share (*MktShare*), and financial distress (*Distress*) are meant to control for firm performance. *ROA* is income before extraordinary items scaled by lagged assets for firm i in year t; *MktShare* is equal to total sales scaled by industry sales for firm i in year t; and *Distress* is equal to the modified Altman Z-Score for firm i in year t. I use industry[14] and year fixed-effects, as this allows me to investigate influences at the firm-level while controlling for industry related factors and time-series trends (i.e., macro-economic factors). Standard errors are

[13] In an untabulated analysis I include a series of controls relating to corporate governance: CEO tenure, board size, and board independence. As prior literature finds a positive relation between weak corporate governance and corporate misconduct (Dechow et al. 1996), I control for these factors in order to control the within-firm variation in corruption. My results are robust to the inclusion of these additional controls.
[14] I use Fama-French 48 industry classifications when performing my analyses.

clustered by both state and time to ensure robustness to unspecified state and time correlations (i.e., correlation across firms in states).[15]

To examine the relation between corruption in the environment and investor demand for disclosure (H2), I estimate the following model:

$$Demand_t = \alpha_1 Corruption_t + \alpha_2 Controls_t + \varepsilon_t \qquad (2)$$

where *Demand* is equal to one of my two dependent variables of interest: *GeneralDisclosure* or *PoliticalDisclosure*. *GeneralDisclosure* is equal to the logarithm of the number of proposals made by shareholders during the year that relate to any type of disclosure and *PoliticalDisclosure* is equal to the logarithm of the number of proposals made by shareholders during the year that relate to political disclosure. *Controls* are equal to a list of variables intended to capture firm characteristics that prior literature finds as determinants of investor demand for disclosure (Baloria et al. 2019).

I control for firm size (*Size*), market-to-book ratio (*MTB*), growth (*SalesGrowth*), and performance (*ROA*, *Loss*) as prior literature finds that large, poorly performing firms with low growth options tend to attract greater investor attention and activism (Karpoff et al. 1996; Baloria et al. 2019). *Size, MTB,* and *ROA* follow the same definition as those included in equation (1) and defined in Appendix A. SalesGrowth is equal to the percent change in sales from year t-1 to t, and *Loss* is a dummy variable, equal to one if the net

[15] For robustness, I rerun my main analyses including additional state-level controls that potentially could impact the relation between corruption and various firm policies: the logarithm of median state income and the percent of the total population 25-years and over with a bachelor's degree or higher (Glaeser and Saks 2006). State-level income and education data come from the Census Bureau. My results hold consistent to the inclusion of state-related controls.

income of firm i in year t is negative, zero otherwise. Additionally, I incorporate controls relating to firm governance (*CEODuality*, *BoardSize*, and *Independence*), as prior literature finds that the likelihood of receiving a shareholder proposal is greater for firms that have poor governance structures (Renneboog and Szilagyi 2011). I also control for both highly litigious industries (*Litigation*) and acquisitions (*Acqusitions*) as both litigation and acquisitions are significant and high-profile events that potentially draw investor attention and thus can influence overall investor demand for disclosure.[16] I use industry and year fixed-effects, as this allows me to investigate influences at the firm-level while controlling for industry related factors and time-series trends (i.e., macro-economic factors). Standard errors are clustered by both state and time to ensure robustness to unspecified state and time correlations (i.e., correlation across firms in states).

To examine if political connections moderate the negative relation between corruption in the environment and voluntary disclosure (H3), I rerun my main analysis (equation (1)) for two different subsamples: politically connected firms and non-politically connected firms. Firms are classified as politically connected if they made lobbying expenditures or campaign contributions during the fiscal year. In both cases, my variable of interest for this is *Corruption*. If political connections moderate the effect of a corrupt environment on voluntary disclosure, I expect a non-significant (or less significant) coefficient estimate on *Corruption* for my politically connected subsample. On the other

[16] For robustness, I rerun my main analyses including additional state-level controls that potentially could impact the relation between corruption and various firm policies: the logarithm of median state income (*lnIncome*) and the percent of the total population 25-years and over with a bachelor's degree or higher (*Education*) (Glaeser and Saks 2006). State-level income and education data come from the Census Bureau. My results hold consistent to the inclusion of state-related controls.

hand, for my non-politically connected subsample, I expect the coefficient on *Corruption* to be negative and significant as suggested by prior literature (Dass et al. 2016). I also expect the coefficient estimates for these two subsamples to be significantly different from each other.

4.4. Sample Selection

I pull relevant financial statement data and headquarter information from Compustat, excluding firms in the financial and utility industries (SIC 6000-6999 and SIC 4900-4999), firms with missing sales, and firms with total assets less than $10 million. Managerial guidance and analyst following data are collected from the I/B/E/S database. All input variables are winsorized at the 1% and 99% levels. One issue with the Compustat headquarter data is that Compustat only reports the current state of firms' headquarters. To adjust for this deficiency, I cross-check the headquarter information against the augmented header data provided by the University of Notre Dame.[17]

Table 4.2 presents descriptive statistics for my main analysis (equation (1)). To compare and contrast between more and less corrupt environments, I split the sample into two groups: those with an above average public official corruption conviction rate per capita (Panel A) and those with a below average public official corruption conviction rate per capita (Panel B). Consistent with prior literature (Dass et al. 2016), I find that the total level of voluntary disclosure (*lnGuidance*) provided by firms operating in more corrupt environments is lower compared to firms operating in less corrupt environments. Also

[17] See data provided by Tim Loughran and Bill McDonald at https://sraf.nd.edu/data/augmented-10-x-header-data/.

consistent with prior literature, I find that cash holdings (*Cash*) are lower and debt obligations (*Leverage*) are higher for firms located in areas with higher corruption (Smith 2016). Comparing political connections between groups, I find that those firms that operate in a more corrupt environment are more likely to develop political connections compared to firms in less corrupt environments.

Table 4.2 Descriptive Statistics

Panel A: Firms operating in a more corrupt environment

	Count	Mean	Median	S.D.	25%	75%
Corruption	4,304	4.569	4.280	1.363	3.431	5.096
lnGuidance	4,304	2.162	2.197	0.842	1.609	2.833
Cash	4,304	0.200	0.116	0.236	0.038	0.276
Leverage	4,304	0.211	0.171	0.209	0.017	0.327
PC	4,304	0.186	0.000	0.389	0.000	0.000
Size	4,304	6.935	6.746	1.737	5.671	8.115
MTB	4,304	3.471	2.452	5.119	1.495	4.025
Leverage	4,304	0.211	0.171	0.209	0.017	0.327
Litigation	4,304	0.389	0.000	0.488	0.000	1.000
lnAnalyst	4,304	2.362	2.398	0.729	1.946	2.944
GeoCount	4,304	2.986	2.000	2.546	1.000	4.000
BusCount	4,304	2.560	1.000	2.126	1.000	4.000
ROA	4,304	0.043	0.059	0.130	0.016	0.101
MktShare	4,304	1.273	0.220	2.667	0.059	0.908
Distress	4,304	1.836	2.112	2.169	1.339	2.839

Panel B: Firms operating in a less corrupt environment

	Count	Mean	Median	S.D.	25%	75%
Corruption	7,978	1.910	1.968	0.692	1.496	2.396
lnGuidance	7,978	2.245	2.398	0.850	1.609	2.890
Cash	7,978	0.290	0.209	0.284	0.071	0.429
Leverage	7,978	0.172	0.117	0.200	0.000	0.277
PC	7,978	0.145	0.000	0.352	0.000	0.000
Size	7,978	6.586	6.375	1.757	5.319	7.766
MTB	7,978	3.404	2.435	4.780	1.480	4.029
Leverage	7,978	0.172	0.117	0.200	0.000	0.277
Litigation	7,978	0.492	0.000	0.500	0.000	1.000
lnAnalyst	7,978	2.352	2.398	0.751	1.792	2.944
GeoCount	7,978	3.427	3.000	2.608	1.000	5.000
BusCount	7,978	2.187	1.000	1.896	1.000	3.000
ROA	7,978	0.008	0.047	0.176	-0.022	0.095
MktShare	7,978	0.893	0.124	2.092	0.032	0.624
Distress	7,978	1.201	1.835	3.012	0.830	2.661

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise.

5. RESULTS

Results for my main analyses are presented in Table 5.1. Columns (1) and (2) present the results relating to my first hypothesis, which examines the relation between corruption in the environment and voluntary disclosure. Columns (3) to (6) present the results relating to my second hypothesis, which examines whether political connections moderate the relation between corruption in the environment and voluntary disclosure. Consistent with prior literature (Dass et al. 2016), I find a negative and significant relation between a corrupt environment (*Corruption*) and the level of voluntary disclosure provided by the firm (*lnGuidance*). This suggests that, when firms operate in a corrupt environment, the threat of illegal expropriation leads them to decrease voluntary disclosure.[18] Further, I find that this relation is robust to the inclusion of additional state-level controls shown to be significant determinants of corruption (Glaeser and Saks 2006): *lnIncome* and *Education*.[19]

After confirming these findings, I then examine the question of whether or not political connections successfully moderate this negative relation (H3). Columns (3) and (4) present results for my non-politically connected (*Non-PC*) firm subsample and my politically connected (*PC*) firm subsample, respectively. As expected, the negative

[18] These results hold consistent to when I use an alternative voluntary disclosure measure based on the frequency of conference calls (Tasker 1998; Mayew and Venkatachalam 2012; Kimbrough and Louis 2011; Hassan et al. 2019).
[19] *lnIncome* is equal to the logarithm of median income per state, while *Education* is equal to the percent of the total population 25-years and over with a bachelor's degree or higher per state (Glaeser and Saks 2006). State-level income and education data come from the Census Bureau.

relation remains significant for my *Non-PC* firm subsample. However, the previously found negative relation between a corrupt environment and voluntary disclosure is reversed for my *PC* subsample. That is, the coefficient estimate on *Corruption* is positive and significant for my *PC* subsample. This indicates that the incentives for *PC* firms to decrease disclosure in corrupt environments are weaker (and, in fact, reverse) compared to their *Non-PC* counterparts. These findings hold to the inclusion of additional state-level controls (columns (5) and (6)), however the positive and significant relation for my *PC* firm subsample is reduced in significance. I confirm that the coefficient estimates on *Corruption* are significantly different for these two subsamples and present the associated chi-squared statistics at the bottom of Table 5.1.

Table 5.1 Political Connections, Corrupt Environments, and Voluntary Disclosure

	(1)	(2)	(3)	(4)	(5)	(6)
	All Firms		Non-PC	PC	Non-PC	PC
	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance
Corruption	-0.0107***	-0.0106***	-0.0154***	0.0179**	-0.0151***	0.0171*
	(-2.69)	(-2.64)	(-3.45)	(2.00)	(-3.35)	(1.91)
Size	0.0261***	0.0261***	0.0338***	0.0283	0.0343***	0.0291
	(3.25)	(3.23)	(3.67)	(1.28)	(3.69)	(1.28)
MTB	-0.0009	-0.0009	-0.0012	0.0016	-0.0011	0.0017
	(-0.70)	(-0.69)	(-0.75)	(0.64)	(-0.71)	(0.66)
Leverage	0.0556	0.0591	0.0604	-0.1061	0.0651	-0.0992
	(1.38)	(1.45)	(1.36)	(-1.02)	(1.46)	(-0.94)
Litigation	0.0696***	0.0696***	0.1089***	-0.1651***	0.1037***	-0.1593***
	(2.69)	(2.64)	(3.86)	(-3.08)	(3.57)	(-2.82)
lnAnalyst	0.2544***	0.2540***	0.2426***	0.3152***	0.2425***	0.3136***
	(16.50)	(16.39)	(14.75)	(7.30)	(14.60)	(7.27)
GeoCount	0.0166***	0.0166***	0.0170***	0.0098	0.0170***	0.0102
	(5.90)	(5.88)	(5.49)	(1.36)	(5.44)	(1.41)
BusCount	0.0070**	0.0071**	-0.0003	0.0209***	-0.0000	0.0209***
	(2.05)	(2.06)	(-0.06)	(3.51)	(-0.00)	(3.53)
ROA	0.5028***	0.5219***	0.4941***	0.5336***	0.5163***	0.5455***
	(8.76)	(9.09)	(8.45)	(2.60)	(8.81)	(2.63)
MktShare	-0.0120***	-0.0124***	-0.0061	-0.0256***	-0.0078	-0.0263***
	(-3.01)	(-3.11)	(-0.84)	(-3.69)	(-1.06)	(-3.76)
Distress	0.0050	0.0040	0.0043	0.0047	0.0030	0.0049
	(1.46)	(1.18)	(1.14)	(0.45)	(0.80)	(0.48)
Education		0.0066**			0.0072**	0.0045
		(1.99)			(2.08)	(0.68)
lnIncome		-0.0577			-0.0471	-0.3021
		(-0.62)			(-0.46)	(-1.56)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	12,282	12,210	10,322	1,960	10,252	1,958
adj. R^2	0.366	0.366	0.365	0.405	0.366	0.405
Compare Non-PC and PC subsamples						
Coefficients compared			(3)	(4)	(5)	(6)
Chi-squared			12.59		11.59	
p-value			0.0004		0.0007	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. lnGuidance is equal to the logarithm of total managerial guidance offered by firm i during the fiscal year. t-statistics using standard errors clustered by state and year are in parentheses.

5.1. Propensity Score Matched Sample

To examine the robustness of my results relating to political connections and corruption in the environment, I rerun my H2 analyses using a propensity score matched sample. This allows me to compare *PC* firms to a more relevant counterfactual (*Non-PC*) group. Based on prior literature, I generate my propensity score using the following determinants of political connections: firm size, market-to-book ratio, leverage, litigious industry and prior-period cash flows (Hill et al. 2013). I also ensure that each *PC* firm is matched to a *Non-PC* firm within the same industry and year. I match using a propensity score radius (i.e., caliper) of 0.05 and by matching to the nearest two neighbors.[20] To confirm the appropriateness of my match, I follow the Rosenbaum and Rubin (1985) and calculate the standard percentage bias between my treatment and control samples. A sample is considered appropriately balanced if the bias is less than 25. As the bias of my matched sample, 14.4, falls below this threshold, I consider my sample to be appropriately balanced.

Following this, I rerun my original estimation model (equation (1)) using my matched sample. Results are presented in Table 5.2. The first two columns display results for my *Non-PC* and *PC* subsamples excluding state-level controls, while the remaining two columns present results for my *Non-PC* and *PC* subsamples including state-level controls. In both cases, the coefficient estimate on *Corruption* is negative and significant

[20] To further test the robustness of my results, I also match with no replacement. Shipman et al. (2017) argue that matching without replacement can result in low quality matches compared to matching with replacement. This is because if each control observation can only be matched once then, even if it is the best match for several treatment observations, a worse match will be made post-use. My results hold consistent to matching without replacement.

for my *Non-PC* firm group (column (1) and (3)), while the coefficient estimate on *Corruption* is positive and significant for my *PC* firm group (column (2) and (4)). When I compare coefficient estimates between these groups, I find that the coefficient estimates are significantly different. Overall, the results for my propensity score matched sample are consistent with my full sample analysis. That is, they suggest that political connections successfully moderate the negative relation between corruption in the environment and voluntary disclosure.

Table 5.2 Using a Propensity Score Matched Sample

	(1) Non-PC lnGuidance	(2) PC lnGuidance	(3) Non-PC lnGuidance	(4) PC lnGuidance
Corruption	-0.0326**	0.0357***	-0.0356**	0.0359***
	(-2.09)	(2.68)	(-2.27)	(2.70)
Size	0.0885**	0.0418	0.0900**	0.0408
	(2.41)	(1.31)	(2.43)	(1.27)
MTB	0.0004	-0.0001	0.0005	-0.0002
	(0.09)	(-0.04)	(0.10)	(-0.05)
Leverage	0.1205	-0.1905	0.0914	-0.1803
	(0.89)	(-1.27)	(0.67)	(-1.21)
Litigation	0.4161***	-0.0121	0.4619***	-0.0196
	(4.25)	(-0.16)	(4.69)	(-0.24)
lnAnalyst	0.0847	0.3844***	0.0649	0.3890***
	(1.57)	(6.55)	(1.24)	(6.63)
GeoCount	0.0123	0.0019	0.0155	0.0017
	(1.20)	(0.18)	(1.54)	(0.16)
BusCount	-0.0232*	0.0210**	-0.0250*	0.0216**
	(-1.68)	(2.14)	(-1.79)	(2.19)
ROA	0.7959***	0.2562	0.8220***	0.2687
	(3.49)	(1.04)	(3.60)	(1.10)
MktShare	0.0106	-0.0006	0.0111	-0.0001
	(0.44)	(-0.03)	(0.44)	(-0.01)
Distress	0.0109	0.0400***	0.0061	0.0398***
	(0.72)	(4.15)	(0.40)	(4.15)
Education			0.0135	-0.0019
			(1.40)	(-0.14)
lnIncome			-0.7526**	-0.1152
			(-2.48)	(-0.32)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	1,020	786	1,011	785
adj. R^2	0.327	0.376	0.337	0.374

Compare Non-PC and PC subsamples				
Coefficients compared	(1)	(2)	(3)	(4)
Chi-squared	11.98		13.27	
p-value	0.0005		0.0003	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. lnGuidance is equal to the logarithm of total managerial guidance offered by firm i during the fiscal year. t-statistics using standard errors clustered by state and year are in parentheses.

5.2. Controlling for Self-Selection Bias

Running a regression estimation using a non-random sample (such as politically connected firms) can result in an omitted variables problem. That is, characteristics not controlled for in the regression may potentially determine whether or not a firm self-selects into a particular group. These omitted variables potentially bias the coefficient estimates of independent variables. In order to address this endogeneity concern within my study, I use the Heckman (1979) two-stage procedure to correct for self-selection bias for results relating to H2. In the first step, I estimate the likelihood that a firm forms political connections based off of the following determinants of political connections established in prior literature (untabulated): firm size, market-to-book ratio, leverage, litigious industry and prior-period cash flows (Hill et al. 2013; Correia 2014; Heese et al. 2017). I then use these estimates to calculate the inverse mills ratio (*IMR*) for all sample firms. In the second step, I rerun my original estimation model (equation (1)) including the inverse mills ratio as an additional control variable to correct for potential self-selection bias.

Results are presented in Table 5.3. Columns (1) and (2) provide results for my *Non-PC* and *PC* groups, while columns (3) and (4) provide results for my *Non-PC* and *PC* groups with additional state-level controls. Similar to my original analysis (Table 5.1), I find that the coefficient estimate on *Corruption* is negative and significant for my *Non-PC* group and positive and (slightly) significant for my *PC* group. The coefficient estimates on *Corruption* are significantly different from each other when I compare between groups. Thus, my results remain robust to controlling for self-selection bias.

Table 5.3 Controlling for Self-Selection Bias

	(1) Non-PC lnGuidance	(2) PC lnGuidance	(3) Non-PC lnGuidance	(4) PC lnGuidance
Corruption	-0.0156***	0.0171*	-0.0153***	0.0163*
	(-3.52)	(1.91)	(-3.43)	(1.82)
Size	0.2340***	0.1405**	0.2476***	0.1424**
	(3.74)	(2.10)	(3.93)	(2.12)
MTB	0.0022	0.0037	0.0025	0.0038
	(1.12)	(1.29)	(1.27)	(1.31)
Leverage	-0.1165	-0.1781	-0.1233*	-0.1714
	(-1.61)	(-1.54)	(-1.70)	(-1.47)
Litigation	0.0472	-0.1999***	0.0377	-0.1931***
	(1.28)	(-3.72)	(0.99)	(-3.43)
lnAnalyst	0.2449***	0.3246***	0.2449***	0.3231***
	(14.81)	(7.50)	(14.67)	(7.48)
GeoCount	0.0167***	0.0092	0.0167***	0.0096
	(5.38)	(1.28)	(5.31)	(1.33)
BusCount	-0.0000	0.0211***	0.0003	0.0211***
	(-0.01)	(3.54)	(0.06)	(3.55)
ROA	0.4383***	0.4929**	0.4569***	0.5050**
	(7.17)	(2.37)	(7.46)	(2.40)
MktShare	-0.0128	-0.0297***	-0.0149*	-0.0304***
	(-1.63)	(-4.01)	(-1.90)	(-4.08)
Distress	0.0035	0.0074	0.0021	0.0079
	(0.92)	(0.71)	(0.57)	(0.76)
IMR	0.3745***	0.2675*	0.3991***	0.2709*
	(3.31)	(1.73)	(3.50)	(1.75)
Education			0.0074**	0.0053
			(2.13)	(0.80)
lnIncome			-0.0478	-0.3171
			(-0.46)	(-1.64)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	10,266	1,958	10,196	1,956
adj. R^2	0.364	0.406	0.365	0.406

Compare Non-PC and PC subsamples

Coefficients compared	(1)	(2)	(3)	(4)
Chi-squared	12.19		11.28	
p-value	0.0005		0.0008	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. IMR is equal to the inverse mills ratio for firm i in year t. t-statistics using standard errors clustered by state and year are in parentheses.

5.3. Shareholder Proposals

One of the main arguments that I make in my study is that political connections moderate the effects of corruption in the environment through increasing investor demand for disclosure. This occurs because *PC* firms face heightened investor concern over potential reputation damage when they operate in a corrupt environment. To test this argument, I examine shareholder proposals made to *PC* and *Non-PC* firms operating in environments with differing levels of corruption. I expect that while the overall relation between corruption in the environment and investor demand for disclosure will be positive (H2a), the effect will be more significant for *PC* firms as they draw heightened investor attention due to the public disclosure of a relation with a politician (H2b).

Results for my shareholder proposals analyses are presented in Table 5.4. Consistent with my expectations, I find that there is an overall positive relation between corruption in the environment and investor demand for disclosure (for both *PC* and *Non-PC* firms). This holds constant across both my *GeneralDisclosure* and *PoliticalDisclosure* measures. Also consistent with my expectations, I find that the positive relation is more significant for *PC* firms compared to *Non-PC* firms. The coefficient estimate is greater in both size and significance for my politically connected firm subgroup. I confirm that the coefficient estimates on *Corruption* are significantly different for these two subsamples and present the associated chi-squared statistics at the bottom of Table 5.4.

Table 5.4 Political Connections, Corrupt Environments, and Shareholder Proposals

	(1) Non-PC GeneralDisclosure	(2) PC GeneralDisclosure	(3) Non-PC PoliticalDisclosure	(4) PC PoliticalDisclosure
Corruption	0.0022**	0.0099***	0.0013*	0.0064**
	(2.40)	(3.03)	(1.89)	(2.42)
Size	0.0094***	0.0967***	0.0034***	0.0633***
	(7.66)	(17.28)	(4.23)	(13.38)
MTB	0.0076**	-0.0315**	0.0036	-0.0233**
	(2.16)	(-2.33)	(1.42)	(-2.55)
ROA	0.0007	0.0309	0.0036	-0.0518
	(0.09)	(0.45)	(0.81)	(-0.92)
SalesGrowth	-0.0153***	-0.0114	-0.0055**	-0.0146
	(-3.41)	(-0.40)	(-2.28)	(-0.68)
Litigation	-0.0052	-0.0397*	-0.0062**	-0.0291*
	(-1.15)	(-1.67)	(-2.26)	(-1.68)
Loss	-0.0003	0.0388**	0.0005	0.0004
	(-0.09)	(2.23)	(0.24)	(0.03)
Acquisitions	0.0007	-0.2820***	-0.0084	-0.1489**
	(0.03)	(-3.71)	(-0.64)	(-2.58)
CEODuality	0.0132***	0.0460***	0.0069***	0.0263***
	(4.63)	(4.22)	(4.36)	(3.31)
BoardSize	0.0255***	-0.0100	0.0054	-0.0263
	(3.37)	(-0.29)	(1.33)	(-1.10)
Independence	-0.0000	0.0016***	0.0001	0.0012***
	(-0.10)	(2.72)	(1.23)	(3.14)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	7,126	3,040	7,126	3,040
adj. R^2	0.040	0.225	0.034	0.180
Compare Non-PC and PC subsamples				
Coefficients comp.	(1)	(2)	(3)	(4)
Chi-squared	5.37		3.54	
p-value	0.0205		0.0598	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. GeneralDisclosure is equal to the logarithm of the number of proposals made by shareholders during the year that relate to any type of disclosure. PoliticalDisclosure is equal to the logarithm of the number of proposals made by shareholders during the year that relate to political disclosure. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. t-statistics using standard errors clustered by state and year are in parentheses.

In order to test the robustness of my findings for my second set of hypothesis (H2a and H2b), I use two different approaches. To test the robustness of my findings associated with H2b, that corruption in the environment is positively associated with investor demand for disclosure, I run a difference-in-differences analysis based off of an exogenous shock to corruption. In January 2011, Indiana passed a revolving door law that restricted the post-government employment options of public employees (i.e., increased the cool-down period for ex-employees). The law is intended to prevent the misuse of contacts and inside information held by the ex-government employee, as well as to prevent favoritism of current government employees in favor of the ex-employee. I argue that this more stringent law resulted in a negative shock to corruption for firms located in these states. Thus, for these particular firms, the increase to investor demand for disclosure should be reduced compared to firms in states that have no such laws enacted (DC, ID, IL, KS, MI, MN, MD, NE, NH, OK, TX, and WY). I use the passage of the 2011 revolving door law as the basis for a difference-in-differences design.

To run this analysis, I create a dummy variable, *Treat*, equal to one if the firm was headquarter in Indiana (which passed the revolving door law) or zero if they are located in a state that never passed a similar revolving door law (control group). To define my post period, I create a dummy variable, *PostRevolve*, equal to one if the year is after 2012 (i.e., the year the law was first effective) and zero if the year is prior to 2011 (i.e., the year the law was passed).

The main variable of interest for this analysis is the interaction variable, *Treat** *PostRevolve*. Results for this analysis are presented in Table 5.5. As the revolving door law reduces corruption within the environment, I anticipate that there is a negative relation between the interaction variable and investor demand for disclosure. That is, firms located in the state which passed the revolving door law should experience reduced investor demand for disclosure. This is because the reduction in corruption would decrease the potential reputation damage a firm faces in that environment, and thus the investor demand for disclosure from firms should decrease. I find results consistent with this expectation.

Table 5.5 Difference-in-Differences Analysis, Revolving Door Law

	(1) GeneralDisclosure	(2) PoliticalDisclosure	(3) GeneralDisclosure	(4) PoliticalDisclosure
Treat	-0.0134	0.0316	-0.0143	0.0400
	(-0.38)	(0.86)	(-0.38)	(1.05)
PostRevolve	-0.0422**	0.0027	-0.0368	0.0211
	(-2.18)	(0.21)	(-1.21)	(0.97)
Treat*PostRevolve	-0.1137***	-0.1069***	-0.1146***	-0.1086***
	(-3.76)	(-3.16)	(-3.76)	(-3.17)
Controls	Yes	Yes	Yes	Yes
State Controls	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	1,865	1,865	1,865	1,865
R^2	0.165	0.158	0.164	0.158

The sample includes all non-utility, non-financial domestic firms with available data. Variables are winsorized at 1% and 99%. GeneralDisclosure is equal to the logarithm of the number of proposals made by shareholders during the year that relate to any type of disclosure. PoliticalDisclosure is equal to the logarithm of the number of proposals made by shareholders during the year that relate to political disclosure. t-statistics using standard errors clustered by state and year are in parentheses. Treat is a dummy variable, equal to one if the firm was headquarter in Indiana (which passed the revolving door law) or zero if they are located in a state that never passed a similar revolving door law (control group). Post is a dummy variable, equal to one if the year is after 2012 (i.e., the year the law was first effective) and zero if the year is prior to 2011 (i.e., the year the law was passed). t-statistics using standard errors clustered by state and year are in parentheses.

As a robustness test for H2b, where I argue that the positive relation between corruption in the environment and investor demand for disclosure will be greater for PC firms, I run an analysis comparing firms before and after they initially form a political connection. To perform this analysis, I first limit my sample to firms located in highly corrupt environments (i.e., firms who operate in a state that has a corruption conviction rate that falls into the top third). By limiting the sample to firms that share a high corruption environment, I am better able to compare and contrast the differential impact that political connections has on investor demand for disclosure. I compare firms that initiate lobbying or making campaign contributions during my sample period (treatment group) to firms that never engage in lobbying or making campaign contributions (control group). I define connected firms (*Connected*) using an indicator variable, equal to one if the firm lobbies or makes campaign contributions at any time during its life, zero otherwise. I then match connected firms in their first year of lobbying or making campaign contributions to non-connected firms (i.e., firms in my control group) in the same year and industry based on firm size (*Size*) and firm performance (*ROA*). I define my post-political connection formation period (*Post*) using an indicator variable, equal to one if it is during or after the initial year of lobbying or making campaign contributions for the firm, zero otherwise. I assign the same post-period to its corresponding match in the control group. My main variable of interest is the interaction term, *Post***Connected*.

Results for this analysis are presented in Table 5.6. If investors demand a greater amount of disclosure from a politically connected firm that operates in a corrupt environment, compared to a non-politically connected firm, then I anticipate that the coefficient estimate on *Post*Connected* will be positive and significant. My findings are consistent with this expectation. In particular, my results indicate that it is only after a firm forms a political connection that a significant increase in investor demand for disclosure occurs. These findings are robust to both the inclusion (columns (1) and (2)) and exclusion of state-level controls (columns (3) and (4)).

Table 5.6 Pre- and Post-Political Connections and Shareholder Proposals

	(1) GeneralDisclosure	(2) PoliticalDisclosure	(3) GeneralDisclosure	(4) PoliticalDisclosure
Post	-0.0037	-0.0098	-0.0128	-0.0144
	(-0.14)	(-0.63)	(-0.47)	(-0.89)
Connected	-0.0268	-0.0145	-0.0269	-0.0161
	(-0.88)	(-0.94)	(-0.85)	(-1.04)
Post*Connected	0.0872**	0.0697***	0.0926**	0.0720***
	(2.50)	(3.79)	(2.59)	(3.87)
Controls	Yes	Yes	Yes	Yes
State Controls	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	1,093	1,093	1,082	1,082
adj. R^2	0.234	0.206	0.236	0.205

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. Connected is a dummy variable, equal to 1 if the firm lobbied or made campaign contributions at any time during its life, 0 otherwise. Post is a dummy variable, equal to 1 if it is during or after the initial year a firm either lobbies or makes campaign contributions, 0 otherwise. t-statistics using standard errors clustered by state and year are inparentheses.

5.4. Cash Holdings and Debt Obligations

In addition to reducing voluntary disclosure, prior work shows several additional actions that firms take in response to an increased threat of illegal rent seeking: reducing liquid holdings and increasing debt obligations (Caprio et al. 2013; Smith 2016). Smith

(2016) finds that firms in more corrupt areas hold less cash and more leverage compared to firms in less corrupt areas. The underlying argument for these findings is that firms implement such policies in order to reduce their liquidity and thus their ability to pay potential illegal rent seekers. This, in turn, reduces the threat of illegal expropriation for that firm (Svensson 2003). If political connections reduce the likelihood of illegal expropriation, then I expect these known relations between a corrupt environment and various firm policies to be moderated for *PC* firms. That is, I expect *PC* firms operating in a corrupt environment to have greater cash holdings and lower debt obligations compared to *Non-PC* firms operating in the same type of environment.

To examine the impact of political connections on the relation between a high corruption environment and firm policies relating to liquidity, I estimate the following model separately for firms with and without political connections:

$$DV = \alpha_1 Corruption_t + \alpha_2 Controls_t + \varepsilon_t \qquad (3)$$

where *DV* is equal to one of my two dependent variables of interest: *Cash*, or *Leverage*. *Cash* is equal to the cash and cash equivalents of firm i in year t, scaled by total assets. *Leverage* is equal to the short-term debt and long-term debt of firm i in year t, scaled by total assets. Following prior literature, I also include relevant control variables for each of my firm policy analyses (Smith 2016). The controls are intended to capture characteristics of the firm that otherwise might impact firm cash and leverage policies. For my both analysis, I include the following controls: *Size, MTB, SalesGrowth, CapEx, R&D, Acquisitions, Div, Loss,* and *Distress.* Refer to Appendix A for a detailed descriptions of each of these controls. As in equation (1), I use industry and year fixed-effects and cluster standard errors by both state and time.

Results for my cash holdings and debt obligations analyses are presented in Table 5.7 and Table 5.8, respectively. Table 5.7 presents the results for my cash holdings analysis. Columns (1) and (2) confirm the findings in Smith (2016), showing the existence of a significant and negative relation between firm cash holdings and corruption in the environment. Columns (3) and (4) provide results for my *Non-PC* and *PC* subsamples excluding state-level controls, while columns (5) and (6) provide for my *Non-PC* and *PC* subsamples including state-level controls. I find that the negative relation between cash holdings and corruption in the environment is significant for my *Non-PC* subsample, while the magnitude of the negative relation is reduced for my *PC* subsample. This suggests that political connections at least partially mitigate the effect of corruption in the environment on firm cash holdings policies. These findings are robust to the inclusion of state-level controls (columns (5) and (6)).

Table 5.7 Cash Holdings Analysis

	(1)	(2)	(3)	(4)	(5)	(6)
	All Firms		Non-PC	PC	Non-PC	PC
	Cash	Cash	Cash	Cash	Cash	Cash
Corruption	-0.0072***	-0.0059***	-0.0074***	-0.0040***	-0.0059***	-0.0033***
	(-7.04)	(-6.25)	(-6.66)	(-3.15)	(-5.84)	(-2.65)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
State Controls	No	Yes	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	48,270	47,932	43,344	4,926	43,022	4,910
adj. R^2	0.380	0.386	0.379	0.405	0.385	0.410
Compare Non-PC and PC subsamples						
Coefficients compared			(3)	(4)	(5)	(6)
Chi-squared			5.45		3.44	
p-value			0.0196		0.0637	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. Cash is equal to the cash and cash equivalents of firm i in year t, scaled by total assets. Leverage is equal to the sum of short-term and long-term debt for firm i in year t, scaled by total assets. t-statistics using standard errors clustered by state and year are in parentheses.

Table 5.8 presents the results for my debt obligations analysis. Columns (1) and (2) confirm the findings in Smith (2016), showing a positive and significant relation between leverage and corruption in the environment. However, when I compare between *Non-PC* and *PC* subsamples the relation differs. *Non-PC* firms still show a significant and positive relation between corruption in the environment and debt obligations. Meanwhile, this relation is non-significant for *PC* firms. This is robust to both the inclusion and exclusion of state-level controls. In all cases, the coefficient estimates on *Corruption* are significantly different between *Non-PC* and *PC* groups. Overall, these findings provide complementary evidence indicating that political connections help to offset the adverse effects a firm faces from operating in a corrupt environment.

Table 5.8 Debt Obligations Analysis

	(1)	(2)	(3)	(4)	(5)	(6)
	All Firms		Non-PC	PC	Non-PC	PC
	Leverage	Leverage	Leverage	Leverage	Leverage	Leverage
Corruption	0.0031***	0.0022***	0.0035***	-0.0005	0.0025***	-0.0008
	(4.40)	(3.23)	(4.68)	(-0.34)	(3.40)	(-0.54)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
State Controls	No	Yes	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	48,272	47,934	43,344	4,928	43,022	4,912
adj. R^2	0.240	0.245	0.243	0.285	0.247	0.289
Compare Non-PC and PC subsamples						
Coefficients compared			(3)	(4)	(5)	(6)
Chi-squared			6.11		4.01	
p-value			0.0135		0.0452	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. Cash is equal to the cash and cash equivalents of firm i in year t, scaled by total assets. Leverage is equal to the sum of short-term and long-term debt for firm i in year t, scaled by total assets. t-statistics using standard errors clustered by state and year are in parentheses.

5.5. High Political Risk Firms

As a separate subsample analysis, I compare the effects of corrupt environments and political connections on voluntary disclosure when politics are considered by the firm to be a significant influence (i.e., a significant risk) versus a non-significant influence. In order to perform this analysis, I use firm-level political risk data from the Hassan et al. (2019) study. Hassan et al. (HHLT) perform a textual analysis of earnings conference-call transcripts to construct a firm-level measure of the extent and type of political risk faced by individual firms listed in the US. The HHLT approach to quantifying the extent of political risk faced by a firm is to measure the portion of the conference call between participants and firm management that centers on risks associated with politics. I posit that firms which consider politics to be high risk, i.e. significant to their operations, will experience significant influences on their firm policies from corruption or political connections. Thus, I anticipate that my prior findings (Table 5.1) will be stronger for high political risk firms and weaken or disappear for low political risk firms. To test this, I classify firms into a high political risk or low political risk group based on their average HHLT political risk score. I then rerun my main analysis (equation (1)) relating to H2 for both the high and low political risk subsamples.

Results are presented in Table 5.9. The first four columns relate to my high political risk group, while the last four columns relate to my low political risk group. I find that results for the high political risk group are consistent with my prior findings (Table 5.1). For my *Non-PC* group, there is a significant negative relation between corruption in the environment and voluntary disclosure, while this relation is reversed for my *PC* group.

Results also are robust to the inclusion of state-level controls (columns (3) and (4)). As before, the coefficient estimates are significantly different between my *Non-PC* and *PC* groups. However, when I limit my analysis to the low political risk group these findings are largely mitigated. There is a large drop in significance on the relation between *Corruption* and *lnGuidance* and there is no significant difference in the coefficient estimates between my *Non-PC* and *PC* subsamples. This suggests that the effects of both corruption in the environment and political connections are only important for firms that consider politics as a significant risk.

Table 5.9 High vs. Low Political Risk Subsample Analysis

	High Political Risk				Low Political Risk			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Non-PC	PC	Non-PC	PC	Non-PC	PC	Non-PC	PC
	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance
Corruption	-0.0241***	0.0352***	-0.0248***	0.0355***	-0.0104*	-0.0023	-0.0100*	-0.0029
	(-2.79)	(2.91)	(-2.83)	(2.96)	(-1.89)	(-0.18)	(-1.78)	(-0.22)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
State Controls	No	No	Yes	Yes	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	3,394	885	3,368	885	6,928	1,075	6,884	1,073
adj. R^2	0.206	0.362	0.207	0.363	0.423	0.434	0.424	0.433
Compare Non-PC and PC subsamples								
Coefficients compared	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Chi-squared	17.82		18.64		0.37		0.27	
p-value	0.0000		0.0000		0.5410		0.6032	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. Firms are classified into the high political risk category if their HHLT measure of political risk is above average, otherwise they are classified into the low political risk category. t-statistics using standard errors clustered by state and year are in parentheses.

5.6. Small and Medium Firms

One potential argument that can be made is that the effects of corruption on voluntary disclosure are largely driven by small to medium-size firms, which are less costly targets for illegal expropriation compared to their larger counterparts. This could be due to these firms having less influence or being of less significance to the overall economy (and thus receiving less attention from regulators or other monitors). These are the firms that are more likely to face illegal expropriation and that could benefit the most from political connections. To test this argument, I create a dummy variable, *SmallMedium*, equal to 1 if the firm falls into the lower two thirds of firm size, 0 otherwise.[21] I then rerun my main analysis (equation (1)) including the interaction term, *Corruption*SmallMedium*. If previous findings are largely driven by small to medium-size firms, then I anticipate that the main effect, *Corruption*, will be non-significant while the interaction term will display similar sign and significance to what was shown in my prior findings (Table 5.1).

Results for the firm size analysis are presented in Table 5.10. Columns (1) and (2) present the results examining the overall relation between corruption in the environment and voluntary disclosure, while columns (3) to (6) present results comparing between *Non-PC* and *PC* firms. I find that, consistent with the arguments above, results appear to be driven by small to medium-size firms. The coefficient estimate on

[21] In a separate analysis (untabulated), I rerun this test solely comparing large and small firms (i.e., firms that fall into the top third of firm size compared to firms that fall into the bottom third of firm size). The implications of my results are robust to the use of this alternative approach.

*Corruption*SmallMedium* is negative and significant when examining all firms, and when examining *Non-PC* firms in particular. However, consistent with prior findings, this relation reverses for *PC* firms. These findings are robust to the inclusion of additional state-level controls (columns (5) and (6)).

Table 5.10 Small and Medium Firm Subsample Analysis

	(1)	(2)	(3)	(4)	(5)	(6)
	All Firms		Non-PC	PC	Non-PC	PC
	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance	lnGuidance
Corruption	0.0091	0.0090	0.0105	0.0082	0.0104	0.0069
	(1.22)	(1.20)	(1.09)	(0.81)	(1.06)	(0.68)
SmallMedium	0.1734***	0.1707***	0.2274***	-0.1343	0.2226***	-0.1391
	(4.66)	(4.55)	(5.24)	(-1.59)	(5.09)	(-1.63)
SmallMedium*Corruption	-0.0293***	-0.0289***	-0.0328***	0.0544**	-0.0320***	0.0556**
	(-3.24)	(-3.18)	(-3.03)	(2.42)	(-2.93)	(2.41)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
State Controls	No	Yes	No	No	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	12,282	12,210	10,322	1,960	10,252	1,958
adj. R^2	0.367	0.368	0.368	0.406	0.368	0.405
Compare Non-PC and PC subsamples (interaction term)						
Coefficients compared			(3)	(4)	(5)	(6)
Chi-squared			12.27		11.70	
p-value			0.0005		0.0006	

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. SmallMedium is a dummy variable, equal to 1 if the firm falls into the lower two terciles of firm size, 0 otherwise. t-statistics using standard errors clustered by state and year are in parentheses.

5.7. Pre- and Post-Political Connections

Another approach I use to address endogeneity is to compare firms that initiate lobbying or making campaign contributions during my sample period (treatment group) to firms that never engage in lobbying or making campaign contributions (control group). I call this my pre- and post-political connections formation analysis. I define connected firms (*Connected*) using an indicator variable, equal to 1 if the firm lobbies or makes campaign contributions at any time during its life, 0 otherwise. I then match connected firms in their first year of lobbying or making campaign contributions to non-connected firms in the same year and industry based on firm size (*Size*), market-to-book ratio (*MTB*), and performance (*ROA*). I define my post-political connection formation period (*Post*) using an indicator variable, equal to 1 if it is during or after the initial year of lobbying or making campaign contributions for the firm. I assign the same post-period to its corresponding match in the control group.

My main variable of interest is the interaction term, *Post*Connected*Corruption*. Results for my before and after political connections formation analysis are presented in Table 5.11. If political connections mitigate the effects of operating in a corrupt environment, then I expect to see a significant and positive relation between *lnGuidance* and *Post*Connected*Corruption*. This would suggest that the negative influence of operating in a corrupt environment on voluntary disclosure is only mitigated after the formation of political connections. Results are consistent with my expectations (column (1)) and are robust to the inclusion of state-level controls (column (2)).

Table 5.11 Pre- and Post-Political Connections Analysis

	(1) lnGuidance	(2) lnGuidance
Post	0.3179***	0.3085***
	(4.23)	(4.09)
Corruption	-0.0227	-0.0275
	(-1.31)	(-1.54)
Connected	-0.1233	-0.1247
	(-1.37)	(-1.38)
Post*Connected	-0.2019	-0.2032
	(-1.59)	(-1.60)
Connected*Corruption	0.0409	0.0426
	(1.55)	(1.61)
Post*Corruption	-0.0442*	-0.0429*
	(-1.75)	(-1.70)
Post*Connected*Corruption	0.0714*	0.0755**
	(1.87)	(1.98)
Controls	Yes	Yes
State Controls	No	Yes
Industry FE	No	No
Year FE	Yes	Yes
N	1,802	1,802
adj. R^2	0.329	0.330

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. Corruption is equal to the number of corruption convictions of public officials made in a state during year t, divided by the population of the state in millions. Connected is a dummy variable, equal to 1 if the firm lobbied or made campaign contributions at any time during its life, 0 otherwise. Post is a dummy variable, equal to 1 if it is during or after the initial year a firm either lobbies or makes campaign contributions, 0 otherwise. t-statistics using standard errors clustered by state and year are inparentheses.

5.8. Change in Headquarters

One potential concern for my main analysis (Table 5.1) is the endogeneity associated with the choice to locate in a more corrupt environment. I use two approaches to address this concern. First, I exclude all firms that change headquarters during the sample period from my analysis. My results (untabulated) are robust to the exclusion of such firms. Second, I perform a difference-in-differences analysis comparing the two years before and after a firm, politically connected vs. non-politically connected, switches headquarters from a more corrupt environment to a less corrupt environment. I compare firms that change from a more corrupt environment to a less corrupt environment (treatment group) to firms that never change environments (control group) during my sample period. I match treatment firms to control firms during the year of the treatment firm's headquarter change based off of firm size (*Size*) and firm performance (*ROA*). To allow for a greater sample size, I perform the match using a caliper of 0.01. I designate the post-change period using an indicator variable, *PostChange*, set equal to one for years after the year in which a firm changes headquarters from a more corrupt environment to a less corrupt environment, zero otherwise. My main variable of interest is the interaction term, *PostChange*PC*. If politically connected firms increase their voluntary disclosure levels as corruption in the environment increases, then I expect PC firms that change headquarters from a more corrupt environment to a less corrupt environment will decrease their overall voluntary disclosure levels. That is, I expect that the coefficient estimate on *PostChange*PC* will negative and significant.

My results, shown in Table 5.12 below, indicate that prior to switching to a less corrupt environment, politically connected firms offer more voluntary disclosure compared to their non-politically connected counterparts (i.e., the coefficient estimate on *PC* is positive and significant). This is consistent with my argument that politically connected firms experience weaker incentives to reduce disclosure in more corrupt environments. My findings also indicate that after PC firms switch to a less corrupt environment, they offer incrementally less voluntary disclosure (i.e., the coefficient estimate on *PostChange*PC* is negative and significant). This supports the argument that more corruption in the environment induces PC firms to increase their voluntary disclosure levels. Thus, switching from a more corrupt environment to a less corrupt environment decreases the incentive for PC firms to increase voluntary disclosure, although the overall amount of voluntary disclosure does increase (as shown by the positive and significant coefficient on the *PostChange* variable).

Table 5.12 Change in Headquarters Analysis

	(1) ΔlnGuidance
PostChange	0.3951***
	(2.68)
PC	0.7922**
	(2.13)
PostChange*PC	-0.6532*
	(-1.75)
Controls	Yes
Industry FE	No
Year FE	No
N	146
R^2	0.582

The sample includes all non-utility, non-financial domestic firms with available data. The input variables are winsorized at 1% and 99%. PostChange is a dummy variable, set equal to 1 for years after the year in which a firm changes headquarters from a more corrupt environment to a less corrupt environment, 0 otherwise. PC is a dummy variable, equal to 1 if the firm had lobbying expenditures or made campaign contributions during the year, 0 otherwise. t-statistics using standard errors clustered by state and year are inparentheses.

6. CONCLUSION

The purpose of my study is to investigate whether political connections, defined as corporate lobbying and campaign contributions, mitigate the incentive for firms in corrupt environments to decrease voluntary disclosure. For this paper, a corrupt environment refers to a state with a high public official corruption conviction rate per capita. In these environments firms have incentives to decrease voluntary disclosure in order to reduce the likelihood of facing illegal expropriation by public officials. I argue that if a firm develops a political connection, i.e. a *legal* and public relationship with a politician, that firm obtains a form of political protection from the connected official and thus faces a lower likelihood of illegal expropriation. At the same time, by establishing a political connection in a corrupt environment, the firm also faces an increased demand from investors for greater disclosure. Both the lower likelihood of illegal expropriation and the increased investor demand for disclosure work to weaken the incentives a firm has to reduce voluntary disclosure when operating in a corrupt environment.

Consistent with my expectations, I find that the known negative relation between corruption in the environment and voluntary disclosure is moderated in the presence of political connections. My results suggest that political connections appear to successfully reduce incentives for firms to decrease voluntary disclosure when operating in corrupt environments. Additionally, I find evidence indicating that this moderation appears to be partially driven by greater investor demand for disclosure in general and politically-related disclosure in particular. I also find evidence that the moderating impact of political connections extends to corporate policies other than disclosure as well (i.e., firm cash holdings and leverage policies). Overall, my findings offer insight into a mechanism through which firms can offset potential influences from operating in a corrupt environment.

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APPENDIX A

VARIABLE DESCRIPTIONS

Variable	**Definition**
Acquisitions	Equals cash outflow relating to acquisitions scaled by total assets (AQC/AT)
lnAnalyst	Equals the logarithm of the number of analysts following the firm during the fiscal year
BoardSize	Equals the logarithm of the total number of members on the board of directors
BusCount	Equals the total number of operating (business) segments
CapEx	Equals capital expenditures divided by total assets (CAPX/AT)
Cash	Equals cash and cash equivalents divided by total assets (CHE/AT)
CEODuality	An indicator variable, equal to 1 if the CEO was also the chairman of the board during the year, 0 otherwise
Corruption	Equals the corruption conviction rate of public officials per capita (i.e., the ratio of the number of corruption convictions of public officials to population of the state in millions) for the state the firm is headquartered in during the fiscal year
Education	Equals the percent of the total population 25-years and over with a bachelor's degree or higher per state
Distress	Equals the firm's modified Altman-Z Score (i.e., probability of bankruptcy); calculated as 3.3*(IB/AT) + (SALE/AT) + 1.2*(ACT/AT) + 1.4*(RE/AT)
Div	An indicator variable, equal to 1 if the firm pays a dividend in year t, 0 otherwise

GeneralDisclosure	Equal to the logarithm of the number of proposals made by shareholders during the year that relate to any type of disclosure
GeoCount	Equals the total number of geographic segments
Independence	Equals the percentage of the board of directors that consists of independent members
Leverage	Equals the sum of long-term debt and debt in current liabilities divided by total assets ((DLTT+DLC)/AT)
Litigation	An indicator variable, equal to 1 if the company operates in a high litigation industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961 and 7370–7374), 0 otherwise
Loss	An indicator variable, equal to 1 if the firm's net income for the year (NI) is less than zero, 0 otherwise
lnGuidance	Equals the natural logarithm of one plus the number of management guidance disclosures of earnings and sales issued during year t
lnIncome	Equals the logarithm of median income per state for the year t
Loss	An indicator variable, equal to 1 if the firm's net income for the year (NI) is less than zero, 0 otherwise
MktShare	Equals the percentage of the firm's total sales (SALE) to the total Fama-French 48 industry sales
MTB	Equals the market to book ratio (PRCC_F*CSHO/CEQ)
PC	An indicator variable, equal to 1 if the firm has lobbying expenditures or made campaign contributions during the fiscal year, 0 otherwise
PoliticalDisclosure	Equal to the logarithm of the number of proposals made by shareholders during the year that relate to political disclosure
R&D	Equals research and development expenses scaled by total sales (XRD/SALE)

ROA	Equal to income before extraordinary items divided by total assets (IB/AT)
SalesGrowth	Equal to the percent change in sales from year t-1 to t
Size	Equal to the logarithm of the total assets (AT) of the firm