Abstract
We use a panel of 4979 cross-border and domestic takeovers to test the relation between host country corruption and premiums paid for local targets. Host country corruption is negatively associated with target premiums, after correcting for other governance related factors such as political stability, legal systems, and financial disclosure standards. We estimate that deterioration in the corruption index by one point (on a ten point scale) is, on average, associated with a reduction of 21% of local targets' premiums. Our results do not support the notion that local corruption constitutes a significant market barrier to foreign investors. It rather represents a discount on local takeover synergies, which affects foreign and domestic acquirers alike. However, we find that the major effects of corruption can alternatively be explained by government effectiveness, pointing towards an endogenous relationship between bribery and bureaucracy.