

Local Happiness and Financial Misconduct: Does Happiness Reduce Organizational Opportunistic Behavior?

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Abstract

This study examines the impact of local happiness on corporate financial misconduct. Using the large-scale survey data to measure local happiness, we find that firms headquartered in happier regions are less likely to engage in financial misconduct. Our mechanism analysis shows that happy surroundings promote forward-looking thinking and the ability of self-control, which explains the mitigating effect of local happiness on corporate misconduct. Moreover, the local happiness effect is more salient when firms' monitoring mechanisms are weak, and when firms are in regions with a lower level of marketization. Our results highlight that happiness, a measure of subjective well-being, can serve as a substitute for formal institutions to alleviate organizational misconduct, especially when formal institutions are weak.

Key words: Local happiness; forward-looking thinking; self-control; organizational misconduct

JEL Classification: G34; D01; M41

1. Introduction

There is a growing interest in better understanding the factors that affect organizational misconduct (Carberry et al., 2018; Larkin et al., 2021). Organizational misconduct takes on many forms, among which, financial misconduct significantly damages the soundness of organizations (Graham et al., 2005; Roychowdhury, 2006; Brown et al., 2016; Khanna et al., 2021), but unfortunately, financial misconduct is common in organizations (Khanna et al., 2021). Literature highlights that misconduct behavior needs to be understood in a social, legal, political, and economic context (Davis and Pesch, 2013). Motivated by the importance of social environment, this study examines the impact of local happiness on corporate financial misconduct.

Happiness, a measure of subjective well-being, refers to the evaluation of individual positive emotions and cognitive on their own life (Diener et al., 2018). Subjective well-being plays an important role in the behavior choice of individuals in organizations and influences the evolution of relevant socialization problems (Kingdon and Knight 2007; Bakker and Oerlemans, 2011; Binder, 2016; Clark et al.2019). For example, life- and self-evaluation has demonstrated huge impacts on human health and productivity (Helliwell, 2006; Graham et al., 2009; De Neve and Oswald, 2012). Being happy sometimes may serve as a therapy for many human difficulties, while on the contrary, suffering from negative emotions has been a very serious issue throughout the world (Ifcher and Zarghamee, 2011). In the era of extreme uncertainty caused by COVID-19, happiness may function as an efficient force for achieving sustainable organizational development. Different from the existing studies that investigate the impact of happiness at both the personal and macroeconomic level (Helliwell, 2006; Graham et al., 2009; De Neve and Oswald, 2012; DiMaria et al., 2020), this study aims at adding evidence on the impact of subjective well-being factors at firm level by exploring the relationship between local happiness and financial misconduct (the managerial opportunistic behavior). The research topic is of great importance and interest to better understand whether and how subjective well-being factors influence opportunistic behavior in organizations.

Our research is also motivated by the studies demonstrating that social environmental factors play a big role in shaping organizational behavior (Chuluun and Graham 2016; Dong et al., 2018; Dyreng et al., 2012; Jha and Chen, 2015; Jha, 2019). Two streams of theories support the empirical evidence. First, local environment factors can serve as an informal institution to regulate organizational behavior, and therefore, the cross-region cultural differences influence the behavior of firms headquartered in the region (Eun et al., 2015). Second, the social norm theory argues that individuals avoid deviations from the proper behavior of their surroundings

because people may develop disagreeable or even guilty feelings if the deviation between individual behavior and what is happening surrounding is big (Dyrenge et al., 2012).¹

We expect that a higher level of local happiness is associated with a lower incidence of financial misconduct based on the above two streams of literature. First, in line with the effect of informal institution argument, literature documents that positive emotion, for example happiness, promotes responsible organizational behavior and enhances the ability of self-control (Isen and Reeve 2005), on the contrary, unhappiness induces breakdowns in self-control (Baumeister and Exline, 2000). Meanwhile, Erez and Isen (2002) indicate that happy people are willing to put forth effort because they believe the effort will generate good results. Given the positive effects of happiness, we expect that local happiness can serve as a regional cultural force that enhances organizational self-control and induces longer-run motivations (Ifcher and Zarghamee, 2011), which in turn, discipline opportunistic behavior in organizations. Second, in line with the social norm theory, we expect that managerial behavior conforms to social norms adhered to by the reference group (Dyrenge et al., 2012; Dong et al., 2018). Managers surrounded by happier reference group will be more long-term motivated and equipped with better self-control ability (Isen and Reeve, 2005; Ifcher and Zarghamee, 2011), both of which reduce opportunistic behavior in organizations.

The Chinese market is suitable for our research question for two main reasons. First, an intra-country analysis captures the impact of local happiness on financial misconduct without the interrupt of the issues that challenge cross-country studies, for example, the differences on legal and tax system, capital market regulation, and codes of corporate governance (Li et al., 2017; Dong et al., 2018). In this study, the level of regional average happiness is calculated based on the Chinese General Social Survey (hereafter, CGSS) published by National Survey Research Center (hereafter, NSRC) for the period from 2003 to 2016. Our summary statistics verify the large variations in local happiness across regions in China,² which is essential for examining the influence of local average happiness on firm decisions. Our results are in line with Wu et al. (2014) and Ang et al. (2015) who document the large regional heterogeneity in

¹ Warren and Schweitzer (2021) indicate that organizational constraints and psychological factors are of great significance in deterring misconduct, even though when the economic sanctions are weak. As such, top executives conform to social norms adhered to by the reference group surrounding them (Dyrenge et al., 2012; Dong et al., 2018).

² The National Survey Research Center conducted the Chinese General Social Survey in 31 provinces in mainland China. As shown in Figure 1 of this study, the variation in regional average happiness in China is big, with higher happiness score in Jiangsu, Shanghai, Anhui and Zhejiang and lower happiness level in Gansu and Ningxia. The result is in line with Ang et al. (2015), which suggests that the differences of social conditions across the 31 provinces of China tend to be larger than those in 13 European counties included in their sample, indicating large regional heterogeneity in China.

China, including differences on socioeconomics, ethnicity, culture, language, and philosophy. Second, financial misconduct is a serious legitimate concern in China due to its weak institution settings. As the largest emerging economy, governance mechanisms and law enforcement in China is still far from efficient (Allen et al., 2005; Liao et al., 2018). It is argued that informal institutions can serve as a substitute for formal institutions in shaping corporate behavior especially when formal institutions are weak (Pevzner et al., 2015). Therefore, the substitution role of local happiness is more likely to be captured in the Chinese market due to its weak formal institutions.

Using a big sample of 2,347 Chinese listed firms for the period from 2003 to 2017, we find firms headquartered in happy regions carry out less financial misconduct. Our results are robust when using an alternative measure of local happiness, which captures residual happiness by excluding the effect of demographic determinants of individual happiness (Su et al., 2022), e.g., individual age, gender, marital and employment status, health, education, and property ownership. The residual happiness variable allows us to obtain a “pure” local happiness measure to examine the local happiness effect on financial misconduct. We also exclude the influence of CEO’s hometown happiness to further check the robustness of results, and our baseline results still hold.

We conduct several estimations to address endogeneity concerns. It is possible that residents in happy regions have better education and are more likely to have religious belief, which may explain the low incidence of financial misconduct in happy regions. In addition, some factors such as regional economic development and government regulation may affect both the level of local happiness (Chuluun and Graham, 2016) and the incidence of financial misconduct (Liu, 2016). First, following Espenshade (1979) and Stack and Eshleman (1998), we employ the regional divorce rate, which affects local happiness but is not directly associated with misconduct, as the instrumental variable to perform a two-stage least squares (2SLS) estimation and our baseline results remain robust. Second, we add regional level variables, e.g., social trust, religion, and corruption culture, in the baseline regression to address the effect of regional factors that may affect financial misconduct (Dong et al., 2018; Li et al., 2017; Liu, 2016). We also control for additional macroeconomic factors, such as the provincial measures of GDP growth, population growth rate, education, the percentage of female population, and the supervision of financial markets, which may affect corporate opportunistic behavior (Hilary and Hui, 2009; Almazan et al., 2010; Becker et al., 2011; Dougal et al., 2015; Chuluun and Graham, 2016). Our baseline regression controls for industry and year fixed effects, for robustness checks, we also control for firm fixed effects and industry×year fixed effects.

Additionally, we address the intensity of local happiness using the propensity score matched sample to re-estimate our baseline regression. Our findings remain robust after all the above analyses.

We estimate the economic mechanisms through which local happiness affects financial misconduct. First, we examine the relationship between happiness and long-term perspectives and the ability of self-control at personal level. The results indicate that happy people tend to have more long-term perspectives and better ability of self-control. Using survey data obtained from the CGSS database, long-term perspective is measured based on the respondents to the survey question: “I tend to plan ahead.” The ability of self-control is constructed based on the question: “Spending tomorrow’s money to achieve today’s needs, overdraft consumption is common for me.” Furthermore, we provide firm-level evidence that happiness increases firm long-run motivation proxied by accounting conservatism, in addition, happiness enhances managerial self-control measured by spending on entertainment and travel costs (ETCs). Further heterogeneity analysis shows that the local happiness effect varies across firm characteristics, monitoring mechanisms, and regional marketization. We find the happiness effect is stronger when monitoring mechanisms are weak, and when firms are located in regions with lower marketization. The results indicate that the effect of local happiness is more salient in firms with weak formal institutions.

This study first contributes to the growing literature on understanding how subjective wellbeing factors influence financial misconduct, which is highly associated with the soundness of organizations. We find that local average happiness, a subjective wellbeing factor, explains opportunistic behavior in organizations, which is an important expansion of the literature on the role of social factors in disciplining managerial opportunistic (Dyreng et al., 2012; Dong et al., 2018; Jha, 2019; Chen et al., 2020). While prior research has examined the impact of happiness on human health, productivity and macroeconomic development, empirical evidence on the impact of happiness on organizational decisions is still very limited. Our study contributes to the literature on whether and how subjective well-being factors opportunistic behavior in organizations. Our study provides direct empirical support to the statement that misconduct needs to be understood in a social context (Davis and Pesch. 2013).

Second, this study reveals that opportunistic behavior in organizations can be mitigated by individual’s long-term perspectives and better ability of self-control. Using the unique survey data obtained from the CGSS database, we find happy surroundings induce long-term perspectives and better self-control at the personal level, which in turn, mitigates opportunistic behavior in organizations. Our results demonstrate that happiness promotes ethical behavior in

organizations.

In addition, our study makes an important contribution to the misconduct literature by providing evidence that informal institutions can serve as a substitute to discipline opportunistic behavior in organizations especially when formal institutions are weak. Our paper expands existing studies on the impact of formal governance institutions on organizational misconduct, such as board characteristics, analyst coverage, ownership structure (Bushman et al., 2006; Albrecht et al., 2015; Chakrabarty et al., 2015; Hass et al., 2016; Raval, 2018). We find that on one hand, happiness, an informal institutional factor, mitigates financial misconduct, while on the other hand, formal institutional mechanisms (such as board independence and institutional ownership) can moderate the impact of local happiness on financial misconduct. Our study enriches the growing literature on the substitution between social and governance factors in the context of opportunistic behavior (Liu, 2016).

The remainder of this paper is organized as follows. Section 2 presents the literature review and hypotheses development. Section 3 introduces the data, variable construction, and research design. Section 4 reports the empirical results and addresses endogeneity concerns. Section 5 discusses the mechanism analysis. Section 6 examines the heterogeneous impact of local happiness on financial misconduct. Section 7 concludes the study.

2. Literature review and hypothesis development

2.1. Social environment and organizational behavior

Environment factors play an important role in shaping firm behavior in a variety of contexts. The empirical evidence is supported by two streams of theories. First, regional environment factors can serve as informal institutions to regulate organizational behavior (Du, 2013; Wu et al., 2014; Eun et al., 2015; Xia et al., 2017). Informal institutions such as social trust, religiosity and cultural forces can function as an alternative mechanism to formal systems and play a substitutive role in shaping organizational behavior because regional culture permeates individual corporate culture (Jha, 2019) and therefore can influence corporate behavior. The second stream of argument is based on the social norm theory which has been widely applied in business ethics research (Blay et al., 2018). Social psychology studies suggest that social norms guide human behavior via the perception of how most others would approve, and therefore, norms affect human behavior systematically and significantly (Milgram et al. 1969; Cialdini et al. 1991). Individuals act in ways that conform to the behavioral norms of their associate groups (Bicchieri, 2006; Dyreng et al., 2012), so ethical concerns can serve as

an “internally mediated” form of control (Blay et al., 2018). Like formal institutions can constrain behaviors, social norms can also discipline individual behaviors (Campbell, 2004; Griffin & Sun, 2018). That is, organizational behavior is affected by the social norms conformed by surrounded reference group (Dyrenge et al., 2012; Dong et al., 2018).

Importantly, environmental factors tend to be localized, thereby, disciplining corporate behavior in the same region (Jha and Chen, 2015; Callen and Fang, 2015; Jha, 2019; Chen et al., 2020). As discussed, preferences and attitudes of corporate executives are influenced by social norms of the region (Dyrenge et al., 2012; Dong et al., 2018). In addition, the regional environment shapes corporate culture of the region, which in turn, affects corporate decision-making (Jha, 2019). Empirical evidence shows that regional social trust can reduce earnings management and improve the quality of financial reporting (Li et al., 2017; Jha, 2019), while the lack of trust increases the fees that the auditors charge (Jha and Chen, 2015). Moreover, literature suggests that greater religion intensity is associated with higher financial reporting quality (Grullon et al., 2009; Dyrenge et al., 2012) and less earnings manipulation (McGuire et al., 2012). Furthermore, Parsons et al., (2018) find that political corruption can explain the geographic cross-section of financial misconduct.

2.2. Local happiness and financial misconduct

Inspired by literature showing that regional environmental factors can serve as informal institutions that discipline firm behavior (for example, Du, 2013; Wu et al., 2014; Xia et al., 2017), especially in regions where formal institutions are weak (Kong et al., 2021), we study whether regional happiness reduces financial misconduct of firms in the region.

Consistent with the literature on informal institutions (North, 1990; Allen et al., 2005; Du, 2013; Wu et al., 2014; Xia et al., 2017), local happiness as an important local environment factor is expected to serve as an informal institution that enhances corporate governance and regulates organizational opportunistic behavior. Happiness refers to people’s evaluation to the multidimensional living conditions, including natural environment, civilization degree, education and health serves, public security, living convenience, economic development, and others (Diener, 2000; Diener et al., 2018). Studies suggest that happiness induces forward-looking thinking and actions (Ifcher and Zarghamee, 2011) and improves the ability of self-control (Isen and Reeve, 2005). In addition, happiness is positively correlated with ethics (Frank, 1999; James, 2011), and negatively correlated with violent or illegal behavior (Valois et al., 2001). Given the positive effects of happiness on individual behavior, local happiness, as an important regional factor, may also have strong influences on corporate decision-making. In particular, a higher level of local happiness may induce organizational long-term motivations

and better self-control ability, which in turn, reduce opportunistic behaviors, such as financial misconduct.

More importantly, in line with the argument based on the social norm theory, environmental factors tend to be localized and function as social norms to regulate corporate behaviors (Campbell, 2004; Dyreng et al., 2012). Individuals behave in ways that conform to the behavioral norms of their associate groups (local reference group) and avoid deviations from proper behavior from their surroundings (Dyreng et al., 2012; Dong et al., 2018). Literature documents that happiness spread across social networks and contribute to the increase of regional average happiness (Fowler and Christakis, 2008; Harbi and Grolleau, 2012). Happy people are found to be more willing to connect with others, and therefore, the clustering of happiness is statistically significant (Fowler and Christakis, 2008).

Literature also demonstrates that happiness is positively correlated with ethics (Frank, 1999; James, 2011), and negatively correlated with violent or illegal behavior (Valois et al., 2001). Moreover, Guven (2011) suggests that happy people engage in more volunteer work, attend more community and cultural events, and have higher charitable giving. Happiness is found to be correlated with more participation in social governance, such as political elections (Xu et al., 2010; Jackson, 2019). Lane (2017) provides an extensive review and indicates that, in general, there is a negative association between happiness and selfishness and a positive association with trust. In addition, positive emotions generated from happiness can improve the quality of social production (Oswald et al., 2015). Combined with the evidence that happiness promotes long-term thinking and actions (Ifcher and Zarghamee, 2011) as well as enhances better self-control ability (Isen and Reeve, 2005), managers surrounded by a happy reference group tend to be more long-term motivated and equipped with higher self-control, thereby, reduce opportunistic behaviors.

To our knowledge, there is no prior study that investigates the relationship between happiness and corporate financial misconduct, although misconduct seriously damage the soundness of financial markets and organizations. To fill this gap, this paper examines the impact of local average happiness on financial misconduct in depth.

Due to the highly concentrated ownership structure of Chinese listed firms and the fact that the government has the ultimate control over company decisions in China, researchers always view the corporate governance in the Chinese listed firms are relatively weak (Li et al., 2017; Kong et al., 2021). In addition, external governance mechanism such as auditing quality and investor protection is also weak in the Chinese stock market (Li et al., 2017). Organizational opportunistic behavior is a serious concern in Chinese listed firms, which harm the interests of

organizations and the efficiency of financial markets (Dong et al., 2018). Previous literature has investigated the role of formal institutions in mitigating financial misconduct and has found mixed evidence (Liu, 2016). As discussed in Peng et al. (2009), once formal institutions are absent or weak, informal institutions will gain importance. Thus, we expect that local happiness is likely to play a role in mitigating the opportunistic behavior in organizations, where corporate governance mechanisms and legal enforcement is relatively inefficient. Based on the above analysis, we propose the following hypothesis:

Hypothesis 1: Firms located in happier regions are associated with less engagement in financial misconduct, *ceteris paribus*.

3. Data and methodology

3.1. Transparency and openness

We describe our sampling plan, all data exclusions (if any), all manipulations, and all measures in the study, and we adhered to the Journal of Applied Psychology methodological checklist. Materials for this study are available by emailing the corresponding author. Data are not available due to their proprietary nature. Data were analyzed using Stata 15. The study design was not preregistered.

3.2. Data source and sample selection

The initial sample of this study includes all companies listed in the Shanghai and Shenzhen Stock Exchanges from 2003 to 2017. The sample period is from 2003 to 2016 for the local happiness measure and control variables, and from 2004 to 2017 for financial misconduct measures. Local happiness is measured based on the survey question about life satisfaction collected from the CGSS³ database. “*Happiness*” is constructed based on the responses to the question: “Overall, do you feel happy about your life?”. The level of happiness is scaled as 1 to 5, including: very unhappy (1); unhappy (2); neutral (3); happy (4); and very happy (5). The survey data is available for nine years, including 2003, 2005, 2006, 2008, 2010, 2011, 2012, 2013, and 2015. We use the data of the latest survey-year as the proxy for the following non-survey-year in the regression analysis considering that the overall subjective change of regional

³ The CGSS database, first launched in 2003, is a nationwide, comprehensive, and continuous large-scale social survey project. CGSS data is constructed by distributing questionnaires to Chinese residents in 31 provinces. Sufficient valid responses were received in each survey year, for example 10,968 valid responses received in 2015. The survey questions cover all aspects about Chinese society, summarize the long-term development of social environment, explore the major social issues of theoretical and practical significance, and therefore, provide unique data for Chinese social science research.

average happiness should not be significant in a short period.⁴

We use China Security Regulatory Commission (CSRC) enforcement actions to classify financial misconduct. All data of CSRC enforcements are collected from the China Stock Market and Accounting Research (CSMAR) database and the Chinese Research Data Services Platform (CNRDS) database. The accounting and financial data are obtained from the CSMAR and WIND databases. We also manually collect the CEOs' hometown information if it is not available in the databases mentioned. Following Dong et al. (2018), we exclude financial firms and special treatment (ST) firms. We remove observations with missing information and all continuous variables are winsorized at the 1% and 99% level. The final sample consists of 20,218 firm-year observations of 2,347 firms.

3.3. Variable construction

3.3.1. Financial misconduct

The CSRC performs the regulatory function in Chinese financial markets, including deploying enforcement actions to financial misconduct and other serious violations. The CSRC makes individual announcement for each enforcement action about the violation year, enforcement year, and the type of enforcement action. In general, financial misconduct is categorized as the follows, e.g., profit inflation, asset fabrication, misleading statements, disclosure delay, major omission, non-truthful disclosure, assets expropriations, illegal share buybacks, stock price manipulation, and irregular guaranties (Ren et al., 2021). Following Ren et al. (2021), we construct *Foccur*, a dummy variable equals one if the firm has committed at least one financial misconduct action in the observation year, and zero otherwise. We also employ two additional misconduct variables including *Ffreq*, which refers to the number of enforcement actions taken by the CSRC against the firm in a fiscal year; *Fdegree* refers to the severity of the CSRC enforcement actions scaled from 0 to 3, e.g., no punishment (0); public criticism (1); public condemnation (2, including condemnation and warning); and public punishment (3, including fine, confiscation of illegal income and market ban), respectively. Following Ren et al. (2021), the published violation year is employed to identify the year of financial misconduct.

3.3.2. Local Happiness

As discussed, the level of individual happiness is measured based on the responses to the question: "Overall, do you feel happy about your life?". We compute "*Local Happiness*" score

⁴ For robustness checks, we use the sample only includes the surveyed years for regression analysis, and the results are quantitatively similar to those tabulated.

by averaging all the responses from a given region (province, autonomous region, and municipality level) where the listed firm is headquartered.⁵

3.3.3. Firm-level control variables

Following the literature (Liu, 2016; Dong et al., 2018; Ren et al., 2021), we employ a series of firm-level variables to control for factors that may explain financial misconduct, including market value of equity (*Size*), book-to-market ratio (*BM*), financial leverage (*Lev*), return on assets (*ROA*), growth capacity (*Growth*) and managerial ownership (*Mgshare*). A dummy variable *Loss* is included, which equal to one if the income before the extraordinary items is less than zero in two years prior to the observation year, and zero otherwise. We also control for cash flow volatility (*VolatilityofCashflow*), firm listing age (*Age*), analyst coverage (*Analyst*) and *Big4* dummy that equals one if the firm hires a Big 4 auditor, and zero otherwise. The variable definitions are presented in Appendix A.

3.4. Regression model

To examine the relationship between local happiness and financial misconduct, we use the following model:

$$\begin{aligned} & \text{Financial Misconduct}_{i,t+1} \\ & = \beta_0 + \beta_1 \text{Local Happiness}_{i,t} + \sum_k \beta_k \text{Controls}_{k,i,t} + \epsilon_{i,t+1} \end{aligned} \quad (1)$$

where *Financial Misconduct*_{*i,t+1*} refers to the measures of financial misconduct of firm *i* in year *t+1*, including *Foccur*_{*i,t+1*}, *Ffreq*_{*i,t+1*}, and *Fdegree*_{*i,t+1*}. *Local Happiness*_{*i,t*} refers to the local happiness measure, and *Controls*_{*k,i,t*} is a set of control variables, including *Size*_{*i,t*}, *BM*_{*i,t*}, *Lev*_{*i,t*}, *ROA*_{*i,t*}, *Growth*_{*i,t*}, *Mgshare*_{*i,t*}, *Age*_{*i,t*}, *Loss*_{*i,t*}, *VolatilityofCashflow*_{*i,t*}, *Analyst*_{*i,t*}, and *Big4*_{*i,t*}. Industry and year fixed effects are controlled for to estimate the regressions.

4. Empirical results

4.1. Descriptive statistics

Table 1 reports the summary statistics and correlation coefficients. Panel A reports the descriptive statistics of the variables. Local average happiness has a mean of 3.786 and a median of 3.796, both are close to the answer of “happy (4)” to the survey question. The minimum

⁵ Our sample includes firms from 22 provinces (e.g., Hebei, Shanxi, Liaoning, Jilin, Heilongjiang, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong, Henan, Hubei, Hunan, Guangdong, Hainan, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, Qinghai), five autonomous regions (Xinjiang, Tibet, Ningxia, Inner Mongolia, Guangxi) and four municipalities (Beijing, Tianjin, Shanghai, Chongqing) in mainland China.

value of *Local Happiness* is 3.195 which is close to “neutral (3)”, and the maximum value is 4.340, between “happy (4) and “very happy (5)”. The mean of *Foccur* is 6.3%, indicating that 6.3% of Chinese listed firms engage in at least one financial misconduct during the sample period. On average, the mean of frequency of misconduct per year and severity of misconduct (scaled from 0 to 3) is 0.085 and 0.132, respectively.

Panel B reports the Spearman (above diagonal) and Pearson (below diagonal) correlation coefficients. *Local happiness* is significantly and negatively correlated with the three financial misconduct measures (*Foccur*, *Ffreq* and *Fdegree*), providing preliminary evidence supporting *H1*. The pairwise correlation matrix of the key variables do not suggest any serious multicollinearity concerns.

[Insert Table 1 about here]

4.2. Baseline results

We report the results of the impact of local happiness on financial misconduct in Table 2. Local average happiness is negatively associated with the three measures of financial misconduct (*Foccur_{t+1}*, *Ffreq_{t+1}* and *Fdegree_{t+1}*), and the relationships are all significant at the 1% level (in Columns 1 to 3) after controlling for firm characteristics and industry and year fixed effects. The negative relationship between local happiness and financial misconduct is also economically significant. For example, the coefficient on *Local Happiness_t* (in Column 1) is -0.342, which suggests that a one standard deviation increase in the score of local happiness reduces the likelihood of financial misconduct (*Foccur_{t+1}*) by 33.07%.⁶ Column 2 examines the relation between local happiness and frequency of financial misconduct, which is measured by the number of the CSRC enforcement actions of the firm in a fiscal year. The coefficient on *Local Happiness_t* is -0.042, indicating that a one standard deviation increase in the local happiness is associated with a 2.47% decrease in the frequency of financial misconduct.⁷ In Column 3, the coefficient on *Local Happiness_t* (-0.039) indicates that a one standard deviation increase in the local happiness is associated with a 2.01% decrease in the severity of financial misconduct.⁸ These results suggest that local happiness reduces the incidence of financial misconduct. We argue that managers of firms located in happy regions are more likely to have forward-looking thinking and higher ability of self-control, which reduces the incentives to engage in opportunistic activities.

We find well-performing firms are less likely to engage in misconduct behavior, but firms

⁶ Economic significance is calculated as $0.342 \times 0.235 / 0.243$.

⁷ Economic significance is calculated as $0.042 \times 0.235 / 0.399$.

⁸ Economic significance is calculated as $0.039 \times 0.235 / 0.454$.

with higher growth opportunities tend to be more likely to commit misconduct. The significantly negative coefficient on *Mgsharet* suggests that financial misconduct decreases with the increase of managerial shareholding, which aligns shareholders' interests and managers' benefits. Moreover, a positive and significant coefficient on *Lev* indicates that highly levered firms tend to carry out more financial misconduct. In addition, the coefficient on *Volatility of Cashflow* is significantly positive, suggesting that firms with volatile cash flows are more likely to conduct misconductulent behavior. These results are generally consistent with existing studies, for example Liu (2016) and Dong et al. (2018).

[Insert Table 2 about here]

4.3. Addressing the impact of respondents' characteristics and CEO's hometown happiness

4.3.1. The impact of respondent's characteristics

Respondents' characteristics such as marital status, employment, health conditions, education, and household property ownership may have significant impacts on individual happiness level. Thus, the significantly negative influence of local happiness on financial misconduct may be driven by respondents' characteristics. Our local happiness measure will be able to capture the effect of local surroundings better if the impact of respondents' characteristics is addressed. Therefore, we test whether the impact of local happiness on financial misconduct is robust when controlling for the effect of respondents' characteristics on happiness. Following Graham et al. (2009) and Chuluun and Graham (2016), we construct "Residual Local happiness" variable that refers to the residuals from a regression where respondents' happiness is regressed on several demographic determinants of individual happiness.

Panel A of Table 3 reports the regression results of the determinants of individual happiness controlling for year fixed effects with standard errors clustered by province. The regression, is shown as follows:

$$\begin{aligned}
 \text{Individual Happiness}_i &= \beta_0 + \beta_1 \text{Individual_Age}_i + \beta_2 \text{Individual_Age}_i^2 + \beta_3 \text{Female}_i \\
 &+ \beta_4 \text{Married}_i + \beta_5 \text{Employed}_i + \beta_6 \text{Health}_i + \beta_7 \text{Education}_i \\
 &+ \beta_8 \text{Property ownership}_i + \varepsilon_i,
 \end{aligned} \tag{2}$$

where *Individual Happiness_i* is the measure of respondent's response to the following question: "Overall, how do you feel about your life?" The level of satisfaction is scaled as 1 to 5, including very unsatisfied (1); unsatisfied (2); neutral (3); satisfied (4); and very satisfied (5). We use seven variables to measure respondents' demographic characteristics that are shown to

impact individual happiness (Chuluun and Graham, 2016; Su et al., 2022). *Individual_Age* refers to the respondent's age.⁹ *Female* is a dummy variable equal to one if the respondent is female, and zero otherwise. *Married* is a dummy variable equals one if the respondent is married, and zero otherwise. *Employed* is a dummy variable equal to one if the respondent is employed, and zero otherwise. *Health* refers to the respondent's self-assessment of health condition, which is scaled from 1 to 5 as extremely bad (1); bad (2); neutral (3); good (4); and extremely good (5). *Education* indicates the highest level of education achieved by the respondent, which is scaled from 1 to 9 as no formal education (1); primary school (2); middle school (3); high school (4); senior high school (5); college (6); bachelor's degree (7); master's degree (8); doctor's degree or above (9). *Property ownership* is a dummy variable equal to one if the respondent owns a house, and zero otherwise.

We first regress *Individual Happiness_i* on *Individual_Age_i*, *Individual_Age_i²*, *Female_i*, *Married_i*, *Employed_i*, *Health_i*, *Education_i*, and *Property ownership_i*. The residual term ε_i can capture the components of happiness that might be shared across individuals in the same region but cannot explained by identified characteristic factors (Graham et al., 2004; Chuluun and Graham, 2016). Then, we obtain the residuals from the regression and construct *Residual Local Happiness_{i,t}* by averaging of the residuals of a given region where the listed firms are headquartered.

Panel A of Table 3 reports the results of determinants of individual happiness. It shows that respondents who are healthy, married, and employed have a higher level of happiness. Higher education and property ownership also enhances individual happiness. The negative coefficient on *Individual_Age* and positive coefficient on *Individual_Age_i²* suggests a U-shaped relation between age and happiness that is consistent with prior studies such as Graham et al. (2009). *Female* dummy is positively related to individual happiness suggesting women tend to be happier than men under the same setting (Graham and Chattopadhyay, 2013).

In Panel B, we use *Residual Local Happiness_{i,t}* constructed from Panel A to re-estimate the baseline regression. All controls are the same in Table 2. The model is shown as:

$$\begin{aligned}
 & \text{Financial Misconduct}_{i,t+1} \\
 &= \beta_0 + \beta_1 \text{Residual Local Happiness}_{i,t} + \sum_k \beta_k \text{Controls}_{k,i,t} \quad (3) \\
 &+ \varepsilon_{i,t+1}
 \end{aligned}$$

⁹ The regression results of adopting the logarithm value of respondents' age are quantitatively similar to those tabulated.

Panel B in Table 3 shows that the coefficients on *Residual Local Happiness_t* in Columns (1) to (3) are all significantly negative at the 5% level, with financial misconduct measured by *Foccur*, *Ffreq* or *Fdegree*, respectively. The results indicate that the components of happiness, which are not explained by demographic determinants of individual happiness and are shared across individuals in the same region, reduce financial misconduct significantly. We argue that this supports our expectation that contextual factors, happiness in this study, tend to be localized and influence firm accounting decisions.

[Insert Table 3 about here]

Overall, the results in Tables 2 and 3 reveal that local happiness, measured with or without addressing observable demographic characteristics that influence individual happiness, can reduce financial misconduct.

4.3.2. Addressing the influence of CEO's hometown happiness

It is possible that the level of CEO's hometown happiness may also affect our baseline results. We construct a *CEO's Hometown Happiness* variable to address this concern. The estimation is shown as:

$$\begin{aligned}
 \text{Financial Misconduct}_{i,t+1} &= \beta_0 + \beta_1 \text{Local Happiness} + \beta_2 \text{CEO's Hometown Happiness}_{i,t} \\
 &+ \sum_k \beta_k \text{Controls}_{k,i,t} + \epsilon_{i,t+1},
 \end{aligned} \tag{4}$$

We collect CEO's birthplace information from the CSMAR and CNRDS databases. We also manually collect the unreported CEO's hometown information from Baidu search engine. *CEO's Hometown Happiness_{i,t}* refers to the level of CEO's hometown happiness, based on the same survey question for constructing *Local Happiness*: "Overall, how do you feel about your life?"

It shows in Table 4 that *CEO's Hometown Happiness_t* is negatively associated with both *Foccur_{t+1}* and *Ffreq_{t+1}* in Columns (1) and (2). It suggests that the likelihood of engaging in accounting misconduct is low if the CEO is from a happy region. Importantly, the coefficients on *Local Happiness* are still negative and significant in Columns (1) to (3), when controlling for CEO's hometown happiness. The results confirm that happy surroundings motivate top management to pursue long-term gains, which reduce the engagement in financial misconduct.

[Insert Table 4 about here]

4.4. Endogeneity

Our baseline estimation adopts the lagged local happiness and control variables to regress

on financial misconduct measures, which may partially address endogeneity problem. However, as is discussed in Larkin et al. (2021), causal identification is indeed an inescapable issue in the misconduct or misconduct field. For example, it is reasonable to argue that financial misconduct may influence the happiness level of a region where a firm locates. The potential reverse causality between regional happiness and financial misconduct might be a concern of our baseline results. Meanwhile, the relationship between local happiness and financial misconduct could also be driven by other regional factors such as social trust, religiosity, and corruption culture. In addition, unobservable factors, for example local government interference, may affect both regional happiness and financial misconduct.

4.4.1. Controlling for the effects of regional factors

Prior studies document that regional factors such as social trust, religiosity and corruption culture has a significant influence on financial misconduct (Dong et al., 2018; Xu et al., 2017; Liu, 2016). Thus, the negative impact of local happiness on financial misconduct may be driven by other regional factors. To alleviate this concern, we include *Trust*, *Religion* and *Corruption* in the baseline regression for robustness checks. The data related to social trust and religion is obtained from the CGSS database. *Trust* is constructed according to the response to the following question: “In general, do you agree that most people are trustable in the society?” Answers are scaled from 1-5, including totally disagree (1); relatively disagree (2); neutral (3); relatively agree (4); and totally agree (5). *Religion* refers to the mean value of responses in a region to the survey question: “Do you believe religion?” with answers of No (0) and Yes (1) respectively. The variable *Corruption* indicates the number of officials who had been investigated in each city during Xi Jinping’s anti-corruption campaign started from 2012. Following Wang and Dickson (2020), the data to proxy corruption is obtained from the China’s Corruption Investigations Dataset of Harvard University, which provides the detailed information on about 20,000 officials who had been investigated since the anti-corruption campaign.¹⁰ We aggregate the data of all cities at the province level, which is used as an indicator of corruption culture of each province.

As shown in table 5, local happiness is significantly and negatively related to all financial

¹⁰ Wang and Dickson (2020) collected the data from Tencent, the largest Internet company in China. During Xi Jinping’s anti-corruption campaign, Tencent launched a searchable online database including all corruption investigations in China.

misconduct measures ($Foccur_{t+1}$, $Ffreq_{t+1}$ and $Fdegree_{t+1}$) after controlling for the effects of social trust, religiosity, and corruption culture. $Trust_t$ and $Corruption_t$ is negatively and positively associated with misconduct measures respectively, which is in line with the results of Dong et al., (2018) and Liu, (2016). Overall, the results in Table 5 indicates that our empirical results are robust when controlling for additional regional factors.

[Insert Table 5 about here]

4.4.2. Controlling for macro-economic variables

Literature suggests that macro-economic factors influence firm opportunistic behaviors (Chuluun and Graham, 2016; Li et al., 2017). Thus, to address the potential influence of regional macro-economic factors on financial misconduct, we control for provincial macro-economic factors to further check the robustness of our baseline results. We add five annual provincial variables, e.g., GDP growth rate ($GDP\%$), population growth rate ($POPG$), the proportion of population with college degree or above (EDU), the percentage of female population ($FEMALEP$), and government expenditure on financial supervision ($Supervision$) and re-estimate the baseline regression.

Table 6 shows that local happiness is significantly and negatively associated with financial misconduct measures in Columns (1) to (3), and our baseline results continue to hold when controlling for the regional macro-economic factors.¹¹ EDU is significantly and negatively related to misconduct measures. The coefficient on $Supervision$ is significantly negative, indicating that expenditure on financial supervision can reduce financial misconduct. We do not find evidence that GDP and $FEMALEP$ are significant determinants of financial misconduct.

[Insert Table 6 about here]

4.4.3. Controlling for multiple fixed effects

Following Gormley and Matsa (2014) and Liu (2016), we include firm fixed effects, and industry×year fixed effects to address the concern that unobserved firm characteristics and time-varying heterogeneity across industries that may affect financial misconduct. Given the large number of fixed effects included in the regression model, following Liu (2016), we estimate all regressions by ordinary least squares in Table 7.

The coefficients on $Local\ Happiness_t$ in Table 7 are all negative and significant at the 5% level after controlling for the multiple fixed effects in Columns (1) to (3). As for economic

¹¹ As for economic significance, a one standard deviation increase in local happiness measure is associated with a decrease of the incidence of financial misconduct, the frequency of financial misconduct, and the severity of misconduct by 0.334, 0.031, and 0.031, respectively.

significance, a one standard deviation increase in local happiness variable is related to a decrease in the incidence of financial misconduct, the frequency of misconduct, and the severity degree of misconduct of 0.306 ($=0.316*0.235/0.243$), 0.024 ($=0.040*0.235/0.399$), and 0.020 ($=0.038*0.235/0.454$), respectively. The significant regression coefficients indicate that our baseline results are robust when controlling for the multiple fixed effects.

[Insert Table 7 about here]

4.4.4. Instrumental variable approach

We further address the endogeneity concern by using the instrumental variable approach. Following Espenshade (1979) and Stack and Eshleman (1998), we use regional divorce rate (*Divorce*) as the instrumental variable for local happiness. As divorce reduces happiness (Chen, 2012), we expect a negative relationship between regional divorce rate and the local happiness variable, while regional divorce rate can hardly influence opportunistic behavior in organizations directly. As such, regional divorce rate can serve as a suitable instrumental variable of local happiness.

Table 8 presents the impact of local happiness on financial misconduct using the instrumental variable 2SLS estimation. In the first-stage analysis, we regress *Divorce_t* on *Local Happiness_t* with other independent variables as the same in the baseline regression. The coefficient on *Divorce_t* is negative and significant at the 1% level, which is in line with our expectation that regional divorce rate is negatively associated with local happiness. In the second-stage analysis, the fitted values generated from the first-stage estimation is used as the instrumental variable of *Local Happiness_t*. The negative coefficients on *Local Happiness_t* in the second-stage estimation (in Columns (1) to (3)) confirm the negative association between local happiness and financial misconduct. Following Ben-Nasr and Ghouma (2018), we perform the under-identification test (Kleibergen-Paap rk LM statistic equals 68.76) and the weak identification test (Wald F statistic equals 38.16), indicating that our instrumental variable is valid. Overall, the results in Table 8 confirm that firms headquartered in happy province conduct less financial misconduct.

[Insert Table 8 about here]

4.4.5. Controlling for happiness intensity

In the above analysis, we compute “*Local Happiness*” score by averaging all the responses from a given region where the listed firm is headquartered. To further address the issue of happiness intensity, we hand collect the city-level happiness data developed by “Xinhua Oriental Outlook” and “Outlook Think-tank” since 2007. The two institutions jointly host surveys to select the top10 happiest cities in China. The wide scope of the survey can not only

measure respondents' subjective feelings of happiness, but also cover topics related to city development and public service. In 2012, for example, the survey collected more than 20,000 independent household surveys, and more than 30 million people nationwide responded to the questionnaires.

We employ the propensity score matching (PSM) estimates to match the ten happiest cities selected annually from 2007 to 2017 with non-selected cities. Firstly, we run a logistic regression to predict the likelihood that a city is voted as one of the top 10 happiest cities according to city level macroeconomic variables, e.g., GDP per capita, the added value of the primary industry accounted for GDP, industrial added value accounted for GDP, service industry added value accounted for GDP, the fixed asset investment ratio to GDP, and the saving rate. Then, we estimate Eq. (5) using the propensity matched sample.

$$Financial\ Fraud_{i,t+1} = \beta_0 + \beta_1 Happiest_{c,t} + \sum_k \beta_k Controls_{k,i,t} + \epsilon_{i,t+1}, \quad (5)$$

where $Happiest_{c,t}$ is a dummy variable equal to one if the city where a listed firm headquartered is selected as one of the top 10 happiest cities in year t , and zero otherwise. The control variables are the same as in Table 2. Table 9 reports the results using the PSM sample to examine the relationship between happiness and financial misconduct. As shown in Columns (1) to (3), the coefficients on $Happiest_{c,t}$ are significant and negative at least at the 5% level. Thus, the local happiness effect on corporate financial misconduct is robust after addressing the happiness intensity issue.

In addition, we rank the top 10 happiest cities with the value from 10 to 1 (with 10 as the happiest city). We re-regress Eq. (5) replacing $Happiest_{c,t}$ with $Happiest_Rank_{c,t}$. The results in Columns (4) to (6) indicate that happiness ranking is negatively related to misconduct measures. Overall, the results in Table 9 show that firms headquartered in the top 10 happiest cities are less likely to engage in financial misconduct.

[Insert Table 9 about here]

5. Mechanism analysis

We expect that firms located in happy provinces are less likely to engage in misconduct activities, because health emotion promotes the generation of long-term motivation and the ability of self-control. Therefore, we expect that firms headquartered in happy regions are more likely to lay out conservative accounting policies and improve managerial self-control, all of which reduces financial misconduct. We examine the relationship between happiness and long-

term motivations and managerial self-control at both the individual and firm level.

5.1. Personal level happiness effects

Literature documents that better life evaluation promotes long-term perspectives and improves the ability of self-control (Isen and Reeve 2005; Ifcher and Zarghamee, 2011; Chuluun and Graham, 2016). In this section, we first examine the effect of happiness using individual level survey data. We expect that happy people would be more likely to have long-term perspectives and higher self-control ability. We employ two variables *Pre-incident plan* and *Overdraw consumption* to measure individual long-term perspectives and self-control. The data is collected from the CGSS database. *Pre-incident plan* is constructed based on the question: “I tend to plan ahead.” Answers to the questions is scaled from 1 to 5, including totally disagree (1); relatively disagree (2); neutral (3); relatively agree (4); and totally agree. *Overdraw consumption* is constructed according to responses to the question: “Spend tomorrow’s money to achieve today’s needs, overdraft consumption is common for me.” Answers to the question is scaled from 1 to 5, including totally disagree (1); relatively disagree (2); neutral (3); relatively agree (4); and totally agree (5).

The results shown in Table 10 suggest that *Individual Happiness* is positively associated with *Pre-incident plan*, while negatively associated with *Overdraw consumption* after controlling for the same individual characteristics as in panel A of Table 3. These results indicate that happiness promote long-term motivations and the ability of self-control at the individual level.

[Insert Table 10 about here]

5.2. Firm-level happiness effects

5.2.1. Long-term motivation: Accounting conservatism

Literature documents that accounting conservatism is higher in firms with long-term growth activities (Ma et al., 2020). Thus, higher accounting conservatism reflects managers’ long-term perspectives. We examine whether local happiness reduces financial misconduct through improving accounting conservatism in Table 11. In the first-step estimation, we examine the impact of local happiness on accounting conservatism. In the second-step analysis, we examine the influence of accounting conservatism on financial misconduct.

Following Khan and Watts (2009), we use *CScore*, the conditional conservatism measure to proxy the degree of accounting conservatism. A firm with a higher *CScore* tends to be more

conservative, thus, is less likely to engage in financial misconduct. In Panel A of Table 11, the coefficient on *Local Happiness_t* is significantly positive, indicating that firms headquartered in happy regions have higher accounting conservatism. In Panel B, the coefficients on *CScore* are significantly negative when regressing on misconduct measures (*Foccur_{t+1}*, *Ffreq_{t+1}* and *Fdegree_{t+1}*), indicating that conservative accounting behavior reduces financial misconduct. Overall, the results in Table 11 demonstrate that managers in happy provinces are more likely to have long-term perspectives when making accounting decisions, which in turn, reduce financial misconduct.

[Insert Table 11 about here]

5.2.2 Managerial self-control: Entertainment and travel costs (ETCs)

ETCs is typically used to reimburse businesses expenses, which is directly related to top executives' self-control ability. ETCs can serve as a channel to pursue managerial entrenchment in China, in addition, ETCs is also used as a measure of corruption in Chinese firms (Cai et al., 2011). Gul et al. (2011) find that firms with higher ETCs are related to lower financial reporting quality. Literature argues that people with a lower level of happiness are less likely to have self-imposed ethical standard in their daily economic activities (Frank, 1999; Jha 2019). We expect firm managers in less happy regions are associated with more spending on ETCs.

We utilize a two-step regression approach to examine whether local happiness reduces financial misconduct through constraining the spending on ETCs. We expect a negative association between local happiness and ETCs in the first-step analysis and a positive association between ETCs and financial misconduct in the second-step analysis.

Panel A of Table 12 reports the result of the relationship between local happiness and ETCs. The coefficient on *Local Happiness_t* is significantly negative, suggesting that firms located in happy regions are more likely to reduce the spending on ETCs. In Panel B, the coefficients on *ETC* are significantly positive with all financial misconduct measures (Columns (1) to (3)), which suggest that constraining the spending on ETCs can reduce financial misconduct. Overall, the above findings support our expectation that local happiness reduces financial misconduct through improving top executives' self-control ability.

[Insert Table 12 about here]

6. Additional analysis

6.1. Alternative measures of financial misconduct

In this section, we construct three alternative measures of misconduct to further examine the robustness of our baseline results. *Restate* is a dummy variable equal to one if financial

reports are restated in the observation year, and zero otherwise. *AuditType* is a dummy variable equal to one if a firm receives qualified audit opinions, and zero otherwise. *EM* refers to discretionary accruals, which are calculated following the modified Jones model (Dechow et al., 1995).

Table 13 presents the regression results of employing alternative measures of misconduct. Column (1) examines the relation between local happiness and financial restatement. The coefficient on *Local Happiness_t* is -0.218, significant at the 5% level, suggesting that local happiness reduces the likelihood of financial restatement. Using *AuditType* as the measure of misconduct in Column (2), the coefficient on *Local Happiness_t* is 0.017 and significant at the 5% level, suggesting that firms in happy provinces release higher quality financial reports. In Column (3), the coefficient on *Local Happiness_t* is -0.007 and significant at the 5% level. It suggests that firms located in happy provinces are less likely to conduct accrual-based earnings management.

Overall, the results reported in Table 13 demonstrate that firms headquartered in happy regions are related to less financial restatement, higher financial reporting quality, and less earnings management.

[Insert Table 13 about here]

6.2. Heterogeneity analysis

In this section, we examine whether different firm characteristics, monitoring mechanisms, and regional marketization shape the impact of local happiness on financial misconduct. Peng et al. (2009) suggest that the role of informal institutions (such as social norms) is strong when formal institutions are absent or weak. Informal institutional factors tend to play an essential role in mitigating financial misconduct where corporate governance and legal system is weak, such as in China.

In Panel A of Table 14, following Chen et al. (2018), we divide our sample into small/large-cap, and SOE/Non-SOE subsamples. Large-cap (small-cap) subsample includes firms with firm size larger (smaller) than the median of sample distribution in the same industry-year. State owned enterprises (SOEs) are identified if the firm's ultimate controller is the government, and zero otherwise. We also divide the full sample into Old (Young) subsamples, which includes firms with firm age higher (lower) than the median of sample distribution in the same industry-year.

In Table 14, we re-estimate Table 2 using the subsamples respectively. The results of Columns (2) and (4) in Panel A suggest that local happiness measure is significantly and negatively related to financial misconduct in small-cap firms and non-SOEs, while the effect

becomes insignificant in Columns (1) and (3) when firms are large in size and SOEs. The results are in line with literature that small-cap firms are more likely to conduct earnings manipulation (Ho and Wong, 2001). The local happiness effect is less significant in non-SOEs, it may be because of the cautiousness of top executives in SOEs given SOEs are heavily monitored by government authorities. The coefficient on *Local Happiness_t* is significantly negative in Column (6) but not in Column (5), indicating that younger firms would be more sensitive to local environment factors than older firms.

Literature documents that firms with effective monitoring mechanisms (such as higher board independence and institutional ownership) are associated with less earnings management (Chung, Firth and Kim, 2002; Klein, 2002). Therefore, it is of great significance to examine whether monitoring mechanisms influence the relation between local happiness and financial misconduct. We expect that the impact of local happiness on financial misconduct will be weakened when monitoring mechanisms are effective. Following Hermalin and Weisbach (1988) and Chen et al. (2018), we employ board independence (the proportion of independent directors on the board) and institutional ownership (the proportion of institutional shareholding) to proxy monitoring mechanisms. Based on whether board independence and institutional ownership is above/below the median of sample distribution in the same industry-year, we divide the full sample into high/low board independence (BI) firms, and high/low institutional ownership (IO) firms, respectively. We re-estimate Table 2 using the sub-samples and present the results in Panel B of Table 14. The coefficients on *Local Happiness_t* are significantly negative in Columns (2) and (4), while the effect becomes insignificant in Columns (1) and (3). The results demonstrate that the role of local happiness in reducing financial misconduct is stronger in firms with weaker monitoring mechanisms.

In Panel C of Table 14, we divide our full sample into higher/lower regional marketization based on the marketization index in Wang et al. (2021). Then, we re-estimate Table 2 using high/low regional marketization sub-samples, which include firms located in provinces with Wang et al. (2021)'s index above (below) the median of the index each year. As shown in Panel C, the coefficients on *Local Happiness_t* are negatively associated with all financial misconduct measures at the 5% level in Columns (2), (4), and (6) when the regional marketization is low. While the local happiness effect is insignificant in Columns (1) and (5) when the regional marketization is high. The results suggest that local happiness can serve as an informal institutional factor to reduce financial misconduct in regions with a lower level of marketization.

[Insert Table 14 about here]

7. Conclusion

Empirical evidence on the impact of happiness on organizational decisions is rather limited despite the positive effects of happiness on macroeconomic and personal soundness. Using the unique CGSS data published by NSRC, we construct the local happiness measurement and examine whether firms headquartered in happy regions carry out less financial misconduct. Using a sample of 2,347 Chinese listed firms for the period from 2003 to 2017, we find that local happiness is significantly and negatively associated with financial misconduct. We perform robustness checks by excluding CEO's hometown happiness, controlling for multiple fixed effects, including additional macroeconomic control variables, and estimating the instrumental variable 2SLS analysis to address potential endogeneity. Our results remain robust. We find that the local happiness effect is more salient in firms with low institutional ownership and board independence and in regions with a lower level of marketization. The above results indicate that the effect of local happiness is more prevalent in firms with weak formal governance institutions. We support the proposal that the contextual factors can play a significant role in organizational decisions. In addition, when the formal institutions are weaker, the influence of informal contextual factors will be stronger. Our study adds new evidence to the literature by focusing on the impact of happiness, a measure of subjective wellbeing, on opportunistic behavior in organizations.

Our paper also sheds lights on the economic channels through which local happiness affects financial misconduct. The mechanism analysis using the firm-level data and individual-level survey data both show that happiness reduces opportunistic behavior via increasing managerial long-term motivations and the ability of self-control.

In the financial markets where financial misconduct is prevalent, how to effectively discipline the behavior of management is always a research interest. It is important to point out that our aim is not to offer an alternative theory of financial misconduct. As discussed in Christ et al. (2012), it is interesting and insightful to explore whether and how social norms can impact the managerial self-interested behavior, which can extend economic-based models with insights from the social psychology.

We provide direct empirical evidence related to the opportunistic and self-interested behavior from the perspective of a measure of subjective well-being, happiness. Different from the existing studies that examine the impact of the formal governance institutions on misconduct (Bushman et al., 2006; Albrecht et al., 2015; Chakrabarty et al., 2015; Hass et al., 2016; Raval, 2018), we find that under the influence of reference groups, proxied by local average happiness, promote ethical behavior. Our results support the social norm theory that

managerial behavior conforms to social norms adhered to by a social group (Dyrenge et al., 2012; Dong et al., 2018). Meanwhile, as an important informal institution, the local happiness effect on mitigating financial misconduct can also extend the growing literature on the substitution between informal and formal institutions in a range of organizational decisions.

Declaration of interest

All authors contributed to the study conception and design. All authors read and approved the final manuscript. No conflict of interest exists in the submission of this manuscript.

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Fig. 1. Average happiness level across China

This figure reports the level of regional average happiness of 31 provinces included in our sample from 2003 to 2016. Happiness is measured by the survey question about life satisfaction, collected from the Chinese General Social Survey data published by National Survey Research Center at Renmin University of China. “Happiness” is measured by respondents’ response to the following question: “Overall, how do you feel about your life?” Answers to the question include very unhappy (1), unhappy (2), natural (3), happy (4), and very happy (5).

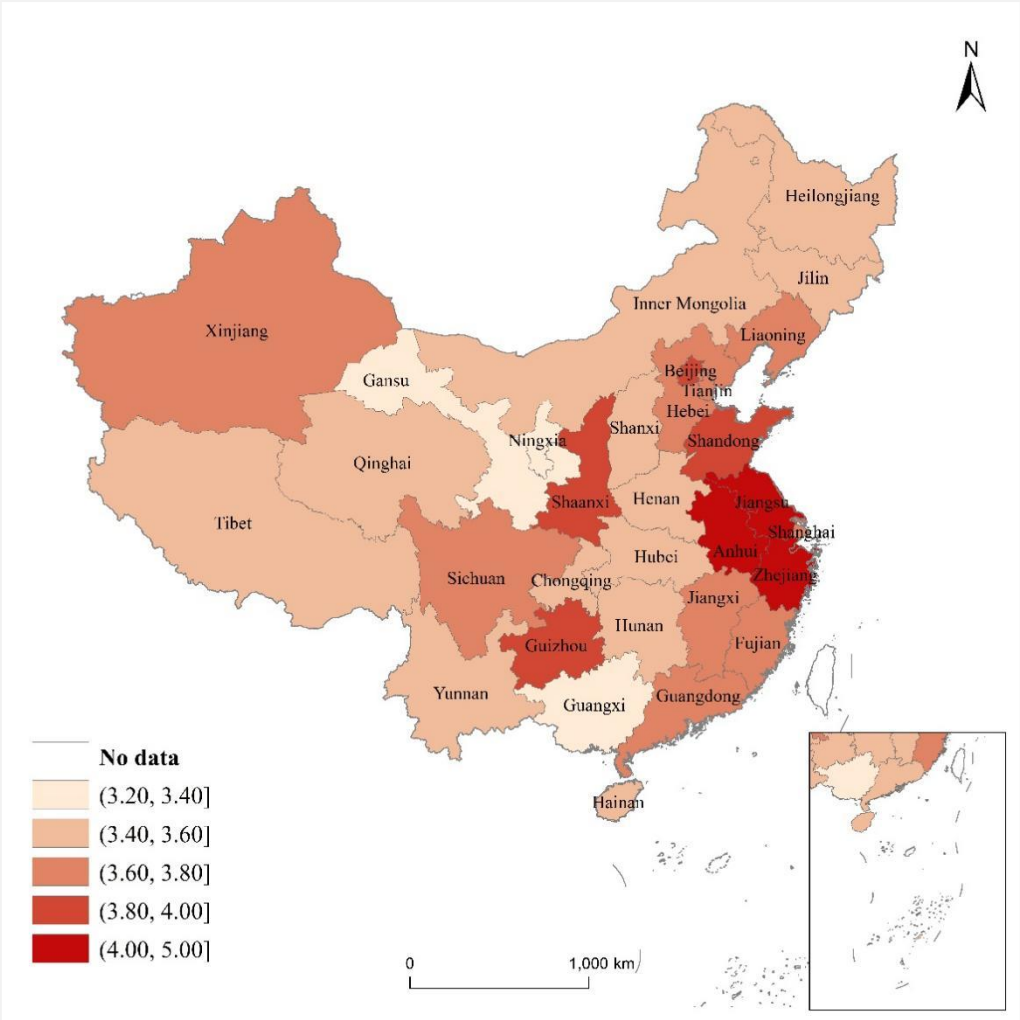


Table 1
Descriptive statistics and correlation coefficients

Panel A reports the descriptive statistics of the main variables used in this study. For the local happiness measure and control variables, the sample period is from 2003 to 2016, while for the financial misconduct measures, the sample period is from 2004 to 2017. Panel A reports the summary statistics of the variables. Panel B reports the Spearman (above diagonal) and Pearson (below diagonal) correlation coefficients. The correlations significant at the 5% level are in bold font. Appendix A presents the detailed variable definitions.

Panel A: Sample statistics

Variables	N	Mean	Std.Dev	Min	25th	Median	75th	Max
Individual level variables (individual-year observations)								
<i>Happiness</i>	83,232	3.671	0.858	1	3	4	4	5
<i>Individual_Age</i>	83,232	46.674	15.650	15	35	46	58	102
<i>Female</i>	83,232	0.518	0.500	0	0	1	1	1
<i>Married</i>	83,232	0.642	0.480	0	0	1	1	1
<i>Employed</i>	83,232	0.818	0.385	0	1	1	1	1
<i>Health</i>	83,232	3.608	1.066	1	3	4	4	5
<i>Education</i>	83,232	4.837	2.860	1	3	4	6	9
<i>Property ownership</i>	83,232	0.836	0.370	0	1	1	1	1
Firm characteristics (firm-year observations)								
<i>Foccur_{t+1}</i>	20,218	0.063	0.243	0	0	0	0	1
<i>Ffreq_{t+1}</i>	20,218	0.085	0.399	0	0	0	0	17
<i>Fdegree_{t+1}</i>	20,218	0.316	0.454	0	0	0	1	8
<i>Size_t</i>	20,218	6.430	0.542	5.273	6.054	6.433	6.775	7.928
<i>BM_t</i>	20,218	0.948	0.896	0.093	0.391	0.674	1.172	1.264
<i>Lev_t</i>	20,218	0.424	0.234	0.019	0.241	0.410	0.583	1.164
<i>ROA_t</i>	20,218	0.035	0.067	-0.084	0.011	0.035	0.066	0.223
<i>Growth_t</i>	20,218	2.219	2.116	0.165	0.845	1.570	1.806	2.306
<i>Mgshare_t</i>	20,218	0.103	0.187	0	0	0	0.109	0.682
<i>Age_t</i>	20,218	9.907	6.307	1	4	9	15	24
<i>Loss_t</i>	20,218	0.142	0.349	0	0	0	0	1
<i>VolatilityofCashflow_t</i>	20,218	0.141	0.264	0.003	0.033	0.069	0.141	2.057
<i>Analyst_t</i>	20,218	1.490	1.416	0	0	1.386	2.708	4.477
<i>Big4_t</i>	20,218	0.064	0.245	0	0	0	0	1
Province level factors (province-year observations)								
<i>Local Happiness_t</i>	20,218	3.786	0.235	3.195	3.668	3.796	3.959	4.340
<i>GDP%_t</i>	20,218	0.101	0.029	-0.025	0.078	0.096	0.123	0.238
<i>POPG_t</i>	20,218	0.005	0.002	-0.001	0.003	0.005	0.007	0.012
<i>EDU_t</i>	20,218	0.139	0.094	0.009	0.078	0.112	0.156	0.476
<i>FEMALEP_t</i>	20,218	0.489	0.011	0.454	0.483	0.490	0.495	0.514
<i>Supervision_t</i>	20,218	2.554	0.937	0.148	1.889	2.634	3.075	5.078

Table 1. (Continued)
Panel B: Spearman (above diagonal) and Pearson (below diagonal) correlation coefficients

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
1. $Foccur_{t+1}$	1.00	0.91	0.92	-0.01	0.02	-0.01	0.06	-0.11	0.05	-0.03	-0.07	0.09	0.01	-0.08	-0.01	-0.07	0.01	-0.02	-0.01	-0.04
2. $Ffreq_{t+1}$	0.87	1.00	0.91	-0.01	0.02	-0.01	0.06	-0.11	0.05	-0.03	-0.07	0.09	0.01	-0.08	-0.01	-0.06	0.01	-0.02	-0.01	-0.04
3. $Fdegree_{t+1}$	0.88	0.83	1.00	-0.02	0.02	-0.01	0.06	-0.11	0.05	-0.03	-0.07	0.09	0.01	-0.08	-0.01	-0.06	0.01	-0.02	-0.01	-0.04
4. $Local\ Happiness_t$	-0.02	-0.02	-0.02	1.00	0.09	0.01	-0.01	0.01	-0.01	0.01	0.03	0.01	-0.05	0.02	0.01	0.08	0.25	0.35	0.28	-0.03
5. $Size_t$	0.02	0.02	0.03	0.08	1.00	0.15	0.13	0.19	-0.09	-0.09	0.17	-0.16	-0.12	0.52	0.31	0.21	-0.03	0.18	-0.07	0.05
6. BM_t	-0.02	-0.02	-0.02	-0.01	0.27	1.00	0.54	-0.31	-0.81	-0.22	0.23	-0.08	-0.36	-0.06	0.22	0.08	-0.02	0.05	0.05	-0.03
7. Lev_t	0.07	0.07	0.07	-0.02	0.15	0.51	1.00	-0.40	-0.55	-0.24	0.24	0.20	0.30	0.04	0.14	0.07	0.02	-0.05	0.05	-0.05
8. ROA_t	-0.11	-0.11	-0.09	-0.01	0.19	-0.18	-0.38	1.00	0.27	0.19	-0.12	-0.54	-0.18	0.41	0.02	0.05	-0.03	0.05	0.04	0.06
9. $Growth_t$	0.07	0.06	0.05	-0.01	-0.04	0.46	-0.34	0.12	1.00	0.29	-0.21	-0.04	-0.27	-0.01	-0.24	0.16	0.03	0.06	-0.08	0.13
10. $Mgshare_t$	-0.04	-0.04	-0.04	-0.06	-0.24	-0.22	-0.26	0.10	0.25	1.00	-0.46	-0.13	-0.16	0.20	-0.13	-0.17	0.01	0.07	-0.07	0.21
11. Age_t	-0.07	-0.06	-0.06	-0.01	0.13	0.18	0.23	-0.08	-0.12	-0.54	1.00	-0.10	-0.19	0.23	0.02	0.01	-0.05	0.01	-0.01	-0.07
12. $Loss_t$	0.09	0.09	0.07	0.02	-0.16	0.06	0.22	-0.52	-0.02	-0.10	-0.10	1.00	0.12	-0.31	-0.06	-0.05	-0.04	-0.06	0.03	-0.05
13. $VolatilityofCashflow_t$	0.01	0.01	0.01	-0.02	-0.12	0.16	0.17	-0.11	-0.10	-0.08	-0.02	0.07	1.00	0.11	-0.14	-0.02	0.02	-0.03	0.01	-0.01
14. $Analyst_t$	-0.07	-0.06	-0.05	-0.01	0.53	0.03	0.01	0.35	0.01	0.07	0.16	-0.24	-0.02	1.00	0.22	-0.05	0.01	0.05	0.03	0.05
15. $Big4_t$	-0.01	-0.01	-0.01	-0.03	0.39	0.31	0.15	0.04	0.16	-0.12	0.02	-0.06	-0.06	0.26	1.00	-0.11	0.03	0.12	0.07	0.01
16. $GDP\%_t$	-0.07	-0.06	-0.04	0.01	0.16	0.12	0.06	0.02	0.13	-0.15	0.01	-0.03	-0.03	0.02	-0.08	1.00	0.19	0.55	0.28	0.27
17. $POPG_t$	0.01	0.01	0.01	-0.17	0.04	0.03	0.02	-0.03	0.02	0.01	-0.06	-0.04	0.01	0.01	-0.02	0.17	1.00	0.57	0.36	0.08
18. EDU_t	-0.01	-0.01	-0.01	0.23	0.22	0.10	-0.02	0.06	0.05	0.03	0.01	-0.06	0.01	0.10	0.18	0.41	0.35	1.00	0.08	0.03
19. $FEMALEP_t$	-0.02	-0.02	-0.02	0.43	-0.06	0.02	0.05	-0.02	-0.08	-0.08	0.01	0.03	-0.01	0.02	-0.07	0.20	0.31	0.01	1.00	0.23
20. $Supervision_t$	-0.05	-0.04	-0.03	0.15	0.10	-0.05	-0.05	0.01	0.17	0.13	-0.06	-0.03	-0.01	0.01	0.01	0.19	0.16	-0.13	-0.40	1.00

Table 2**Relationship between local happiness and financial misconduct**

This table reports the results of the regression as follows:

$$Financial\ Fraud_{i,t+1} = \beta_0 + \beta_1 Local\ Happiness_{i,t} + \sum_k \beta_k Controls_{k,i,t} + \epsilon_{i,t+1}$$

where $Financial\ Fraud_{i,t+1}$ is the measure of financial misconduct of firm i in year $t+1$, including $Foccur_{i,t+1}$, $Ffreq_{i,t+1}$, and $Fdegree_{i,t+1}$. $Local\ Happiness_{i,t}$ refers to the local average happiness measure, and $Controls_{k,i,t}$ is a set of control variables, including $Size_{i,t}$, $BM_{i,t}$, $Lev_{i,t}$, $ROA_{i,t}$, $Growth_{i,t}$, $Mgshare_{i,t}$, $Age_{i,t}$, $Loss_{i,t}$, $VolatilityofCashflow_{i,t}$, $Analyst_{i,t}$, $Big4_{i,t}$. Appendix A presents the detailed variable definitions. All continuous variables are winsorized at the 1% level in each tail. Industry and year fixed effects are controlled for, and the t -statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	$Foccur_{t+1}$ (1)	$Ffreq_{t+1}$ (2)	$Fdegree_{t+1}$ (3)
<i>Local Happiness_t</i>	-0.342*** (-2.873)	-0.042*** (-3.207)	-0.039*** (-3.405)
<i>Size_t</i>	0.022 (0.160)	0.001 (0.099)	0.009 (0.437)
<i>BM_t</i>	-0.082* (-1.769)	-0.008** (-2.339)	-0.019** (-2.258)
<i>Lev_t</i>	0.909*** (4.719)	0.105*** (4.944)	0.170*** (5.486)
<i>ROA_t</i>	-0.025*** (-3.770)	-0.002*** (-3.330)	-0.002** (-2.129)
<i>Growth_t</i>	0.055*** (3.052)	0.007*** (3.077)	0.010*** (3.095)
<i>Mgshare_t</i>	-0.612* (-1.819)	-0.077** (-2.115)	-0.095* (-1.878)
<i>Age_t</i>	-0.016** (-2.038)	-0.001 (-1.327)	-0.002 (-1.347)
<i>Loss_t</i>	0.401*** (3.776)	0.028*** (2.585)	0.046*** (2.825)
<i>VolatilityofCashflow_t</i>	0.351*** (2.628)	0.029** (2.037)	0.039* (1.815)
<i>Analyst_t</i>	-0.011*** (-3.522)	-0.001* (-1.893)	-0.001** (-2.510)
<i>Big4_t</i>	-0.168 (-0.899)	-0.024 (-1.160)	-0.008 (-0.284)
Constant	-0.376 (-0.267)	0.532*** (2.906)	1.015*** (3.720)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	20,218	20,218	20,218
Adjusted/Pseudo R ²	0.098	0.059	0.061

Table 3
Adding the impact of respondent’s characteristics

Panel A reports the results of the regression as follows:

$$\begin{aligned}
 & \text{Individual Happiness}_i \\
 & = \beta_0 + \beta_1 \text{Individual_Age}_i + \beta_2 \text{Individual_Age}_i^2 + \beta_3 \text{Female}_i + \beta_4 \text{Married}_i \\
 & \quad + \beta_5 \text{Employed}_i + \beta_6 \text{Health}_i + \beta_7 \text{Education}_i + \beta_8 \text{Property ownership}_i + \varepsilon_i
 \end{aligned}$$

where Happiness_i is the measure of respondent i 's response to the question: "Overall, how do you feel about your life?". The independent variables include Individual_Age_i , $(\text{Individual_Age}_i)^2$, Female_i , Married_i , Employed_i , Health_i , Education_i , and Houseowner_i .

Panel B reports the results of the regression as follows:

$$\text{Financial Fraud}_{i,t+1} = \beta_0 + \beta_1 \text{Residual Local Happiness}_{i,t} + \sum_k \beta_k \text{Controls}_{k,i,t} + \varepsilon_{i,t+1}$$

where $\text{Financial Fraud}_{i,t+1}$ is the measure of financial misconduct of firm i in year $t+1$, including $\text{Foccur}_{i,t+1}$, $\text{Ffreq}_{i,t+1}$, and $\text{Fdegree}_{i,t+1}$. $\text{Residual Local Happiness}_{i,t}$ refers to the residual local happiness, which be calculated as the value of ε_i in Panel A. Control variables are the same as in Table 2. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Determinants of individual happiness

Variable	Happiness
<i>Individual_Age</i>	-0.006*** (-11.937)
<i>Individual_Age</i> ²	0.001*** (7.240)
<i>Female</i>	0.082*** (3.303)
<i>Married</i>	0.139*** (6.256)
<i>Employed</i>	0.020*** (2.801)
<i>Health</i>	0.201*** (7.881)
<i>Education</i>	0.033*** (9.683)
<i>Houseowner</i>	0.124*** (14.270)
Constant	2.014*** (2.735)
Year fixed effects	Yes
Observations	83,232
Adjusted R ²	0.112

Panel B: The impact of residual local happiness on financial misconduct

Variable	$Foccur_{t+1}$ (1)	$Ffreq_{t+1}$ (2)	$Fdegree_{t+1}$ (3)
<i>Residual Local Happiness_t</i>	-0.339** (-2.583)	-0.037** (-2.201)	-0.043** (-2.356)
<i>Size_t</i>	0.083*** (7.291)	0.004 (0.242)	0.109*** (6.075)
<i>BM_t</i>	-0.025 (-0.544)	-0.006 (-1.020)	-0.001 (-0.047)
<i>Lev_t</i>	0.679*** (3.588)	0.104*** (4.858)	0.145*** (4.623)
<i>ROA_t</i>	-0.027*** (-4.146)	-0.002** (-2.526)	-0.002** (-2.431)
<i>Growth_t</i>	0.099*** (6.036)	0.007*** (2.970)	0.016*** (5.282)
<i>Mgshare_t</i>	-0.765** (-2.401)	-0.088** (-2.364)	-0.076 (-1.586)
<i>Age_t</i>	-0.031*** (-3.704)	-0.001 (-0.945)	-0.005*** (-3.521)
<i>Loss_t</i>	0.432*** (4.059)	0.029*** (2.629)	0.044*** (2.667)
<i>VolatilityofCashflow_t</i>	0.378*** (2.818)	0.027* (1.910)	0.040* (1.864)
<i>Analyst_t</i>	-0.022*** (-7.132)	-0.001* (-1.802)	-0.002*** (-5.700)
<i>Big4_t</i>	-0.390** (-2.067)	-0.025 (-1.187)	-0.041 (-1.388)
Constant	-0.811*** (-10.331)	0.427** (2.509)	-0.605*** (-4.726)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	20,218	20,218	20,218
Adjusted/Pseudo R ²	0.065	0.054	0.041

Table 4
Excluding the impact of the happiness level of CEO's hometown

This table reports the results of the regression as follows:

$$Financial\ Fraud_{i,t+1} = \beta_0 + \beta_1 Local\ Happiness + \beta_2 CEO's\ Local\ Happiness_{i,t} + \sum_k \beta_k Controls_{k,i,t} + \epsilon_{i,t+1}$$

where $Financial\ Fraud_{i,t+1}$ is the measure of financial misconduct of firm i in year $t+1$, including $Foccur_{i,t+1}$, $Ffreq_{i,t+1}$, and $Fdegree_{i,t+1}$. $Local\ Happiness_{i,t}$ refers to the local average happiness measure. $CEO's\ Local\ Happiness_{i,t}$ refers to the level of local happiness of CEO's hometown. Control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	$Foccur_{t+1}$ (1)	$Ffreq_{t+1}$ (2)	$Fdegree_{t+1}$ (3)
<i>Local Happiness_t</i>	-0.294*** (-2.825)	-0.039** (-2.061)	-0.026*** (-2.610)
<i>CEO's Local Happiness_t</i>	-0.023** (-2.277)	-0.009** (-2.472)	-0.012 (-1.579)
<i>Size_t</i>	0.023 (0.160)	0.003 (0.193)	0.008 (0.375)
<i>BM_t</i>	-0.077 (-1.559)	-0.006 (-1.022)	-0.016* (-1.915)
<i>Lev_t</i>	0.932*** (4.731)	0.103*** (4.800)	0.169*** (5.372)
<i>ROA_t</i>	-0.035*** (-3.441)	-0.165** (-2.010)	-0.163 (-1.598)
<i>Growth_t</i>	0.061*** (3.347)	0.006*** (2.909)	0.011*** (3.284)
<i>Mgshare_t</i>	-0.661* (-1.943)	-0.086** (-2.332)	-0.104** (-2.028)
<i>Age_t</i>	-0.015* (-1.848)	-0.001 (-0.923)	-0.002 (-1.166)
<i>Loss_t</i>	0.405*** (3.726)	0.029*** (2.629)	0.044*** (2.690)
<i>VolatilityofCashflow_t</i>	0.361*** (2.671)	0.027* (1.890)	0.038* (1.866)
<i>Analyst_t</i>	-0.011*** (-3.636)	-0.000* (-1.828)	-0.001*** (-2.640)
<i>Big4_t</i>	-0.188 (-0.990)	-0.025 (-1.155)	-0.010 (-0.342)
Constant	-0.867 (-0.602)	0.556*** (3.032)	1.005*** (3.662)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	10,648	10,648	10,648
Adjusted/Pseudo R ²	0.087	0.055	0.058

Table 5
Endogeneity: Controlling for additional regional factors

This table reports the regression results after controlling for additional regional factors, e.g., social trust, religiosity and corruption culture. Control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	<i>Foccur</i> _{t+1} (1)	<i>Ffreq</i> _{t+1} (2)	<i>Fdegree</i> _{t+1} (3)
<i>Local Happiness</i> _t	-0.331** (-2.141)	-0.035** (-2.633)	-0.040** (-2.219)
<i>Size</i> _t	0.062 (0.361)	0.005 (0.394)	0.019 (0.942)
<i>BM</i> _t	-0.022 (-0.368)	-0.008 (-1.508)	-0.014* (-1.876)
<i>Lev</i> _t	0.930*** (3.955)	0.084*** (4.102)	0.145*** (4.611)
<i>ROA</i> _t	-0.025*** (-3.160)	-0.003*** (-3.875)	-0.003** (-2.402)
<i>Growth</i> _t	0.066*** (3.122)	0.007*** (3.425)	0.013*** (3.895)
<i>Mgshare</i> _t	-0.191 (-0.473)	-0.041 (-1.301)	-0.067 (-1.386)
<i>Age</i> _t	0.024** (2.420)	0.001* (1.728)	0.002* (1.863)
<i>Loss</i> _t	0.389*** (2.982)	0.030** (2.541)	0.060*** (3.295)
<i>VolatilityofCashflow</i> _t	0.350** (2.189)	0.023 (1.529)	0.056** (2.481)
<i>Analyst</i> _t	-0.010*** (-2.783)	-0.001** (-2.155)	-0.001** (-2.387)
<i>Big4</i> _t	-0.228 (-0.973)	-0.012 (-0.741)	-0.004 (-0.142)
<i>Trust</i> _t	-0.228 (-1.590)	-0.025*** (-2.878)	-0.035*** (-2.787)
<i>Religion</i> _t	-0.413 (-0.933)	-0.002 (-0.054)	-0.049 (-1.007)
<i>Corruption</i> _t	0.117* (1.730)	0.023* (1.738)	0.020** (2.106)
Constant	-3.062 (-1.594)	0.123 (0.831)	-0.012 (-0.054)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	17,668	17,668	17,668
Adjusted/Pseudo R ²	0.101	0.039	0.047

Table 6**Endogeneity: Controlling for additional macro-economic variables**

This table reports the results after adding additional provincial level macro-economic variables, including GDP growth rate ($GDP\%_{i,t}$), population growth rate ($POPG_{i,t}$), educational ($EDU_{i,t}$), the percentage of female population ($FEMALEP_{i,t}$), and the supervision over the financial industry ($Monitor_{i,t}$). Other control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Independent variables	Dependent variable		
	$Foccur_{t+1}$ (1)	$Ffreq_{t+1}$ (2)	$Fdegree_{t+1}$ (3)
<i>Local Happiness_t</i>	-0.345** (-2.525)	-0.053** (-2.118)	-0.060*** (-2.977)
<i>Size_t</i>	0.042 (0.285)	0.002 (0.132)	0.013 (0.514)
<i>BM_t</i>	-0.083 (-1.618)	-0.011* (-1.856)	-0.022** (-2.331)
<i>Lev_t</i>	0.881*** (4.150)	0.123*** (4.716)	0.175*** (4.699)
<i>ROA_t</i>	-0.027*** (-3.703)	-0.003*** (-3.402)	-0.003** (-2.327)
<i>Growth_t</i>	0.060*** (3.080)	0.009*** (3.419)	0.012*** (3.186)
<i>Mgshare_t</i>	-0.733** (-2.088)	-0.089** (-2.251)	-0.106* (-1.936)
<i>Age_t</i>	-0.018** (-2.154)	-0.002 (-1.332)	-0.002 (-1.378)
<i>Loss_t</i>	0.293** (2.552)	0.020 (1.551)	0.029 (1.522)
<i>VolatilityofCashflow_t</i>	0.376*** (2.699)	0.029* (1.910)	0.041* (1.874)
<i>Analyst_t</i>	-0.011*** (-3.263)	-0.001* (-1.770)	-0.001** (-2.472)
<i>Big4_t</i>	-0.084 (-0.430)	-0.013 (-0.564)	0.004 (0.108)
<i>GDP%_t</i>	-0.730 (-0.241)	-0.229 (-0.704)	-0.091 (-0.195)
<i>POPG_t</i>	-4.811** (-2.174)	-1.540 (-0.556)	-3.223 (-0.842)
<i>EDU_t</i>	-1.152* (-1.905)	-0.119*** (-3.610)	-0.120* (-1.769)
<i>FEMALEP_t</i>	-1.176 (-0.253)	-0.074 (-0.160)	0.428 (0.626)
<i>Monitor_t</i>	-0.001*** (-3.363)	-0.002** (-2.011)	-0.001** (-2.317)
Constant	-1.027 (-0.436)	0.415 (1.631)	0.080 (0.219)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	20,218	20,218	20,218
Adjusted/Pseudo R ²	0.090	0.065	0.063

Table 7**Endogeneity: Controlling for multiple fixed effects**

This table reports the regression results after controlling for firm fixed effects as well as time-varying industry and province fixed effects. Control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	<i>Foccur</i> _{t+1} (1)	<i>Ffreq</i> _{t+1} (2)	<i>Fdegree</i> _{t+1} (3)
<i>Local Happiness</i> _t	-0.316** (-2.163)	-0.040** (-2.178)	-0.038** (-2.196)
<i>Size</i> _t	0.010 (0.021)	0.001 (0.064)	0.009 (0.540)
<i>BM</i> _t	-0.007** (-2.151)	-0.011** (-2.493)	-0.021*** (-2.993)
<i>Lev</i> _t	0.060*** (4.791)	0.087*** (4.924)	0.141*** (5.253)
<i>ROA</i> _t	-0.002*** (-4.232)	-0.003*** (-4.587)	-0.003*** (-3.195)
<i>Growth</i> _t	0.006*** (4.306)	0.007*** (3.612)	0.010*** (3.485)
<i>Mgshare</i> _t	-0.046** (-2.422)	-0.069** (-2.514)	-0.095** (-2.299)
<i>Age</i> _t	-0.001*** (-2.724)	-0.001* (-1.948)	-0.002* (-1.684)
<i>Loss</i> _t	0.034*** (4.701)	0.038*** (3.687)	0.063*** (4.022)
<i>VolatilityofCashflow</i> _t	0.026*** (2.748)	0.025* (1.914)	0.048** (2.357)
<i>Analyst</i> _t	-0.002*** (-2.643)	-0.001** (-2.367)	-0.001*** (-2.946)
<i>Big4</i> _t	-0.008 (-0.834)	-0.001 (-0.047)	-0.006 (-0.290)
Constant	0.312*** (2.590)	0.379** (2.191)	0.829*** (3.153)
Industry×Year fixed effects	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes
Observations	20,218	20,218	20,218
Adjusted/Pseudo R ²	0.053	0.046	0.039

Table 8**Endogeneity Correction: instrumental variable (IV) estimation**

This table presents the impact of local happiness on financial misconduct using instrumental variable estimation. We use local divorce rate (*Divorce*) as the instrumental variable for local happiness. In the first-stage analysis, we regress *Local Happiness_t* on *Divorce_t* and the other independent variables are the same as in Table 2. In the second-stage analysis, we use the fitted values generated from the first-stage estimation as the instrument variable for *Local Happiness_t*, and rerun the baseline regression. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively. Following Ben-Nasr and Ghouma (2018), we perform the under-identification test and weak identification test.

Variable	First stage	Second stage		
	<i>Local Happiness_t</i>	<i>Foccur_{t+1}</i>	<i>Ffreq_{t+1}</i>	<i>Fdegree_{t+1}</i>
		(1)	(2)	(3)
<i>Divorce_t</i>	-0.089*** (-8.938)			
<i>Local Happiness_t</i>		-0.111*** (-2.649)	-0.132** (-2.209)	-0.201** (-2.189)
<i>Size_t</i>	0.043*** (7.995)	0.037*** (4.528)	0.052*** (3.750)	0.074*** (4.140)
<i>BM_t</i>	-0.008*** (-6.325)	-0.001 (-0.401)	-0.001 (-0.060)	-0.001 (-0.024)
<i>Lev_t</i>	0.018 (1.114)	0.010 (1.447)	0.018** (1.961)	0.025* (1.954)
<i>ROA_t</i>	0.007*** (3.341)	-0.019* (-1.777)	-0.029* (-1.780)	-0.027* (-1.789)
<i>Growth_t</i>	0.035*** (7.764)	0.011 (1.289)	0.020* (1.776)	0.026 (1.612)
<i>Mgshare_t</i>	0.088*** (5.644)	-0.052*** (-2.940)	-0.058** (-2.504)	-0.060 (-1.572)
<i>Age_t</i>	0.003*** (7.137)	-0.003*** (-4.344)	-0.003*** (-3.186)	-0.004*** (-2.974)
<i>Loss_t</i>	-0.001** (-2.216)	0.057*** (6.632)	0.072*** (5.920)	0.099*** (5.515)
<i>VolatilityofCashflow_t</i>	-0.010 (-1.358)	0.001 (0.197)	0.002 (0.680)	0.002 (0.066)
<i>Analyst_t</i>	-0.001 (-1.462)	-0.001*** (-5.303)	-0.001*** (-4.991)	-0.001*** (-4.794)
<i>Big4_t</i>	-0.016** (-2.013)	-0.022** (-2.481)	-0.020 (-1.321)	-0.011 (-0.476)
Constant	3.361*** (6.743)	-0.633*** (-4.157)	-0.798*** (-3.594)	-1.177*** (-3.478)
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Observations	17,318	17,318	17,318	17,318
Adjusted/Pseudo R ²	0.109	0.078	0.062	0.110
Kleibergen-Paap rk LM		68.760		
Wald F statistics		38.160		

Table 9**PSM regression results and the impact of the intensity of local happiness**

Columns (1) to (3) report the regression results using the PSM sample, where $Happiest_{c,t}$ is an indicator variable equals one if the headquarter of a firm is in the city c that is selected as one of the Top10 happiest cities in China in year t , and zero otherwise. Columns (4) to (6) show the impact of happiness ranking in the ten happiest cities on corporate financial misconduct, where $Happiest_Rank_{c,t}$ represents 10 to 1 if a given city ranks first to tenth in year t . Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t -statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	$Foccur_{t+1}$ (1)	$Ffreq_{t+1}$ (2)	$Fdegree_{t+1}$ (3)	$Foccur_{t+1}$ (4)	$Ffreq_{t+1}$ (5)	$Fdegree_{t+1}$ (6)
$Happiest_{c,t}$	-0.485*** (-2.68)	-0.056*** (-2.69)	-0.039** (-2.13)			
$Happiest_Rank_{c,t}$				-0.011** (-2.14)	-0.001** (-2.30)	-0.002* (-1.79)
$Size_t$	0.069 (0.22)	-0.008 (-0.23)	-0.043 (-0.91)	0.187 (0.63)	0.003 (0.07)	-0.001 (-1.00)
BM_t	-0.180* (-1.70)	-0.030** (-2.47)	-0.045*** (-2.65)	-0.119 (-1.21)	-0.032** (-2.33)	-0.041** (-2.18)
Lev_t	1.718*** (3.96)	0.201*** (4.11)	0.313*** (4.52)	1.938*** (4.36)	0.251*** (4.60)	0.338*** (4.56)
ROA_t	-0.041*** (-3.03)	-0.005*** (-3.07)	-0.005** (-2.36)	-0.042*** (-2.90)	-0.003 (-1.61)	-0.004 (-1.57)
$Growth_t$	0.112*** (3.21)	0.020*** (4.22)	0.038*** (5.60)	0.083** (2.19)	0.013** (2.40)	0.027*** (3.59)
$Mgshare_t$	-0.436 (-0.61)	-0.162** (-2.21)	-0.260** (-2.49)	0.523 (0.69)	-0.037 (-0.40)	-0.079 (-0.63)
Age_t	0.010 (0.61)	0.002 (0.86)	0.003 (0.99)	-0.044** (-2.53)	0.003 (1.13)	0.004 (1.12)
$Loss_t$	0.431* (1.80)	0.047* (1.74)	0.047 (1.26)	0.275 (1.13)	0.039 (1.34)	0.046 (1.19)
$VolatilityofCashflow_t$	0.382 (1.37)	0.045 (1.36)	0.044 (0.94)	0.156 (0.50)	0.005 (0.14)	0.042 (0.83)
$Analyst_t$	-0.012* (-1.73)	-0.001 (-1.11)	-0.001 (-1.01)	-0.009 (-1.32)	-0.001* (-1.77)	-0.001 (-0.99)
$Big4_t$	0.695** (1.98)	0.035 (0.82)	0.111* (1.79)	0.415 (1.21)	0.032 (0.66)	0.026 (0.39)
Constant	-0.726 (-0.28)	1.481*** (4.07)	1.559*** (3.04)	-4.412* (-1.81)	0.587* (1.70)	0.425 (0.90)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,410	4,410	4,410	2,154	2,154	2,154
Adjusted/Pseudo R ²	0.105	0.109	0.116	0.110	0.107	0.112

Table 10
Channel test: Long-term motivation and self-control

This table presents the impact of happiness on long-term perspectives and self-control at the individual level. We employ two variables including *Pre-incident plan* and *Overdraw consumption* to measure individual long-term perspectives and self-control ability, respectively. The data is obtained from the CGSS database. *Pre-incident plan* is constructed based on answers to the following question: “I tend to plan ahead.” Responses to the questions is scaled from 1 to 5, including totally disagree (1); relatively disagree (2); neutral (3); relatively agree (4); and totally agree (5). *Overdraw consumption* is constructed according to responses to the following question: “Spend tomorrow’s money to achieve today’s needs, overdraft consumption is common for me.” Agreement to the questions is scaled from 1 to 5, including totally disagree (1); relatively disagree (2); neutral (3); relatively agree (4); and totally agree (5). Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	<i>Pre-incident plan</i>	<i>Overdraw consumption</i>
	(1)	(2)
<i>Individual Happiness</i>	0.065** (2.53)	-0.027** (-2.33)
<i>Female</i>	0.062 (1.54)	-0.098*** (-4.76)
<i>Individual_Age</i>	-0.001 (-0.35)	-0.008*** (-10.88)
<i>Married</i>	0.063 (1.22)	-0.035 (-1.38)
<i>Employed</i>	0.027 (0.54)	0.080*** (3.52)
<i>Health</i>	-0.006 (-0.26)	0.002 (0.19)
<i>Education</i>	0.021*** (2.63)	0.042*** (10.60)
<i>Property ownership</i>	0.045 (1.07)	0.051** (2.44)
<i>City</i>	0.015 (0.33)	-0.054** (-2.36)
Constant	-2.679*** (-17.46)	2.222*** (30.80)
Province fixed effects	Yes	Yes
Observations	1,685	11,644
R-squared	0.016	0.047

Table 11**Channel test-long-term motivations: Improving accounting conservatism**

This table presents the impact of local happiness on financial misconduct via improving firm accounting conservatism. Panel A is the results of the impact of local happiness on accounting conservatism, and Panel B is the results of the impact of accounting conservatism on financial misconduct. Following Khan and Watts (2009), we use the conditional conservatism measure *CScore* to measure the degree of accounting conservatism. Control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Panel A:			Panel B			
Variable	<i>CScore_t</i>	<i>CScore_t</i>	Variable	<i>Foccur_{t+1}</i>	<i>Ffreq_{t+1}</i>	<i>Fdegree_{t+1}</i>
	(1)	(2)		(1)	(2)	(3)
<i>Local Happiness_t</i>	0.249*** (2.698)	0.216** (2.104)	<i>CScore_t</i>	-0.017** (-2.134)	-0.015*** (-2.486)	-0.020*** (-2.896)
<i>Size_t</i>		0.509*** (3.056)	<i>Size_t</i>	0.002 (0.158)	0.004 (0.255)	0.018 (0.823)
<i>BM_t</i>		0.307*** (5.463)	<i>BM_t</i>	-0.007* (-1.812)	-0.010* (-1.896)	-0.014 (-1.600)
<i>Lev_t</i>		-0.304*** (-3.486)	<i>Lev_t</i>	0.082*** (5.074)	0.131*** (5.604)	0.179*** (4.969)
<i>ROA_t</i>		1.299*** (4.448)	<i>ROA_t</i>	-0.001 (-0.242)	0.001 (1.079)	0.001 (0.678)
<i>Shrholder_t</i>		0.768*** (7.899)	<i>Growth_t</i>	0.004** (2.012)	0.001 (0.437)	0.007 (1.619)
<i>Cash_t</i>		-0.012 (-1.423)	<i>Mgshare_t</i>	-0.008 (-0.338)	-0.016 (-0.425)	-0.002 (-0.028)
<i>Board_t</i>		-0.145 (-0.548)	<i>Age_t</i>	0.001* (1.772)	0.002 (0.287)	0.001 (0.901)
<i>Mgshare_t</i>		-0.190* (-1.852)	<i>Loss_t</i>	0.017** (2.071)	0.013** (2.112)	0.020** (2.103)
<i>Age_t</i>		0.003 (1.085)	<i>VolatilityofCashflow_t</i>	0.016*** (2.491)	0.014*** (2.892)	0.029* (1.906)
<i>SOE_t</i>		-0.096*** (-2.736)	<i>Analyst_t</i>	-0.006** (-2.103)	-0.011*** (-2.775)	-0.017*** (-2.926)
			<i>Big4_t</i>	-0.009 (-0.743)	-0.016 (-0.834)	-0.001 (-0.034)
Constant	-0.666* (-1.934)	-0.818*** (-4.537)	Constant	0.151 (1.360)	0.511*** (3.249)	0.332 (1.337)
Industry fixed effects	Yes	Yes	Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Year fixed effects	Yes	Yes	Yes
Observations	19,439	19,439	Observations	19,439	19,439	19,439
Adj. R ²	0.037	0.079	Adj./Pseudo R ²	0.064	0.074	0.071

Table 12**Channel test-better self-control: constraint entertainment and travel costs**

This table presents the impact of local happiness on financial misconduct through constraining managers' spending on entertainment and travel costs (ETCs). Panel A is the result of regression of ETCs on local happiness, and Panel B is the result of regression of misconduct on ETCs. Appendix A presents the detailed variable definitions. The *t*-statistics reported in parentheses are based on standard errors clustered by firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Panel A: regression of ETC on local happiness			Panel B: regression of financial misconduct on ETC			
Variables	<i>ETC_t</i>	<i>ETC_t</i>	Variables	<i>Foccur_{t+1}</i>	<i>Ffreq_{t+1}</i>	<i>Fdegree_{t+1}</i>
	(1)	(2)		(1)	(2)	(3)
<i>Local Happiness_t</i>	-0.020*** (-5.614)	-0.007** (-2.041)	<i>ETC_t</i>	0.065** (2.089)	0.137*** (2.905)	0.195*** (2.835)
<i>Size_t</i>		-0.022*** (-2.807)	<i>Size_t</i>	0.004 (0.384)	0.008 (0.532)	0.021 (0.997)
<i>BM_t</i>		-0.025*** (-2.857)	<i>BM_t</i>	-0.007* (-1.912)	-0.008 (-1.437)	-0.017** (-2.054)
<i>Lev_t</i>		0.030*** (8.519)	<i>Lev_t</i>	0.072*** (5.008)	0.109*** (5.008)	0.177*** (5.572)
<i>ROA_t</i>		-0.255*** (-3.479)	<i>ROA_t</i>	-0.001*** (-2.634)	-0.001** (-2.128)	-0.001 (-0.825)
<i>Shrholder_t</i>		-0.063*** (-4.923)	<i>Growth_t</i>	0.002 (1.542)	0.003 (1.220)	0.003 (0.788)
<i>Cash_t</i>		-0.001 (-1.390)	<i>Mgshare_t</i>	-0.024 (-1.055)	-0.051 (-1.405)	-0.061 (-1.193)
<i>Board_t</i>		0.049*** (4.374)	<i>Age_t</i>	-0.001** (-2.128)	-0.001 (-0.919)	-0.001 (-0.941)
<i>Mgshare_t</i>		-0.011** (-2.447)	<i>Loss_t</i>	0.015* (1.926)	0.010 (0.910)	0.019 (1.105)
<i>Age_t</i>		0.001*** (3.082)	<i>VolatilityofCashflow_t</i>	0.029*** (2.910)	0.038** (2.568)	0.058*** (2.636)
<i>SOE_t</i>		0.008*** (5.165)	<i>Analyst_t</i>	-0.005* (-1.830)	-0.008** (-2.108)	-0.014** (-2.523)
			<i>Big4_t</i>	-0.017 (-1.354)	-0.023 (-1.119)	-0.020 (-0.683)
Constant	0.182*** (3.544)	0.253*** (3.334)	Constant	-0.049 (-0.205)	-0.124 (-0.365)	-0.159 (-0.306)
Year	Yes	Yes	Year	Yes	Yes	Yes
Industry	Yes	Yes	Industry	Yes	Yes	Yes
Observations	20,122	20,122	Observations	20,122	20,122	20,122
Adj. R ²	0.031	0.099	Adj./Pseudo R ²	0.062	0.063	0.067

Table 13

Additional analyses: alternative measures of financial misconduct

Restate is a dummy variable equals one if financial reports stated in this year are restated, and zero otherwise. *AuditType* is a dummy variable equals one if auditors issue modified audit opinions on annual financial reports, and zero otherwise. *EM* refers to discretionary accruals, which are calculated with the modified Jones model in Dechow et al. (1995). Control variables are the same as in Table 2. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Variable	<i>Restate</i> _{t+1}	<i>AuditType</i> _{t+1}	<i>EM</i> _{t+1}
	(1)	(2)	(3)
<i>Local Happiness</i> _t	-0.218** (-2.014)	0.017** (2.201)	-0.007** (-2.152)
<i>Size</i> _t	-0.247*** (-2.804)	0.037*** (6.523)	-0.010** (-2.516)
<i>BM</i> _t	-0.070** (-2.117)	0.011*** (5.017)	-0.005*** (-3.323)
<i>Lev</i> _t	0.366*** (2.766)	-0.187*** (-21.715)	0.035*** (5.804)
<i>ROA</i> _t	-0.008* (-1.770)	0.004 (1.310)	-0.001 (-0.968)
<i>Growth</i> _t	0.046*** (3.427)	-0.024*** (-5.258)	0.005*** (7.206)
<i>Mgshare</i> _t	0.108 (0.566)	0.013 (0.987)	0.003 (0.267)
<i>Age</i> _t	-0.004 (-0.790)	-0.002*** (-5.796)	-0.001*** (-3.235)
<i>Loss</i> _t	0.216*** (2.921)	-0.075*** (-4.942)	0.009*** (2.695)
<i>VolatilityofCashflow</i> _t	0.157* (1.794)	-0.011* (-1.718)	0.115*** (4.025)
<i>Analyst</i> _t	-0.001 (-0.476)	0.001 (0.864)	-0.001 (-0.373)
<i>Big4</i> _t	-0.305** (-2.513)	0.026*** (3.694)	-0.001 (-0.201)
Constant	1.321* (1.719)	0.982*** (2.639)	-0.016 (-0.135)
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	17,642	16,960	16,599
Adjusted/Pseudo R ²	0.051	0.098	0.079

Table 14

Additional analyses: Heterogeneity analysis

This table reports the heterogeneous impact of local happiness on financial misconduct. In Panel A, we divide the full sample into the following sub-groups: larger/smaller cap, SOE/Non-SOE, and older/younger firms, based on firm size, government ownership, and the number of years that a firm has been listed in the SHSE or SZSE. In Panel B, we divide the full sample into the following sub-groups: higher/lower board independence, and higher/lower institutional ownership, based on the proportion of independent directors on the board and institutional shareholdings. In Panel C, we divide the full sample into higher/lower regional marketization based on Wang et al. (2021)'s index. We rerun Table 2 using the subsamples. Appendix A presents the detailed variable definitions. Industry and year fixed effects are controlled for, and the t-statistics are reported in parentheses with standard errors clustered at firm level. *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Firm characteristics

Variable	<i>Ffreq_{t+1}</i>					
	Large-cap (1)	Small-cap (2)	SOEs (3)	Non-SOEs (4)	Old (5)	Young (6)
<i>Local Happiness_t</i>	-0.030 (-1.014)	-0.071*** (-3.032)	-0.012 (-1.387)	-0.053** (-2.228)	-0.002 (-0.107)	-0.087*** (-3.039)
<i>Size_t</i>	0.006 (0.157)	0.003 (0.134)	0.021 (0.871)	-0.013 (-0.715)	0.001 (0.068)	-0.011 (-0.484)
<i>BM_t</i>	-0.011* (-1.796)	-0.013** (-2.031)	-0.001 (-0.034)	-0.006 (-0.856)	-0.011* (-1.721)	-0.008 (-0.796)
<i>Lev_t</i>	0.100*** (3.423)	0.096*** (3.331)	0.151*** (4.369)	0.085*** (3.222)	0.088*** (3.756)	0.120*** (3.158)
<i>ROA_t</i>	-0.005*** (-4.881)	-0.010 (-0.541)	-0.011 (-0.300)	-0.003*** (-3.628)	-0.002** (-2.417)	-0.003*** (-2.657)
<i>Growth_t</i>	0.007** (2.289)	0.005* (1.787)	0.020*** (4.353)	0.003 (1.134)	0.011*** (4.406)	-0.001 (-0.192)
<i>Mgshare_t</i>	-0.084* (-1.829)	-0.078 (-1.507)	-0.078 (-0.254)	-0.077* (-1.927)	-0.075 (-0.733)	-0.074* (-1.787)
<i>Age_t</i>	-0.002 (-1.495)	-0.002 (-1.382)	-0.001 (-0.058)	-0.002* (-1.690)	-0.005*** (-2.831)	-0.001 (-0.235)
<i>Loss_t</i>	0.020 (1.248)	0.040*** (2.684)	-0.001 (-0.047)	0.040*** (2.903)	0.037*** (2.887)	0.013 (0.708)
<i>VolatilityofCashflow_t</i>	0.039** (2.028)	0.015 (0.669)	0.040* (1.754)	0.029 (1.545)	0.018 (1.072)	0.046* (1.820)
<i>Analyst_t</i>	-0.002 (-0.311)	-0.013*** (-2.880)	-0.008 (-1.249)	-0.004 (-0.766)	-0.004 (-0.857)	-0.012** (-2.070)
<i>Big4_t</i>	-0.097** (-2.031)	-0.018 (-0.859)	-0.015 (-0.465)	-0.030 (-1.129)	-0.023 (-1.059)	-0.051 (-1.491)
Constant	0.083 (0.190)	0.681*** (3.262)	-0.055 (-0.158)	0.716*** (3.300)	-0.058 (-0.206)	0.813*** (3.217)
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,139	10,079	7,813	12,405	10,216	10,002
Adjusted/Pseudo R ²	0.067	0.096	0.057	0.055	0.099	0.089

Panel B: Monitoring mechanisms

Variable	<i>Ffreq_{t+1}</i>			
	High-BI (1)	Low-BI (2)	High-IO (3)	Low-IO (4)
<i>Local Happiness_t</i>	-0.036 (-1.469)	-0.047*** (-2.912)	-0.029 (-1.185)	-0.050*** (-2.789)
<i>Size_t</i>	-0.032 (-0.873)	-0.001 (-0.067)	-0.001 (-0.031)	0.004 (0.160)
<i>BM_t</i>	-0.011 (-0.636)	-0.007 (-1.071)	-0.010 (-1.514)	-0.005 (-0.485)
<i>Lev_t</i>	0.064 (1.322)	0.116*** (4.860)	0.125*** (4.469)	0.068*** (2.271)
<i>ROA_t</i>	-0.004*** (-2.655)	-0.002*** (-2.767)	-0.002** (-2.212)	-0.003*** (-2.834)
<i>Growth_t</i>	0.010** (2.166)	0.007*** (2.795)	0.006* (1.705)	0.007** (2.213)
<i>Mgshare_t</i>	-0.112 (-1.596)	-0.072 (-1.608)	-0.077 (-1.090)	-0.143*** (-3.067)
<i>Age_t</i>	0.004 (1.420)	0.001 (1.082)	0.001 (1.020)	0.001 (0.263)
<i>Loss_t</i>	0.023 (0.916)	0.028** (2.349)	0.006 (0.408)	0.050*** (3.054)
<i>VolatilityofCashflow_t</i>	0.063** (2.036)	0.018 (1.103)	0.016 (0.760)	0.040** (2.051)
<i>Analyst_t</i>	-0.005 (-0.599)	-0.004 (-0.978)	-0.010** (-2.177)	-0.004 (-0.594)
<i>Big4_t</i>	-0.006 (-0.088)	-0.039* (-1.777)	-0.028 (-1.277)	-0.015 (-0.393)
Constant	0.619 (1.495)	0.599** (2.209)	0.432** (1.995)	0.565* (1.727)
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Observations	10,166	10,052	10,092	10,126
Adjusted/Pseudo R ²	0.072	0.063	0.068	0.064

Panel C: Local marketization

Variable	<i>Foccur</i> _{t+1}		<i>Ffreq</i> _{t+1}		<i>Fdegree</i> _{t+1}	
	High	Low	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Local Happiness</i> _t	-0.246 (-1.218)	-0.736** (-2.542)	-0.005* (-1.785)	-0.044** (-2.045)	-0.033 (-0.770)	-0.077** (-2.066)
<i>Size</i> _t	-0.246 (-0.836)	-0.005 (-0.019)	0.001 (0.054)	-0.010 (-0.627)	-0.009 (-0.283)	-0.002 (-0.052)
<i>BM</i> _t	-0.193* (-1.754)	-0.005 (-0.058)	-0.011 (-1.310)	-0.004 (-0.647)	-0.029** (-2.149)	-0.001 (-0.095)
<i>Lev</i> _t	0.070** (2.557)	0.100*** (3.662)	0.051 (1.625)	0.090*** (3.880)	0.093* (1.858)	0.158*** (3.894)
<i>ROA</i> _t	-0.047*** (-3.285)	-0.003 (-0.350)	-0.003*** (-3.214)	0.001 (0.089)	-0.004** (-2.294)	0.001 (0.880)
<i>Growth</i> _t	0.025 (0.537)	0.071** (2.204)	0.007* (1.797)	0.005* (1.858)	0.003 (0.550)	0.009* (1.843)
<i>Mgshare</i> _t	-0.498** (-2.025)	-0.513 (-0.774)	-0.113** (-2.217)	-0.042 (-0.948)	-0.153** (-1.968)	-0.060 (-0.775)
<i>Age</i> _t	0.011 (0.638)	0.011 (0.686)	0.001 (0.448)	0.002 (1.559)	0.002 (0.844)	0.002 (0.843)
<i>Loss</i> _t	0.821*** (3.633)	0.469*** (2.837)	0.040** (2.490)	0.043*** (3.243)	0.078*** (2.902)	0.060*** (2.675)
<i>VolatilityofCashflow</i> _t	0.654*** (2.631)	0.030 (0.121)	0.046** (2.156)	0.005 (0.317)	0.083** (2.352)	0.007 (0.251)
<i>Analyst</i> _t	-0.066 (-0.797)	-0.188*** (-2.902)	-0.007 (-1.221)	-0.008* (-1.748)	-0.010 (-1.089)	-0.021*** (-2.727)
<i>Big4</i> _t	-0.758** (-1.992)	0.241 (0.742)	-0.047* (-1.833)	0.045* (1.857)	-0.059 (-1.531)	-0.070 (-1.623)
Constant	-0.302 (-0.258)	-0.575 (-1.219)	0.040 (0.310)	-0.013 (-0.354)	0.074 (0.401)	-0.038 (-0.563)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,131	10,087	10,131	10,087	10,131	10,087
Adjusted/Pseudo R ²	0.075	0.079	0.056	0.058	0.058	0.057

Appendix A. Variable definitions

Variables	Definitions
Financial misconduct variables	
<i>Foccur</i>	A dummy variable equals one if there is at least one enforcement action taken by the CSRC against the firm, and zero otherwise.
<i>Ffreq</i>	The frequency of financial misconduct behavior, which is measured by the number of the enforcement actions taken by the CSRC against the firm.
<i>Fdegree</i>	The severity of financial misconduct scaled from 0-3, including no punishment (0); public criticism (1); public condemnation (2, including condemnation and warning); and public punishment (3, including fine, confiscation of illegal income and market ban). Following Yao et al. (2020), if firm <i>i</i> is punished several times for the same case in year <i>t</i> , <i>Fdegree</i> equals the greatest assigned value. If firm <i>i</i> faces multiple punishments in the same year, <i>Fdegree</i> equals the sum of the assigned values.
Local happiness variables	
<i>Local Happiness</i>	Annual average happiness level of respondents from a province where the listed firm is headquartered. It is computed according to the responses to the question “Overall, how do you feel about your life?”. The responses can select from the five options include very unhappy (1), unhappy (2), neutral (3), happy (4), and very happy (5). The data is obtained from the CGSS database.
<i>Residual Local Happiness</i>	Residuals generated from a regression where individual happiness score is regressed on several demographic determinants of happiness, as suggested by Graham et al. (2009) and Chuluun and Graham (2016).
<i>CEO’s Hometown Happiness</i>	Annual average happiness level of CEO’s hometown.
Individual-level variables	
<i>Individual Happiness</i>	Respondent’s response to the following question: “Overall, how do you feel about your life?”. The responses can select from the five options include very unhappy (1), unhappy (2), neutral (3), happy (4), and very happy (5). The data is obtained from the CGSS database.
<i>Individual_Age</i>	Respondent’s age.
<i>Female</i>	A dummy variable equals one if the respondent is female, and zero otherwise.
<i>Married</i>	A dummy variable equals one if the respondent is married, and zero otherwise.
<i>Employed</i>	A dummy variable equals one if the respondent is employed, and zero otherwise.
<i>Health</i>	Respondents’ self-assessment about health condition. The responses can select from the five options include extremely bad (1); bad (2); neutral (3); good (4); and extremely good (5).
<i>Education</i>	Highest level of respondents’ education, which includes: no formal education (1); primary school (2); junior high school (3); high school (4); senior high school (5); college (6); bachelor’s degree (7); master’s degree (8); Doctor degree or above (9).
<i>Property ownership</i>	A dummy variable equals one if the respondent owns a property, and zero otherwise.
<i>Overdraw consumption</i>	Respondents’ response to the following question: “Spend tomorrow’s money to achieve today’s dream, overdraft consumption is in common for me.” The responses can select from the five options include totally disagree (1), relatively disagree (2), neutral (3), relatively agree (4), and totally agree (5). The data is obtained from the CGSS database.
<i>Pre-incident plan</i>	Respondents’ response to the following question: “I tend to plan ahead.” The responses can select from the five options include totally agree (1), relatively agree (2), neutral (3), relatively disagree (4), and totally disagree (5). The data is obtained from the CGSS database.
<i>City</i>	A dummy variable equals one if the respondent’s household registration (“hukou”) belongs to an urban area, and zero otherwise.
Firm-level control variables	
<i>Size</i>	The natural logarithm of the market value of equity.
<i>ROA</i>	Return on assets, calculated as net profit divided by total assets.

<i>BM</i>	Book-to-market ratio.
<i>Growth</i>	The growth rate of core business income.
<i>Lev</i>	Firm financial leverage, calculated as total debt divided by total assets.
<i>Mgshare</i>	Managerial ownership, which is measured by the percentage of managerial shareholdings to firm total market value.
<i>Age</i>	The listing age, which is equal to the observation year minus the year of listing.
<i>Loss</i>	A dummy variable equals one if the income before the extraordinary items is negative for the previous two years, and zero otherwise.
<i>VolatilityofCashflow</i>	The volatility of operating cash flows.
<i>Analyst</i>	The natural logarithm of the number of analysts follows the firm.
<i>Big4</i>	A dummy variable equals one if the auditor of the firm is one of the Big4 companies, and zero otherwise.
Province-level variables	
<i>Trust</i>	Respondents' response to the following question: "In general, do you agree that most people can be trusted in this society?" The responses can select from the five options include totally disagree (1), relatively disagree (2), neutral (3), relatively agree (4), and totally agree (5). The data is obtained from the CGSS database.
<i>Religion</i>	The respondents' response (0-1) to the following question: "Do you believe religion?" 0 and 1 corresponds to No (0) and Yes (1), respectively. The data is obtained from the CGSS database.
<i>Corruption</i>	The number of officials who had been investigated during the anti-corruption campaign started from 2012 in each city. Following Wang and Dickson (2020), the data is obtained from China's Corruption Investigations Dataset of Harvard University. We aggregate the data for all cities at the province level as an indicator of corruption culture of that province.
<i>Divorce</i>	The annual provincial divorce rate.
<i>GDP%</i>	The annual provincial GDP growth rate.
<i>POPG</i>	The annual provincial population growth rate.
<i>EDU</i>	The ratio of the provincial population with a college degree and above to the population over sixteen years old.
<i>FEMALEP</i>	The percentage of female population at province level.
<i>Supervision</i>	The natural logarithm of the province-level local government expenditure on financial supervision.
Other variables of interest	
<i>CScore</i>	The degree of accounting conservatism, calculated following Khan and Watts (2009).
<i>Shrholder</i>	The shareholding of the largest shareholder.
<i>Cash</i>	The cash ratio, calculated as cash holding to the total assets.
<i>Board</i>	The proportion of independent directors on the board.
<i>SOE</i>	A dummy variable equals one if the firm is a state-owned-enterprise (SOE), and zero otherwise.
<i>Restate</i>	A dummy variable equals one if the firm restates financial reports, and zero otherwise.
<i>AuditType</i>	A dummy variable equals one if a firm receives qualified audit opinions, and zero otherwise.
<i>EM</i>	Discretionary accruals, calculated following the modified Jones' model (Dechow et al., 1995).
