# Corporate Objectives & Financial Reporting Quality

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# Summary

- We focus on stakeholderism in the banking industry

- US Setting: States passed laws (constituency statutes, CS) to broaden managerial duties

- Assess financial reporting quality (FRQ) of banks in CS states v's counterparts in non-CS states

- Results suggest FRQ improves for stakeholder-orientated banks.

    - Affected banks decrease discretionary loan loss provisions, DLLP relative to unaffected counterparts.

    - Other indicators of FRQ (reporting small positive earnings changes less frequently, recognising loan losses in a timelier fashion, recording lower discretionary gains from available-for-sale securities and operating with a lower level of opaque assets) also improve

- Results hold following additional tests

    - (dynamic treatment effect estimations; placebo tests; propensity score matching; and a reverse causality test).

- The interactions with internal stakeholders (depositors and employees) play a significant role in FRQ.

# Introduction

- FRQ - extent to which accounting information conveys relevant, accurate, complete and objective representation of an organization's financial position.

- Poor FRQ increases information asymmetries between insiders and outsiders

- Impedes the ability of users of these reports to:

  - accurately assess earnings, future cash flows, risks, managerial performance

  - exert discipline on senior management

- Banks have opaque balance sheets, exacerbated by variations in FRQ (from earnings smoothing, capital management, signalling) and fraud (LIBOR price fixing etc.)

- Banks perform vital roles in the financial system and real economy

# Introduction

- Poor FRQ is likely to have profound implications for a myriad of stakeholders.

    - Accounting information is a primary input to construct performance measures

    - Accounting information is a primary input to regulatory processes and measures (capital & liquidity regulation)

    - Accounting information is an important signalling device of bank or system level problems

- Evidence is limited regarding the impact on FRQ of expanding the scope of managers' fiduciary duties to consider the interests of a broad set of stakeholders.

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# Introduction

- Structure of the modern firm necessitates complex management interactions with various stakeholders

- Traditional theory of the firm assumes managers maximize profit

- Maximizing shareholder value is the dominant objective of firms in most market-based economies

- This suggests that the fiduciary duties of managers minimise claims from other stakeholders

- But managers may pursue other objectives (such as growth, market share, or a quiet life)

- Consequently, managers may aim for a satisfactory level of performance - sufficient to allow pursuit of other objectives, and thus satisfy (satisfice) a myriad of stakeholders

- An alternative stakeholder orientation view suggests managers strive to consider the interests of all stakeholders relevant to the ongoing financial sustainability of an organization

- Stakeholders are defined as a group with capability to contribute or be affected by firm decisions

- A shift in focus from profit maximization to a wider set of organizational goals is likely to have implications for facets of organizational behaviour & performance (including financial information)

# Introduction

- International: Calls to transform the corporate purpose from a shareholder-centric to stakeholder approach (World Economic Forum, 2020, 2021).

- OECD Corporate Governance Principles (2015) recognize the collaboration between all stakeholders as a necessary condition for the firm competitiveness.

- Stakeholder rights should be respected even if not protected by explicit contracts.

- US: Business Roundtable (BRT, 2019) - firms should create benefit for all stakeholders - shareholders, customers, workers, communities, and suppliers.

- Corporate law should be revised to encourage firms to operate more socially responsibly.

- Critics question whether managers have incentives to protect stakeholders
  - Promises and claims to considering other stakeholders are difficult to measure and quantify.

# Introduction

- Stakeholderism may have a particular resonance in the mainstream banking industry.

- GFC etc. cast doubt on shareholder model of banking

- Banks operate with a heterogeneous group of stakeholders including but not limited to:

  - Depositors

  - Debtholders

  - Shareholders

  - Managers

  - Employees

  - Regulators

  - Competitors

  - Household, SMEs, corporate and sovereign borrowers

# Introduction

In contrast to industrial firms, banks operate with:

- high leverage

- rapidly changing risk

- inherent opacity and complexity

- dispersed ownership and severe agency problems
    - that limit internal (board monitoring) and external control mechanisms

- Management faces unique challenges in aligning stakeholder interests

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# Introduction

- We investigate the impact of stakeholder orientation on the FRQ of banks.

- FRQ can be regarded as the extent to which accounting information conveys relevant, accurate, complete and objective representation of a firm's financial position.

- High-quality financial reporting reduces information asymmetries between insiders and outsiders

- FRQ refers to the extent to which outside stakeholders (including depositors, shareholders, borrowers, debtholders, rivals, policymakers, counterparties, analysts, researchers) are supplied with reliable information on banks' financial position.

- Prior evidence suggests that banks operate with inherently opaque balance sheets and engage in earnings management.

# Stakeholderism and FRQ

- The likely impact of stakeholder orientation on FRQ is unclear.

- Stakeholder orientation is likely to improve the quality of accounting disclosures if managers embracing stakeholder policies are less likely to maximise profits and manage earnings in order to meet short term shareholder expectations

- A shift toward stakeholder orientation provides managers with discretion to adopt a longer-term planning horizon as a means of serving stakeholder interests

- Prior evidence suggests that firms pursuing long-term strategies engage in less earnings management practices

- BUT stakeholder orientation may reduce FRQ if it is used as a tool to disguise:

- Managerial entrenchment; malfeasance; true underlying firm performance; or facilitate a transfer of wealth toward management, to the detriment of other stakeholders

# Stakeholderism in the United States

- Introduction of CS (commenced in 1984 in Ohio) in part response to an increasing number of hostile takeovers

- However, the relevance goes beyond takeover activity.

- CS extend the scope of fiduciary duties to allow managers to consider the interests of a broader group of stakeholders

- The majority of CS classify employees and customers as stakeholder groups.

- Suppliers, creditors, local community, society, and the environment are also often listed.

- As of 2020, 35 US states had implemented CS.

# Stakeholderism in the United States



Date of Enactment

- ■ [1980 - 1985]
- ■ [1986 - 1989]
- ■ [1990 - 1999]
- ■ [2000 - 2010]
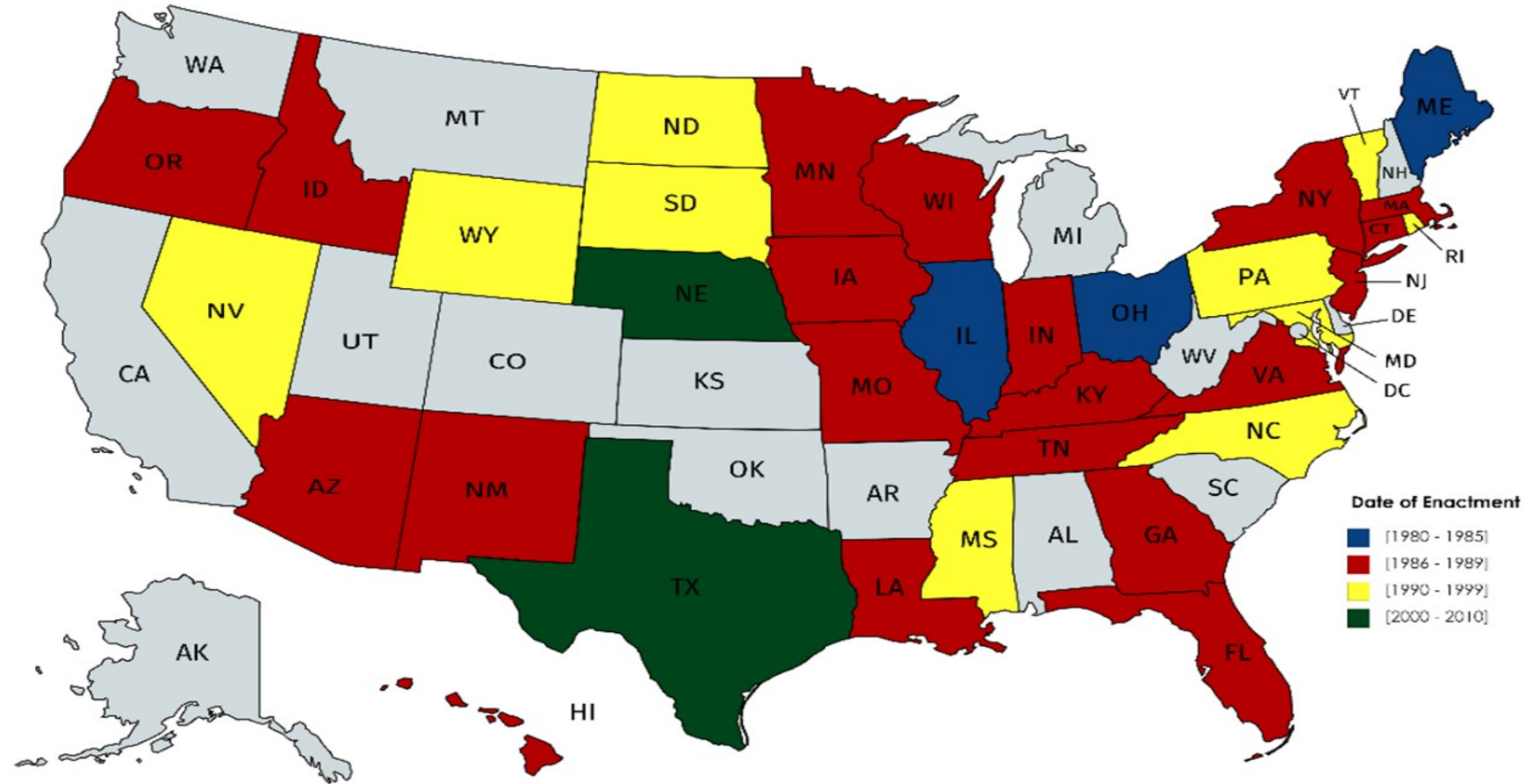
# Prior Evidence

- Literature (next slide) investigates impact of stakeholder approach on firm outcomes (financial performance, innovation, environmental strategy, and organizational structure).

- Stakeholder-oriented (non-financial) firms are better able to pursue proactive environmental strategies, hold directors more accountable, maintain organizational reputation and achieve superior financial performance and innovative capabilities.

- We aim to extend this evidence by examining the implications of stakeholderism for banks, which have been generally neglected in this literature.

- Importance: Given the scale, scope, and significance of the financial services industry in providing liquidity and capital for households, SMEs, and corporates.

- Stakeholderism has resonance in the banking industry given that banks operate with a more heterogeneous group of stakeholders

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# Prior evidence for non-financials

- Prior literature posits that CS represent a meaningful deviation from the dominant shareholder-centric view of managing firms (Orts, 1992; Stout, 2012).

- Moreover, prior evidence suggests that stakeholder orientation is an important determinant of non-financial:
  - firm value (Cremers et al, 2019)
  - innovation (Flammer and Kacperczyk, 2016)
  - cost of debt (Gao et al., 2020)
  - stock price crash risk (Li and Zhang, 2019)
  - cash holdings (Chowdury et al., 2021)
  - earnings management and accounting conservatism (Radhakrishnan et al., 2018; Ni, 2020)
  - payout policy (Ni et al., 2020).

- Banking - limited evidence suggests that the adoption of stakeholder CS reduced bank risk taking and dividends (Leung et al., 2019; Chronopoulos et al., 2023).

# Challenges

- An investigation of the link between stakeholder orientation and financial reporting quality is complicated by endogeneity concerns.
  - Empirical relationships between stakeholder orientation and financial reporting quality is likely to be spurious if other unobserved factors (such as culture, strategy, managerial risk attitudes, reputation and future profitability) influence both bank governance and financial reporting quality.
- The validity of such an analysis could also be threatened by possible reverse causality.
  - Banks with more transparent financial reporting practices are more likely to attract new employees that are more conscious of environmental, social and governance issues.
- Measuring stakeholder orientation is far from straightforward leading much of the salient literature relying on a variety of subjective metrics or questionable measurement scales.

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# Data

- Sample period: 1980-2010

- Reports on Condition and Income (Call Reports) from Federal Reserve Bank, Chicago

- State of incorporation data from National Information Center

- Discard banks with missing total assets and negative total equity values

- Drop banks located outside mainland US territories

- Omit S & Ls, GSEs, cooperative banks and credit unions

- 74,643 bank-year observations belonging to 3,014 unique commercial banks

- State-level macro data: US BEA, Labor Statistics and Federal Housing Finance Agency

# Enactment of CS and Bank Observations

| State Name | Enactment Year | Total Bank-Years of Treated Commercial Banks | Number of Treated Commercial Banks |
|---|---|---|---|
| Ohio | 1984 | 1,729 | 66 |
| Illinois | 1985 | 6,184 | 250 |
| Maine | 1985 | 116 | 5 |
| Indiana | 1986 | 1,495 | 58 |
| Missouri | 1986 | 4,534 | 186 |
| Arizona | 1987 | 58 | 9 |
| Minnesota | 1987 | 5,765 | 223 |
| New Mexico | 1987 | 622 | 26 |
| New York | 1987 | 1,028 | 43 |
| Wisconsin | 1987 | 3,408 | 131 |
| Connecticut | 1988 | 78 | 5 |
| Idaho | 1988 | 157 | 9 |
| Kentucky | 1988 | 2,459 | 99 |
| Louisiana | 1988 | 1,851 | 74 |
| Tennessee | 1988 | 1,936 | 82 |
| Virginia | 1988 | 837 | 41 |
| Florida | 1989 | 836 | 40 |
| Georgia | 1989 | 2,291 | 97 |
| Hawaii | 1989 | 84 | 3 |
| Iowa | 1989 | 6,046 | 227 |
| Massachusetts | 1989 | 159 | 6 |
| New Jersey | 1989 | 292 | 16 |
| Oregon | 1989 | 224 | 11 |
| Mississippi | 1990 | 1,322 | 51 |
| Pennsylvania | 1990 | 1,267 | 50 |
| Rhode Island | 1990 | 41 | 3 |
| South Dakota | 1990 | 949 | 34 |
| Wyoming | 1990 | 493 | 20 |
| Nevada | 1991 | 42 | 3 |
| North Carolina | 1993 | 297 | 16 |
| North Dakota | 1993 | 1,569 | 58 |
| Vermont | 1998 | 101 | 4 |
| Maryland | 1999 | 438 | 20 |
| Texas | 2006 | 4,591 | 177 |
| Nebraska | 2007 | 3,340 | 123 |

# Methodology

- The deviation of loan loss provisions policy from that associated with bank characteristics, loan portfolio and economic cycle ➔ an indicator of FRQ (Kanagaretnam et al., 2010; Beatty and Liao, 2014).

- First-stage regression model to isolate the discretionary part of total provisions ➔

$$LLP_{ilt} = \gamma_0 + \gamma_1 \Delta NPL_{ilt+1} + \gamma_2 \Delta NPL_{ilt} + \gamma_3 \Delta NPL_{ilt-1} + \gamma_4 Size_{ilt-1}$$
$$+ \gamma_5 \Delta Loans_{ilt} + \gamma_6 Growth_{lt} + \gamma_7 HP_{lt} + \gamma_6 \Delta Unemployment_{lt} \quad (1)$$
$$+ \gamma_7 ALW_{ilt-1} + \gamma_8 CO_{ilt} + \varepsilon_{ilt}$$

- Second-stage DiD model to assess the impact of stakeholder orientation on bank FRQ ➔

$$DLLP_{isrt} = \beta CS_{st} + \varphi X_{isrt} + f_i + \delta_{rt} + \varepsilon_{irst} \quad (2)$$

- Bank fixed effects and region-by-year fixed effects

- Bank-level covariates (Size, Solvency, Liquidity, Payout, Loan Growth, Deposit Growth, Loss)

# Variable Definitions and Summary Statistics

| Variable | Definition |
|---|---|
| **Panel A: Variables Used in the Main Analysis** | |
| DLLP | The absolute value of the discretionary portion of loan loss provisions (x100) (residuals attached to Equation (1)) |
| DLLP_Minus | The absolute value of the negative discretionary portion of loan loss provisions (x100) (positive residuals attached to Equation (1)) |
| DLLP_Plus | The absolute value of the positive discretionary portion of loan loss provisions (x100) (negative residuals attached to Equation (1)) |
| CS | An indicator variable taking the value of one after the adoption of constituency statutes for the banks incorporated in the US states with a prevalent statute during the sample period, otherwise assuming the value of zero |
| Size | The natural logarithm of total assets |
| Solvency | The natural logarithm of z-score which is calculated as the sum of equity-to-assets ratio and net income-to-assets ratio normalized by the standard deviation of net income-to-assets ratio |
| Liquidity | The ratio of cash and balances to total assets |
| Payouts | The ratio of dividends to total equity |
| Loan Growth | Annual growth rate of total loans |
| Deposit Growth | Annual growth rate of total deposits |
| Loss | An indicator variable taking the value of one for the banks recording negative net income balances, otherwise assuming the value of zero |
| **Panel B: Variables Used to Construct Discretionary Loan Loss Provisions** | |
| ΔNPL | The change in non-performing loans divided by the lagged total loans |
| ΔLoans | The change in total loans divided by the lagged total loans |
| Growth | The change in state-level income per capita over the year |
| HP | The return on state-level house price index over the year |
| ΔUnemployment | The change in unemployment rate over the year |
| ALW | The loan loss allowances divided by the total loans |
| CO | The charge-offs divided by the total loans |
| **Panel C: Variables Used for Alternative Financial Reporting Quality Dimensions** | |
| DELR | An indicator variable taking the value of one if the differential adjusted R-squared values of Equation (4) (relative to that of Equation (3) which is estimated over 12-quarters rolling window period) is lower than or equal to median value for bank $i$ in year t, otherwise assuming the value of zero |
| SPEC | An indicator variable taking the value of one for the banks reporting the change in income before taxes normalized by total assets (from year t-1 to year t) staying between 0 and 0.001, otherwise assuming the value of zero |
| DRGLS | The absolute value of the discretionary portion of realized gains and losses on available-for-sale securities (x100) (residuals attached to Equation (6)) |
| Real Estate | The ratio of real estate owned to total loans |
| Opaque Assets | The ratio of opaque assets (premises and fixed assets, investments in unconsolidated subsidiaries, intangible assets and other assets) to total loans |
| EBT | The ratio of income before taxes to total assets (Equation (5)) |
| EBTLLP | The ratio of income before taxes and provisions to total assets (Equation (5)) |

| Variables | Observations | Mean | Std. Dev. | Median | P5 | P95 |
|---|---|---|---|---|---|---|
| DLLP | 74,643 | 0.2652 | 0.3425 | 0.1568 | 0.0137 | 0.8988 |
| DLLP_Minus | 40,243 | 0.2391 | 0.2681 | 0.1539 | 0.0146 | 0.8082 |
| DLLP_Plus | 34,400 | 0.2758 | 0.3303 | 0.1613 | 0.0130 | 1.0083 |
| Size | 74,643 | 11.1207 | 1.1819 | 11.0086 | 9.4139 | 13.2337 |
| Solvency | 74,643 | 4.0691 | 1.0511 | 4.1061 | 2.2029 | 5.7584 |
| Liquidity | 74,643 | 0.0606 | 0.0461 | 0.0471 | 0.0197 | 0.1508 |
| Payouts | 74,643 | 0.0538 | 0.0569 | 0.0376 | 0.0000 | 0.1689 |
| Loan Growth | 74,643 | 0.0811 | 0.1293 | 0.0704 | -0.1004 | 0.2917 |
| Deposit Growth | 74,643 | 0.0709 | 0.1083 | 0.0553 | -0.0596 | 0.2501 |
| Loss | 74,643 | 0.0470 | 0.2116 | 0.0000 | 0.0000 | 0.0000 |

# Main Results

$$LLP_{ilt} = \gamma_0 + \gamma_1 \Delta NPL_{ilt+1} + \gamma_2 \Delta NPL_{ilt} + \gamma_3 \Delta NPL_{ilt-1} + \gamma_4 Size_{ilt-1}$$
$$+ \gamma_5 \Delta Loans_{ilt} + \gamma_6 Growth_{lt} + \gamma_7 HP_{lt} + \gamma_6 \Delta Unemployment_{lt} \qquad (1)$$
$$+ \gamma_7 ALW_{ilt-1} + \gamma_8 CO_{ilt} + \varepsilon_{ilt}$$

|  | (1) LLP$_t$ |
|---|---|
| $\Delta$NPL$_{t+1}$ | 0.0029 |
|  | (0.0054) |
| $\Delta$NPL$_t$ | 0.0502*** |
|  | (0.0112) |
| $\Delta$NPL$_{t-1}$ | 0.0291*** |
|  | (0.0045) |
| Size$_{t-1}$ | 0.0003*** |
|  | (0.00004) |
| $\Delta$Loans$_t$ | 0.0062* |
|  | (0.0033) |
| Growth$_t$ | -0.0120*** |
|  | (0.0022) |
| HP$_t$ | -0.0034** |
|  | (0.0016) |
| $\Delta$Unemployment$_t$ | -0.0094 |
|  | (0.0061) |
| ALW$_{t-1}$ | -0.2560*** |
|  | (0.0297) |
| CO$_t$ | 0.9489*** |
|  | (0.0246) |
| CS$_t$ | 0.0026** |
|  | (0.0013) |
| Observations | 74,804 |
| Interaction Terms (CS x Controls) | Yes |
| R-squared | 0.707 |

- Current and past $\Delta NPL$ terms enter the regression positively and significantly
- Banks consider current and prior loan portfolio quality as key inputs to provisioning decisions

# Main Results

$$DLLP_{isrt} = \beta CS_{st} + \varphi X_{isrt} + f_i + \delta_{rt} + \varepsilon_{irst} \qquad (2)$$

| | (1) DLLP | (2) DLLP_Minus | (3) DLLP_Plus |
|---|---|---|---|
| CS | -0.0396*** | -0.0372*** | -0.0414** |
| | (0.0143) | (0.0132) | (0.0169) |
| Size | 0.0045 | -0.0092 | 0.0162 |
| | (0.0067) | (0.0057) | (0.0087) |
| Solvency | -0.0551*** | -0.0444*** | -0.0517*** |
| | (0.0023) | (0.0033) | (0.0021) |
| Liquidity | 0.0854 | 0.1075* | 0.0495 |
| | (0.0601) | (0.0578) | (0.0715) |
| Payouts | -0.1456*** | -0.1237*** | -0.1759*** |
| | (0.0308) | (0.0335) | (0.0409) |
| Loan Growth | 0.0796*** | 0.0974*** | 0.0214 |
| | (0.0201) | (0.0207) | (0.0365) |
| Deposit Growth | 0.1162*** | 0.1077*** | 0.0950*** |
| | (0.0189) | (0.0243) | (0.0295) |
| Loss | 0.3501*** | 0.0869*** | 0.4013*** |
| | (0.0127) | (0.0158) | (0.0106) |
| Observations | 74,643 | 40,155 | 34,366 |
| Controls | Yes | Yes | Yes |
| Bank FE | Yes | Yes | Yes |
| Region x Year FE | Yes | Yes | Yes |
| Adj. R-Squared | 0.281 | 0.246 | 0.359 |

**Baseline (DLLP) – col (1)**
- Affected banks improve FRQ relative to unaffected counterparts.

**Extensions (+ve and –ve DLLP – col (2&3)**
- Banks can under-provision by recording negative $DLLP$ (negative residuals) to inflate earnings
- Banks can over-provision by recording higher $DLLP$ (positive residuals)
- We employ absolute values of signed residuals, $DLLP\_Minus$ and $DLLP\_Plus$, as dependent variables in column (2) and (3).
- Stakeholder orientation reduces both types of discretionary loan loss provisioning.

# Alternative FRQ Proxies

| | (1) DELR | (2) SPEC | (3) $EBT_{t+1}$ | (4) DRGSL | (5) Real Estate | (6) Opaque Assets |
|---|---|---|---|---|---|---|
| CS | -0.0146* (0.0077) | -0.0093** (0.0045) | -0.0016* (0.0006) | -0.0043** (0.0021) | -0.0013* (0.0007) | -0.0059*** (0.0015) |
| CS x $EBTLLP_t$ | | | 0.0994*** (0.0211) | | | |
| $EBTLLP_t$ | | | 0.3606*** (0.0151) | | | |
| Observations | 63,387 | 67,336 | 72,215 | 44,010 | 74,643 | 74,643 |
| Controls | Yes | Yes | Yes | Yes | Yes | Yes |
| Bank FE | Yes | Yes | Yes | Yes | Yes | Yes |
| Region x Year FE | Yes | Yes | Yes | Yes | Yes | Yes |
| Adj. R-Squared | 0.010 | 0.057 | 0.480 | 0.391 | 0.367 | 0.486 |

**Panel C: Variables Used for Alternative Financial Reporting Quality Dimensions**

| | |
|---|---|
| DELR | An indicator variable taking the value of one if the differential adjusted R-squared values of Equation (4) (relative to that of Equation (3) which is estimated over 12-quarters rolling window period) is lower than or equal to median value for bank i in year t, otherwise assuming the value of zero |
| SPEC | An indicator variable taking the value of one for the banks reporting the change in income before taxes normalized by total assets (from year t-1 to year t) staying between 0 and 0.001, otherwise assuming the value of zero |
| DRGLS | The absolute value of the discretionary portion of realized gains and losses on available-for-sale securities (x100) (residuals attached to Equation (6)) |
| Real Estate | The ratio of real estate owned to total loans |
| Opaque Assets | The ratio of opaque assets (premises and fixed assets, investments in unconsolidated subsidiaries, intangible assets and other assets) to total loans |
| EBT | The ratio of income before taxes to total assets (Equation (5)) |
| EBTLLP | The ratio of income before taxes and provisions to total assets (Equation (5)) |

We consider different dimensions and facets of the bank reporting reliability, including:

- timing of provisioning policy

- earnings-based measures

- securities-based proxies

- asset opacity

- Results of all measures suggest that the enactment of CS improves accounting quality

# Internal Validity of Empirical Design

| | (1) DLLP | (2) DLLP | (3) DLLP | (4) DLLP | (5) CS(0) |
|---|---|---|---|---|---|
| CS(-3) | -0.0031 (0.0139) | | | | |
| CS(-2) | -0.0118 (0.0185) | | | | |
| CS(-1) | -0.0219 (0.0154) | | | | |
| CS(0) | -0.0538*** (0.0174) | | | | |
| CS(1) | -0.0477*** (0.0159) | | | | |
| CS(2+) | -0.0456** (0.0193) | | | | |
| Placebo CS | | 0.0132 (0.0142) | -0.0020 (0.0155) | | |
| CS | | | | -0.0497*** (0.0178) | |
| State-Average DLLP | | | | | -0.6887 (0.7022) |
| Observations | 74,643 | 74,643 | 74,643 | 31,755 | 334 |
| Estimation Method | OLS | OLS | OLS | OLS | Probit |
| Estimation Sample | All | All | All | PSM | Pre-Treatment |
| Estimation Level | Bank | Bank | Bank | Bank | State |
| Controls | Yes | Yes | Yes | Yes | Yes |
| Bank FE | Yes | Yes | Yes | Yes | No |
| Region x Year FE | Yes | Yes | Yes | Yes | No |
| Adj. R-Squared | 0.281 | 0.281 | 0.280 | 0.279 | |
| Pseudo R-Squared | | | | | 0.018 |

- ($Col$ 1) $CS$ replaced with $CS(-3)$, $CS(-2)$, $CS(-1)$, $CS(0)$, $CS(1)$, $CS(2+)$, which capture: three, two, and one year before treatment; exact treatment year; one and two (or more) years after the treatment respectively
- (Col 2) retain enactment dates, but randomize the enactment status across states - *Placebo CS*
- (Col 3) retain enactment status across states, but reshuffle enactment years - *Placebo CS*.
- (Col 4) baseline model but based on a PSM sample
- (Col 5) tests whether pre-enactment DLLPs somehow led to CS adoption

# Robustness Checks

| | (1) DLLP | |
|---|---|---|
| | Coefficient | Obs. |
| (1) Only year FE | -0.0304** | 74,643 |
| (2) Division-by-year FE | -0.0399*** | 73,567 |
| (3) Standard errors clustered at bank-level | -0.0396*** | 74,643 |
| (4) Two-way clustered standard errors | -0.0396** | 74,643 |
| (5) Sample period 1980-2000 | -0.0346*** | 48,576 |
| (6) Sample period 1980-2006 | -0.0325** | 65,680 |
| (7) Non-winsorized data | -0.0472*** | 74,643 |
| (8) Lagged covariates | -0.0371** | 74,550 |
| (9) Excluding covariates | -0.0432** | 74,643 |
| (10) Including Lagged LLP as control variable | -0.0354*** | 74,643 |
| (11) Only banks with 15 years-long observations | -0.0393*** | 72,329 |
| (12) Excluding Delaware banks | -0.0395*** | 74,207 |
| (13) Excluding lobbying states | -0.0451*** | 65,899 |
| (14) Excluding states providing opt-in and opt-out clauses | -0.0473*** | 69,920 |
| (15) Enactment dates listed in Barzuza (2009) | -0.0324** | 74,643 |

| | (1) DLLP | |
|---|---|---|
| | Coefficient | Obs. |
| (16) Excluding CS transition years | -0.0383** | 72,718 |
| (17) Controlling for enactment of other antitakeover statutes | -0.0379** | 74,643 |
| (18) Controlling for enactment of UD laws | -0.0396*** | 74,643 |
| (19) Controlling for Ninth Circuit banks | -0.0395*** | 74,643 |
| (20) Controlling for IDD court cases | -0.0397*** | 74,643 |
| (21) Controlling for depositor preference laws | -0.0409*** | 74,643 |
| (22) Controlling for economic policy uncertainty | -0.0394* | 54,211 |
| (23) Excluding publicly traded banks | -0.0390*** | 74,456 |
| (24) Excluding banks below $500 million asset size threshold | -0.0408*** | 70,442 |
| (25) Borusyak et al. (2021) DiD estimator | -0.0621*** | 41,931 |
| (26) Chen et al. (2018) correction for two-step methodology | -0.1521*** | 74,643 |

# Stakeholder Groups: Internal vs. External Stakeholders

- In order to capture any underlying mechanisms driving the link between stakeholder orientation and bank reporting quality, we examine relationships between banks and specific groups of stakeholders.

- This allows us to uncover the interactions (if any) between different stakeholder groups in facilitating the impact of stakeholder orientation on FRQ.

- Stakeholders comprise:

- Employees

- Depositors

- Tax authorities

- Regulators

# Stakeholder Groups: Internal vs. External Stakeholders

Employees

- If managed opportunistically, banks may avoid recording declining earnings by adjusting labour costs.

- Employee orientation and intra-organizational trust can be translated into better accruals quality and fewer financial restatements

- Intuition: We expect that banks enjoying better relationships with employees have less scope to improve financial reporting quality following the enactment of CS.

- Approach: To analyse the role of employees in augmenting (or moderating) the interaction between stakeholderism and bank reporting, we interact CS with a binary variable, *Employee Salaries*.
  - Equals 1 - if the ratio of salaries and employee benefits to the number of employees is larger than median value among other banks located in the same state, otherwise 0

# Stakeholder Groups: Internal vs. External Stakeholders

Depositors

- Depositors contribute to market discipline

- McIntyre and Zhang (2020) banks making discretionary reporting choices - likely to face deposit outflows.

- Banks managed with a stakeholder orientation are expected to refrain from misleading financial reporting

- Intuition: Following the enactment of CS - improvements in FRQ are likely to be more limited for banks already subject to intense depositor scrutiny

- Approach: $Uninsured\ Deposits$ = 1 for banks with higher than sample median uninsured deposits to total deposits ratio, and zero otherwise.
  - we interact this indicator with the treatment term CS.

- We predict a positive coefficient attached to the interaction term lessening the previously documented negative impact of $CS$ on $DLLP$
  - it limits the ameliorating effect of stakeholder orientation on reporting quality.

# Stakeholder Groups: Internal vs. External Stakeholders

Tax Regulators

- Aggressive tax planning behaviour to benefit shareholders is considered unethical and detrimental to stakeholders

- Tax aggressiveness coincides with profound information asymmetries, lowers corporate transparency and generates litigation and reputation risks

- Reporting requirements imposing enhanced transparency deter banks from engaging in aggressive tax management incentives

- Intuition: Following the enactment of CS - improvements in FRQ are likely to be more limited for banks with weaker tax avoidance inclinations and that are subject to scrutiny by tax regulators.

- Approach: Construct Effective Tax Rate = 1 if ratio of total tax expenses to pre-tax income exceeds the sample median value, and 0 otherwise.
  - we interact this indicator with the treatment term CS.

# Stakeholder Groups: Internal vs. External Stakeholders

Bank Supervisors

- High quality financial reporting helps supervisors to assess bank risk and health in a timely fashion.

- Banks can pursue earnings management to avoid disciplinary actions.

- Stricter regulators can reduce the incentives for discretionary provisioning

- BUT banks enjoy preferential treatment via political representation, which reduces supervisory effectiveness

- Intuition: political representation, limits the role of supervision in impact of stakeholderism on FRQ.

- Approach: Create $Supervisory\ Attention = 1$, for banks with located in a state sending at least one member to banking committee, and zero otherwise.
  - we interact this indicator with the treatment term CS.

# Stakeholder Groups: Internal vs. External Stakeholders

| | (1) DLLP | (2) DLLP | (3) DLLP | (4) DLLP |
|---|---|---|---|---|
| CS | -0.0526*** | -0.0503*** | 0.0451*** | -0.0420** |
| | (0.0139) | (0.0115) | (0.0165) | (0.0158) |
| Employee Salaries x CS | 0.0268* | | | |
| | (0.0151) | | | |
| Employee Salaries | -0.0164* | | | |
| | (0.0092) | | | |
| Uninsured Deposits x CS | | 0.0235** | | |
| | | (0.0093) | | |
| Uninsured Deposits | | -0.0176** | | |
| | | (0.0066) | | |
| Effective Tax Rate x CS | | | 0.0023 | |
| | | | (0.0093) | |
| Effective Tax Rate | | | -0.0084 | |
| | | | (0.0055) | |
| Supervisory Attention x CS | | | | 0.0063 |
| | | | | (0.0151) |
| Supervisory Attention | | | | -0.0061 |
| | | | | (0.0131) |
| Observations | 74,643 | 74,643 | 70,758 | 74,643 |
| Controls | Yes | Yes | Yes | Yes |
| Bank FE | Yes | Yes | Yes | Yes |
| Region x Year FE | Yes | Yes | Yes | Yes |
| Adj. R-Squared | 0.281 | 0.281 | 0.227 | 0.281 |

- *Employee Salaries* x CS:  Impact of stakeholder orientation on FRQ is moderated for banks that already treating employees well.

- *Uninsured Deposits* x CS: Impact of stakeholder orientation on FRQ is moderated for banks facing more intense higher depositor scrutiny.

- *Taxes* and *supervisory* attention do not appear to play a significant role in moderating the relation between CS and FRQ.

# Summary

- Inadequate reporting practices allow bank managers to hide risk exposures, avoid supervisory oversight and engage in opportunistic earnings management

- There is a paucity evidence regarding importance of bank objectives on FRQ

- Extending fiduciary duties to stakeholders improves FRQ (reduced DLLP)

- Robust results in the face of alternative FRQ measures and additional tests

- Internal stakeholders are more influential in influencing reporting practices

- A more stakeholder orientated management style leads to improvements in FRQ

# Contributions to Existing Literature

*Determinants and consequences of bank FRQ*

- Competition (Tomy, 2019); deposit funding (Jiang et al., 2022); loan supply (Zheng, 2020); financial safety nets (Fan et al., 2020); financial literacy (Jin et al., 2021); and bank health (Bushman and Williams, 2015)

*Impact of CS on (non-financial firms') organizational level outcomes*

- Liquid asset holdings (Chowdhury et al., 2021); tax avoidance (Chen et al., 2022); innovation (Flammer and Kacperczyk, 2016); cost of debt (Gao et al., 2021)

*Impact of CS on bank outcomes*

- Evidence for banks: higher financial stability (Leung et al., 2019); lower payout ratio (Chronopoulos et al, 2022)

*Balancing stakeholder interests*

- Trade-offs associated with managing stakeholder relations (internal vs. external stakeholders) (Mitchell et al., 1997; Reynolds et al., 2006; Neville et al., 2011)

# What have we learned overall?

- We contribute to ongoing debates contrasting shareholder maximization and stakeholder orientation.

- Especially regarding the impact of the stakeholder approach on firm outcomes including financial performance, innovation, environmental strategy, and organizational structure.

- We extend this evidence by examining the implications of stakeholderism for banks' FRQ.

- Also examine how interactions with specific stakeholders (employees, depositors, supervisors, tax authorities) impact the relation between CS and FRQ

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# Stakeholder Groups

|  | (1) DLLP | (2) DLLP |
|---|---|---|
| CS | -0.0447*** | -0.0433*** |
|  | (0.0136) | (0.0136) |
| Branch Network x CS | 0.0246* |  |
|  | (0.0127) |  |
| Branch Network | -0.0004 |  |
|  | (0.0091) |  |
| Branch County Network x CS |  | 0.0334** |
|  |  | (0.0159) |
| Branch County Network |  | -0.0243* |
|  |  | (0.0127) |
| Observations | 74,643 | 74,643 |
| Controls | Yes | Yes |
| Bank FE | Yes | Yes |
| Region x Year FE | Yes | Yes |
| Adj. R-Squared | 0.281 | 0.281 |