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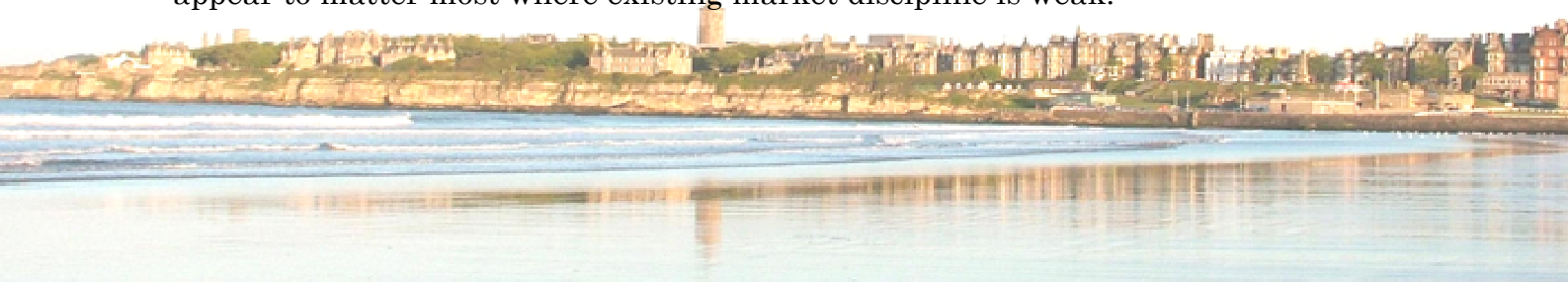
When Many Govern: Stakeholder Orientation and Managerial Discretion in Banking

By *Dimitris K. Chronopoulos, Anna L. Sobiech, John O.S. Wilson, Muhammed Hasan Yilmaz*

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Abstract

The accuracy and reliability of financial reporting plays a critical role in shaping the strategic decisions of investors, managers, regulators and other stakeholders. Using the banking industry as a setting, we investigate how a broadening of corporate objectives beyond shareholders shapes managerial discretion in financial reporting. We exploit the state-level enactment of constituency statutes as an exogenous shift that allows managers to consider the interests of non-shareholder stakeholders. Based on a sample of 3,014 U.S. commercial banks over the period 1980-2010, we find that broader stakeholder orientation reduces managerial discretion in financial reporting. This effect is stronger where market discipline is weak, and is less evident among banks where uninsured depositors or public shareholders already discipline managers. We do not detect a moderating role for tax authorities and bank supervisors. Constituency statutes thus appear to matter most where existing market discipline is weak.

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1. Introduction

Financial reporting is a key channel through which bank managers exercise accounting discretion and shape stakeholders' perceptions of performance, risk, and solvency. This discretion creates opportunities to obscure underlying financial conditions, with important implications for accountability, market discipline, and trust. In corporate law, fiduciary duties define to whom managers are accountable and whose interests they must serve. This shapes both the constraints on and scope for managerial discretion (Williamson, 1963; Fama and Jensen, 1983). Under shareholder-oriented governance, accountability is directed primarily towards shareholders, aligning reporting discretion with shareholder interests. Under stakeholder-oriented governance, accountability extends to a broader set of constituencies, including employees, creditors, and customers, exposing managers to multiple and potentially conflicting claims. By broadening fiduciary duties beyond shareholders, stakeholder-oriented governance may alter the scope for managerial discretion in financial reporting.[1] In this study, we address this issue.

Theory provides competing predictions regarding how a broadening managerial accountability from shareholders to a wider set of stakeholders should affect managerial discretion in financial reporting. This tension is consistent with a broader literature, which finds that managerial discretion responds to the institutional and governance environment in which managers operate

[1] The issue is especially salient given the growing adoption of governance systems oriented toward multiple stakeholders. On the international stage, there has been coordinated and vocal call to transform the corporate purpose from a shareholder-centric to a stakeholder approach that serves a myriad of stakeholder interests (World Economic Forum, 2020). In the United States, a statement issued by the Business Roundtable (BRT) asserts that firms should create benefit for a wide group of stakeholders including shareholders, customers, workers, communities, and suppliers (Business Roundtable, 2019).

(Lambertsen and Lassak, 2026; James et al., 2026). On one hand, stakeholder-oriented governance may reduce managerial discretion by permitting managers to weigh the interests of a broader range of claimants. This increases expectations that managers will provide credible and transparent information to maintain stakeholder support.[2] On the other hand, broader accountability may relax constraints. By spreading oversight across a wider set of stakeholders, stakeholder-oriented governance can weaken the ability of any one group to hold managers accountable. Thus, increasing managerial discretion and making opportunistic accounting practices easier to justify (Jensen, 2001; Leuz et al., 2003; Zheng, 2020). Whether broader stakeholder accountability constrains or facilitates managerial discretion in financial reporting is ultimately an empirical question.

In a banking context, financial and regulatory reports are particularly consequential, given that they are relied upon by both investors and regulators tasked with ensuring the safety and soundness of the financial system (Beatty and Liao, 2014; Acharya and Ryan, 2016). Banks operate with complex and opaque balance sheets, making accounting discretion both more feasible and more consequential than in non-financial firms (Flannery et al., 2004, 2013; Beatty et al., 2025). Weak or distorted reporting imposes costs not only on shareholders, but also on creditors, depositors, supervisors, and broader society (Mehran and Mollineaux, 2012; Berger et al., 2020). Prior research suggests that bank managers exercise discretion in reporting to achieve outcomes such as higher regulatory

[2] Allen and Gale (2000) and Allen (2005) posit that broadening a firm's objective function to stakeholders can correct common market failures. Acharya et al. (2011) argue that stakeholders with different time horizons and interests reduce opportunities for misappropriation by managers and generally improve firm governance.

capital, smoother earnings, or more favourable market perceptions, through loan loss provisions, realized securities gains and losses, or other adjustments (Beatty et al., 1995; Ahmed et al., 1999; Barth et al., 2017). Among these, loan loss provisions have received particular attention as the most economically significant accrual (Beatty and Liao, 2014).

In order to investigate the impact of stakeholder-oriented governance on managerial discretion in financial reporting, we leverage the staggered enactment of so-called constituency statutes across 35 U.S. states.[3] Beginning in the early 1980s, these statutes grant managers the legal discretion to consider the interests of non-shareholder stakeholders, such as employees, creditors, suppliers, or communities, in corporate decision-making.[4] By expanding managerial accountability beyond shareholders, constituency statutes provide a natural setting to identify how governance shapes the use of managerial discretion in financial reporting (Flammer and Kacperczyk, 2016). The staggered adoption across U.S. states allows us to implement a difference-in-differences (DiD) research design. We examine how managerial discretion in financial reporting evolves for banks subject to constituency statutes relative to unaffected counterparts, before and after enactment. Our dataset comprises 3,014 unique U.S. commercial banks spanning the period 1980–2010. We use regulatory filings

[3] Focusing on a single country insulates our analysis from potential cross-country confounders (such as differences in cultural, legal, and political forces as well as institutional frameworks, accounting regimes and financial development) driving managerial discretion in financial reporting (Fonseca and Gonzalez, 2008; Kanagaretnam et al., 2011, 2014). Moreover, the staggered adoption of the constituency statutes provides the necessary regional and intertemporal variation required to deal effectively with potential confounding events that could threaten the validity of any inferences drawn from our empirical analysis (Roberts and Whited, 2013).

[4] Among these, creditors are especially consequential in banking. Depositors, and uninsured depositors in particular, are a bank's principal creditors, and their capacity to discipline managers features centrally in our analysis.

(Call Reports of Condition and Income) to construct various measures used in our empirical analysis.

To examine managerial discretion in financial reporting, we focus on loan loss provisions (LLPs), a core accrual over which bank managers retain considerable discretion. LLPs require the estimation of expected credit losses, which inherently involve private information about loan quality and future performance. This makes LLPs a well-established setting in which to separate discretionary and non-discretionary components of financial reporting (Beatty and Liao, 2014; Beatty et al., 2025; Orozco and Rubio 2025). Following prior literature, we estimate a model that captures the non-discretionary component of LLPs. We define discretionary loan loss provisions (DLLPs) as the absolute value of the resulting residuals of this estimated model. Higher (lower) values indicate greater (less) use of managerial discretion in financial reporting.

By way of preview, we find that the enactment of constituency statutes reduces the extent to which managers exercise discretion in financial reporting. Banks subject to these statutes report lower levels of discretionary loan loss provisions relative to unaffected counterparts. An event-study specification confirms that affected and unaffected banks follow similar trends prior to the enactment of constituency statutes. The decline in discretionary loan loss provisions becomes evident in the year of adoption. This suggests an immediate response to statute enactment. Moreover, the effect remains stable through the fourth year after enactment. This is consistent with a sustained shift in managerial reporting practices rather than a short-lived transition effect.

We also investigate whether the aforementioned reduction extends beyond loan loss provisioning to financial reporting more generally. Given that managers exercise discretion across multiple accounting choices, a single reporting channel may capture only part of the impact of stakeholder-oriented governance. Consequently, we examine a range of additional proxies, including: the timeliness of loss recognition (Bushman and Williams, 2015); the propensity to beat earnings benchmarks (Kanagaretnam et al., 2014); the predictability of future earnings from current cash flows (Altamuro and Beatty, 2010); earnings smoothing through discretionary securities gains (Barth et al., 2017); and reliance on opaque assets that are difficult for outsiders to value (Danisewicz et al., 2021). Across these measures the pattern is consistent. Stakeholder-orientated banks: recognise credit losses more promptly; are less likely to engineer small positive earnings changes; report fewer discretionary securities gains; hold fewer opaque assets; and report cash flows that track future earnings more closely. The impacts are symmetric. In other words, managers become less likely to use discretionary loan loss provisions to either boost or depress earnings. This suggests a broad restraint on reporting discretion rather than a reallocation of discretion across different provisioning strategies. Overall, our results suggest that constituency statutes constrain various forms of discretionary reporting. Thus limiting opportunities for earnings management across a range of accounting choices rather than reducing discretion in a single reporting channel.

We also investigate whether this effect operates uniformly or varies with the influence that different stakeholder groups already exert over managers. Banks are embedded in environments in which some stakeholders already possess strong

incentives and effective means to monitor managerial behaviour, while others exert influence primarily through formal oversight. The incremental impact of constituency statutes is likely to depend on the extent to which the discipline created by broader fiduciary duties overlaps with or adds to existing constraints. Where stakeholders already monitor managers closely and can impose direct economic consequences in response to poor or misleading reporting, managers have less latitude to exercise reporting discretion even before constituency statutes are enacted. In such cases, constituency statutes may substitute for pre-existing discipline, and only have a small marginal impact. Conversely, where existing stakeholder discipline is weak, broadening the interests managers are permitted to consider may provide a more significant change in the constraints surrounding financial reporting. Consequently, examining heterogeneity across different stakeholder groups allows us to identify the conditions under which stakeholder governance matters. Our results suggest that the impact of constituency statutes is substantially weaker in banks where market discipline is already strong. This is evident for banks with a higher proportion uninsured (to total) deposits, and banks affiliated with publicly listed bank holding companies. In both cases, stakeholders have both the incentive and the ability to monitor managers.[5] Consequently, constituency statutes provide little additional constraint (impact) on the reporting discretion of managers. In contrast, we find no evidence that the impact of constituency varies with the presence of stakeholders (such as tax authorities and bank supervisors), who while holding formal authority, lack direct

[5] They can discipline managerial behaviour through deposit withdrawals, funding costs, capital market scrutiny, and governance pressures.

financial economic exposure to changes in reported bank performance flowing from change in financial reporting quality. Lacking direct financial exposure to reporting failures, these stakeholders depend on periodic oversight and enforcement rather than continuous market discipline.

In order to ensure the robustness of our findings, we conduct a series of tests addressing key identification concerns. First, event-study analyses show no evidence in differential pre-trends between treated and control banks prior to statute enactment, with placebo treatments yielding no significant effects. Second, propensity score matching shows that results are not driven by systematic differences between banks incorporated in adopting versus non-adopting states. Third, we do not detect reverse causality. Pre-treatment provisioning behaviour does not predict the timing of constituency statute enactment at the state level. Fourth, we address the concern that our results reflect the 1993 introduction of FAS 114, a concurrent accounting change that tightened loan-loss recognition, by showing that the effect holds when we restrict identification to pre-1993 period, before FAS 114 took effect. Our results do not change when an alternative estimator, accounting for the staggered adoption of statutes, is utilised (Borusyak et al., 2024). Taken together, these checks support the interpretation of our results as reflecting a causal effect of stakeholder-oriented governance on managerial discretion in financial reporting.

Overall, our findings suggest that stakeholder-oriented governance reduces managerial discretion in financial reporting. The impact is pronounced at the time of adoption and persists through the fourth year after enactment. Moreover, the impact appears across both income increasing and income decreasing reporting

choices, and extends beyond loan loss provisioning to a broader set of discretionary accounting practices. The impact is strongest where managers face relatively weak market-based monitoring and is attenuated where depositors or capital markets already exert discipline. Our results are consistent with constituency statutes reducing the scope for opportunistic financial reporting discretion.

The remainder of the paper is structured as follows. Section 2 provides background on constituency statutes and situates our study within related literature. Section 3 describes the data and outlines our empirical methodology. Section 4 presents the baseline and alternative financial reporting measures results, and a series of robustness checks addressing parallel trends, matching, and reverse causality. Section 5 examines heterogeneous effects, focusing on how market discipline mechanisms (via depositors and shareholders) and regulatory oversight (via tax authorities and supervisors) shape the impact of constituency statutes. Section 6 concludes.

2. Background and Literature Review

Shareholder primacy and value maximisation have long been the prevailing view in analyses of the modern corporation (Friedman, 1970; Keay, 2011). Stakeholder theory challenges this view by asserting that managers should balance the interests of all parties. This view led to a long-running debate regarding corporate purpose and the objectives guiding managerial decision-making (Freeman, 1984; Freeman et al., 2010; Bebchuk and Tallarita, 2020; Edmans, 2020; Mayer, 2021).

During the 1980s, academic debates on shareholder primacy and stakeholderism coincided with a surge in hostile corporate takeovers and mergers in the United States. These takeovers often resulted in significant costs for stakeholders, including worker layoffs, organisational downsizing and wealth transfers to shareholders (Bainbridge, 1991; Orts, 1992). In order to mitigate these negative impacts, states introduced anti-takeover statutes, including constituency statutes. These provided managers and directors with the discretion to consider a broader range of stakeholder interests when making operational and strategic decisions (Leung et al., 2019).[6]

Ohio codified the first constituency statute in 1984, followed by 34 other states. By 2007, 35 states had adopted constituency statutes (Online Appendix A1, Figure A1 provides details of the evolution of the enactment of constituency statutes across states). Although the wording of constituency statutes differs across states, a common theme advocates that managers and directors perform fiduciary duties while considering the interests of other stakeholders. Constituency statutes list employees, customers, suppliers, creditors, local communities, society, environment, and other parties as stakeholders (McDonnell, 2003). Following the enactment of constituency statutes, managerial perceptions, corporate policies and governance (evidenced by increased stakeholder representation on company boards) often changes to accommodate wider stakeholder interests (Luoma and Goodstein, 1999; Radhakrishnan et al., 2018).

[6] Geczy et al. (2015) review historical federal and state court cases challenging the validity of constituency statutes, noting that only a few cases resulted in negative court decisions.

Prior research regarding the organisational effects of stakeholder-oriented governance has largely focused on non-financial firms. Results suggest that constituency statutes influence corporate decisions by increasing liquidity and cash holdings (Chowdhury et al., 2021; Atif et al., 2023), reducing tax avoidance (Chen et al., 2023), fostering innovation (Flammer and Kacperczyk, 2016), reducing the cost of debt (Gao et al., 2021), curbing earnings management (Ni, 2020), and curbing share repurchases (Ni et al., 2020). Evidence in the banking sector is more limited and has examined outcomes such as financial stability and payout policy, showing that stakeholder-oriented governance can reduce risk-taking and payouts (Leung et al., 2019; Chronopoulos et al., 2023). We extend this literature by examining managerial discretion in financial reporting. This is of particular importance in banking given the opacity of balance sheets, the reliance on public trust, and the central role of disclosures in supporting both market and regulatory discipline. In line with prior evidence that constituency statutes encourage more prudent policies, we find that discretionary loan loss provisioning and related reporting behaviours decline following the state-level adoption of constituency statutes.

Prior research examines how governance structures (particularly the compositions of boards and various committees), shape financial reporting outcomes (Beekes et al., 2004; Pucheta-Martinez and Garcia-Meca, 2014; García-Meca and Sánchez-Ballesta, 2009). While this research provides valuable insights, it largely overlooks how changes in the legal environment influence managerial discretion. We contribute evidence that the adoption of constituency statutes (which permit managers to consider non-shareholder interests) reduces

the use of managerial discretion in bank financial reporting. The consistency of our findings across multiple measures of reporting discretion suggests they are not an artefact of measurement error or proxy choice.

Our heterogeneity analysis reveals substantial variation across banks, consistent with differences in stakeholders' ability to monitor and discipline managers. We find that the decline in discretion varies systematically with banks' stakeholder environments. Where uninsured depositors or shareholders of publicly listed banks already exert strong and continuous market-based discipline, the incremental effect of statutes is limited. This pattern is consistent with the view that the effect of stakeholder-oriented governance depends on the strength of existing stakeholder discipline. This aforementioned interpretation is grounded in the market discipline literature, which emphasises that stakeholders constrain managerial discretion only when they have both the incentives to monitor managers, and the means to act on the information they obtain. (Boot and Schmeits, 2000; Flannery, 2001; Bliss and Flannery, 2002).[7] For example, depositors with uninsured claims have strong incentives to monitor risk and can discipline banks through withdrawals or funding repricing (Park and Peristiani, 1998; Goldberg and Hudgins, 2002), while bondholders and other debtholders exert discipline through risk premia (Flannery and Sorescu, 1996; Sironi, 2003). Shareholders can also exert internal discipline via governance and turnover mechanisms, though their influence often differs from that of debtholders or regulators (Bliss and Flannery, 2002; Schaeck et al., 2012). Moreover, this

[7] More broadly, governance mechanisms need not operate independently, with their effectiveness depending on the strength of other sources of market discipline (Bozec, 2005).

literature highlights how private stakeholders (as opposed to government agencies) can monitor and influence bank behaviour (Flannery, 2001).

Our findings augment the market discipline literature by showing that the organizational consequences of constituency statutes depend on the salience of market-based stakeholders. Where such stakeholders already exert strong discipline, constituency statutes add little beyond the existing monitoring environment. This finding also contributes to the growing literature on regulatory effectiveness (Agarwal et al., 2014; Costello et al., 2019; Gallemore, 2023) and market discipline in banking (Flannery and Bliss, 2019; Nier and Baumann, 2006). Specifically, it suggests that market discipline may substitute for broader fiduciary duties in constraining managerial financial reporting discretion.

3. Data and Methodology

3.1 Data

Our sample period spans 1980 through 2010, capturing four years before the first constituency statute enactment (passed in Ohio) and three years after the most recent (passed in Nebraska). This timeframe allows us to analyse the complete wave of constituency statute implementations across U.S. states. We collect data from the Federal Reserve Bank of Chicago Consolidated Reports of Condition and Income (Call Reports) database. This database and the Call Reports therein provide detailed information regarding the financial position, performance and risk of U.S. commercial banks (Costello et al., 2019). This data is merged with bank-level state of incorporation information collected from the National

Information Center (NIC) maintained by the Federal Financial Institutions Examination Council (FFIEC).[8]

We retain commercial banks, and omit other financial institutions, including government-sponsored enterprises, savings & loans associations, cooperative banks, and credit unions (Costello et al., 2019). Focusing on a relatively homogeneous group of financial institutions, and the existence of Call Report data allows us to account for financial characteristics potentially correlated with discretion in financial reporting in a standardised way (Gallemore, 2023). Given that banks are involved directly in core banking activities such as lending and deposit-taking, an analysis at the commercial bank level (rather than the bank holding company level) provides richer geographic coverage and effective treatment allocation.[9] We exclude banks with missing total assets and negative total equity values, as well as those located outside mainland U.S. territories.

Our final sample comprises 74,643 bank-year observations from 3,014 unique commercial banks. Of these, 56,630 bank-year observations (75.9%) representing 2,266 unique banks incorporated in a state that enacted constituency statutes at some point during our sample period are treated. The distribution of treated bank observations across U.S. states is provided in Table A1 (Online Appendix A1). Our bank-level financial statement data is combined with state-level macroeconomic data. Per capita state income is collected from the U.S. Bureau of Economic Analysis. State unemployment rates are collected from the

[8] The Call Report data can be accessed at: https://www.chicagofed.org/banking/financial-institution-reports/commercial-bank-data, while the state of incorporation data is accessed at: https://www.ffiec.gov/npw/FinancialReport/DataDownload.
[9] Call Report item RSSD9048 identifies entities with commercial bank charters.

U.S. Bureau of Labor Statistics. The house price index representing all housing market transactions in a given state is collected from the Federal Housing Finance Agency.

3.2 Methodology

Our empirical approach comprises two stages. In the first stage, we estimate expected loan loss provisions and define discretionary loan loss provisions (DLLP) as the residual component. In the second stage, we implement a difference-in-differences (DiD) design to assess how stakeholder-oriented governance (via constituency statutes) affects managerial discretion in financial reporting.

To examine managerial discretion in financial reporting, we focus on loan loss provisions (LLP), the most significant accrual on bank balance sheets. LLPs are typically large relative to net income and equity, and are highly correlated with other income statement items. LLPs require banks to estimate expected credit losses based on private information about loan quality and borrower creditworthiness, which inherently involves substantial managerial judgement (Wahlen, 1994; Liu and Ryan, 2006). Given this discretionary nature and the association between LLP manipulation and financial restatements and regulatory interventions (Beatty and Liao, 2014; Cohen et al., 2014), discretionary LLPs serve as a well-established measure of managerial discretion in financial reporting.

We follow the literature in estimating a provisioning model that captures the non-discretionary (expected) component of LLPs based on loan portfolio characteristics, bank fundamentals, and macroeconomic conditions (Beatty and Liao, 2014). We then define discretionary loan loss provisions (DLLPs) as the

absolute value of the resulting residuals. Higher values indicate greater use of discretion in financial reporting, while smaller residuals imply less scope for managerial discretion.

We adopt a specification based on Beatty and Liao (2014), who show that LLP models incorporating forward-looking loan quality measures (lead changes in non-performing loans) alongside contemporaneous and lagged changes perform particularly well in predicting earnings restatements and SEC comment letters. Following Jiang et al. (2016), we augment this specification by including our treatment variable and fully interacting it with all regressors. Constituency statutes may alter not only banks' discretionary provisioning but also the systematic relationship between provisions and their fundamental determinants. For example, affected banks may shift their loan-portfolio composition, or the sensitivity of their provisions to local macroeconomic conditions may change. Absent the interactions, any such statute-induced shift in the average provisioning function would be absorbed into the residual and mislabelled as discretion. Our estimable model is:

$$\begin{aligned} LLP_{i,t} = {} & \gamma_0 + \gamma_1 \Delta NPL_{i,t+1} + \gamma_2 \Delta NPL_{i,t} + \gamma_3 \Delta NPL_{i,t-1} + \gamma_4 Size_{i,t-1} + \gamma_5 \Delta Loans_{i,t} \\ & + \gamma_6 ALW_{i,t-1} + \gamma_7 CO_{i,t} + \gamma_8 Growth_{l_i,t} + \gamma_9 HP_{l_i,t} + \gamma_{10} \Delta Unemp_{l_i,t} \\ & + \theta_0 CS_{s_i,t} + \sum_{k=1}^{10} \theta_k \left(CS_{s_i,t} \times Controls_k \right) + \eta_{i,t} \end{aligned} \tag{1}$$

where LLP_{it} represents the loan loss provisions (normalised with the beginning period total loans) for bank i in year t and $Controls_k$=$\{ \Delta NPL_{i,t+1}, \Delta NPL_{i,t}, \Delta NPL_{i,t-1}, Size_{i,t-1}, \Delta Loans_{i,t}, ALW_{i,t-1}, CO_{i,t}, Growth_{l_i,t}, HP_{l_i,t}, \Delta Unemp_{l_i,t} \}$. We also include lead, contemporaneous and lagged values of the change in non-performing loans

$\Delta NPL_{i,t}$ (Beatty and Liao, 2011; Bushman and Williams, 2012; Curcio and Hasan, 2015; Curcio et al., 2017). $Size_{i,t-1}$, is the natural logarithm of total assets, $\Delta Loans_{i,t}$ represents the change in total loans divided by beginning period total loans (Jiang et al., 2016; Beatty et al., 2002). $ALW_{i,t-1}$ denotes the lagged value of loan loss allowances-to-total loans ratio and $CO_{i,t}$ is the ratio of charge-offs to total loans (Kanagaretnam et al. 2010; Altamuro and Beatty, 2010). Covariates also include the change in per-capita income ($Growth_{l_i,t}$), the return on house price index ($HP_{l_i,t}$) and the change in the unemployment rate ($\Delta Unemp_{l_it}$, where l_i denotes (headquarter) location state of bank *i*.) $CS_{s_i,t}$equals one if bank *i*'s state of incorporation s has enacted a constituency statute by year *t*, and zero otherwise. $CS_{s_i,t}$ is fully interacted with all other regressors in the model. These interactions allow each component of the provisioning model to differ before and after the statute enactment. By allowing these relationships to shift, we ensure that the residuals reflect bank-specific discretionary deviations from expected provisions, rather than confounding discretionary behaviour with systematic changes in the provisioning model itself. For instance, if constituency statutes lead banks to alter their loan-portfolio composition, the resulting change in how provisions respond to loan-quality measures is captured by the interactions rather than inflating the residual.

Next, we define the discretionary component of the LLPs (our proxy for managerial discretion in financial reporting) as the absolute value of the residual from Equation (1):

$$DLLP_{i,t} = |\eta_{i,t}| \tag{2}$$

We use the absolute value because both positive and negative residuals may reflect discretionary manipulation of provisions beyond that accounted for by the regressors in Equation (1). Higher values of $DLLP_{i,t}$ indicate greater bank-specific discretionary deviations from expected provisions, while lower values indicate smaller discretionary deviations.

Following established practice, in the second stage of our empirical design, we utilise a DiD model to assess the impact of stakeholder orientation on managerial discretion in financial reporting (Leung et al., 2019; Chronopoulos et al., 2023). Our estimable model is:

$$DLLP_{i,t} = \beta CS_{s_i,t} + \varphi X_{i,t} + f_i + \delta_{r(l_i),t} + \varepsilon_{i,t} \quad (3)$$

where i refers to bank, and t denotes the year. The outcome variable, $DLLP_{i,t}$, is discretionary loan loss provisions, measured by the absolute value of the residuals (Equation 2). Higher values imply larger deviations from expected loan loss provisioning behaviour, and thus greater discretion in financial reporting. The main independent variable, $CS_{s_i t}$, is our constituency statute treatment indicator defined earlier in this section. Our specification includes bank fixed effects (f_i) to account for the possible influence of time-invariant unobserved bank characteristics. Region-by-year ($\delta_{r(l_i),t}$) fixed effects are added to control for time-varying local shocks (such as regional macroeconomic outlook, financial conditions or government policies) that may correlate with bank reporting and treatment (Leung et al., 2019), where l_i indexes bank i's (headquarter) location state and r

denotes the corresponding region (West, Midwest, South, and Northeast).[10] We saturate the model with a vector of bank-level covariates ($X_{i,t}$) identified by prior literature as determinants of bank reporting discretion.[11] These include: the natural logarithm of total assets ($Size$); bank risk measured by the Z-score distance to default ($Solvency$); the ratio of cash and balances to total assets ($Liquidity$); the ratio of dividends to total equity ($Payouts$); annual growth rate of loans and deposits ($Loan\ Growth$ and $Deposit\ Growth$); and a binary variable representing banks with negative net income ($Loss$) (Altamuro and Beatty, 2010; Danisewicz et al., 2021; Gallemore, 2023; Luu et al., 2023).

In Equation (3), β captures the causal impact of stakeholder orientation by comparing the change in reporting discretion for banks subject to constituency statutes with the corresponding change for banks that are never subject to constituency statutes. To address potential serial correlation in the dependent variable arising from treatment assignment at the state-of-incorporation level (i.e., constituency statute enactment), we cluster standard errors at the state-of-incorporation level (Bertrand et al., 2004; Abadie et al., 2023). All continuous variables are winsorised at 1% and 99% thresholds to reduce the influence of outliers. Variable definitions are provided in Table 1.

Table 2 presents summary statistics for the variables included in our regression analyses. The average DLLP in our sample is 0.2652. The average bank in our sample has an asset size of $67.6 million, a log Z-score of 4.07 and liquidity

[10] Our results are robust to alternative fixed effects specifications (see Online Appendix Table A3, rows (1) and (2)).

[11] In order to ensure that our results are not driven by cross-state heterogeneity in governance frameworks, legal provisions affecting financial reporting, or bank-specific regulatory thresholds, we conduct additional analyses. The results of which are reported in Online Appendix Table A3.

of 6%. Additionally, the average dividend yield on equity is 5.38%, while loan and deposit growth rates stand at 8% and 7%, respectively. Lastly, banks report losses in 4.7% of bank-year observations. Pairwise correlations among our variables are presented in Table A5 in the Online Appendix. They are generally modest, with the highest being 0.603 between Loan Growth and Deposit Growth. The correlations exhibit theoretically consistent patterns and do not suggest multicollinearity concerns.

[**Insert Table 1 Here**]

[**Insert Table 2 Here**]

4. Empirical Results

4.1 Baseline Findings

In this section, we investigate the effect of stakeholder orientation on managerial discretion in financial reporting. Specifically, we estimate Equation (3) using discretionary loan loss provisions, $DLLP$, as a proxy for bank managerial discretion, while clustering standard errors at the state-of-incorporation level.[12] In column (1) of Table 3, the coefficient on CS is negative and statistically significant at the 1% level. This suggests that managers at treated banks exercise less discretion in loan loss provisioning relative to counterparts at banks in states not enacting

[12] $DLLP$ is obtained from estimating Equation (1), the results of which are presented in Online Appendix A2. These findings are in line with results reported in prior studies on discretion in financial reporting. Clustering at the bank level and two-way clustering at the state-of-incorporation and year levels are also applied to re-estimated versions of our baseline model, as reported in Online Appendix Table A3 (rows (3) and (4)). The results remain unchanged.

constituency statutes. This effect is economically meaningful, given that the coefficient implies a 14.9% decline in $DLLP$ relative to the sample mean (=0.0396/0.2652), and a 25.3% decline relative to the sample median.

Prior literature suggests that discretionary loan loss provisioning can take the form of positive and negative $DLLP$. Banks can under-provision by recording negative $DLLP$ (negative residuals from Equation 1) to inflate earnings, boost capital and conceal risk especially during periods of economic turmoil. Similarly, banks can over-provision by recording higher $DLLP$ (positive residuals from Equation (1)) to depress earnings, disseminate private information regarding credit risk, or smooth earnings and build resources for less buoyant periods in the future (Beatty and Liao, 2014). With this in mind, we employ the absolute values of signed residuals, $DLLP_Minus$ and $DLLP_Plus$, as dependent variables in columns (2) and (3) of Table 3, respectively. In both instances, the coefficient on CS is negative and significant. This suggests that stakeholder orientation reduces discretionary provisioning in both directions rather than shifting it from one to the other.

The signs of other control variables conform to prior expectations. Banks with stronger solvency and higher dividend payouts exhibit less discretion in loan loss provisioning. On the other hand, managers of banks with sufficient liquidity and growth opportunities are more likely to report higher $DLLP$. This is evidenced by positive and significant coefficients on $Liquidity$, $Loan\,Growth$ and $Deposit\,Growth$. $Loss$ is also a significant determinant of reporting discretion, with loss-making banks exhibiting higher $DLLP$.

[**Insert Table 3 Here**]

We execute numerous robustness tests to evaluate the validity of our baseline findings with respect to: an alternative DiD estimator; statistical modelling; sample period coverage; state-level features of constituency statutes; other concurrent legal changes; and structural bank characteristics. Detailed explanations and the results of these tests are provided in Online Appendix A3. These results confirm our baseline findings that decreased discretionary loan loss provisions (of the treated banks) follow the enactment of stakeholder constituency statutes. We also investigate whether our baseline findings are sensitive to the formation of first-stage regressions and the transformation of residuals to create the dependent variable *DLLP*. The results (presented in Online Appendix A4) corroborate our baseline inferences.

4.2 Alternative Measures of Financial Reporting Discretion

In the next stage of our investigation, we assess whether the observed reduction in discretion is specific to loan loss provisioning or also evident in other reporting dimensions. Our baseline measure, *DLLP*, captures discretion exercised through a single accounting channel. The size of the loan loss provision relative to what fundamentals predict. Managers, however, retain discretion over reporting choices that *DLLP* does not capture by construction (Delis et al., 2018; Beatty et al., 2025). We therefore examine three further families of measures: *the timing of provisioning*, which a contemporaneous magnitude residual cannot detect; *earnings-based* and *securities-based* measures, capturing income management accomplished outside the provisioning account; and *asset composition-based*

measures, which capture the opacity of the balance sheet that outsiders struggle to value.

[**Insert Table 4 Here**]

4.2.1 Timing of Provisions

In general, the accurate timing of loss recognition implies that current provisions are highly correlated with contemporaneous and future non-performing loans. However, banks may choose to delay acknowledging loan losses by rolling over problem loans. Such actions are likely to reduce the ability of stakeholders to assess the financial position of banks accurately (Leventis et al., 2013). Banks that do not apply conditional conservatism are slower to reflect deteriorating fundamentals in reported earnings (Nichols et al., 2009). Moreover, given the presence of financial safety net arrangements, banks may conceal non-performing loans and risk overhang in order to pacify market participants, avoid supervisory scrutiny, and reduce the information available to their stakeholders (Beatty and Liao, 2011; Bushman, 2014). Banks failing to recognise loan losses in a timely fashion also: hold weaker loan portfolios; operate with inadequate capital (thus contributing disproportionately to systemic risk); and commit more fraud (Bushman and Williams, 2012; Akins et al., 2017).

We follow a two-step procedure to investigate the impact of stakeholder orientation on delayed expected loan loss recognition ($DELR$). First, we estimate the following regressions:

$$LLP_{i,t} = \gamma_0 + \gamma_1 \Delta NPL_{i,t-1} + \gamma_2 \Delta NPL_{i,t-2} + \gamma_3 Capital_{i,t} + \gamma_4 Income_{i,t} + \gamma_5 Size_{i,t} + \gamma_6 Real\ Estate\ Loans_{i,t} + \gamma_7 Commercial\ Loans_{i,t} + \varepsilon_{i,t} \quad (4)$$

$$LLP_{i,t} = \gamma_0 + \gamma_1 \Delta NPL_{i,t-1} + \gamma_2 \Delta NPL_{i,t-2} + \gamma_3 Capital_{i,t} + \gamma_4 Income_{i,t} + \gamma_5 Size_{i,t} + \gamma_6 Real\ Estate\ Loans_{i,t} + \gamma_7 Commercial\ Loans_{i,t} + \gamma_8 \Delta NPL_{i,t} + \gamma_9 \Delta NPL_{i,t+1} + \varepsilon_{i,t} \quad (5)$$

LLP is loan loss provisions divided by total loan balance in the previous period. ΔNPL is the change in non-performing loans divided by the lagged total loans. $Capital$ is the equity-to-assets ratio. $Income$ is the ratio of total interest and non-interest income normalised by lagged loans. $Size$ is the natural logarithm of total assets. $Real\ Estate\ Loans$ and $Commercial\ Loans$ are the ratios of loans secured by real estate and commercial & industrial loans to lagged loans.

Following Bushman and Williams (2015), we collect quarterly data for our sample banks and estimate Equations (4) and (5) at individual bank-level over a 12-quarter moving window to record time-varying adjusted R-squared values. We create a binary indicator $DELR$, which equals one if the differential adjusted R-squared values of Equation (5) (relative to that of Equation (4)) are lower than or equal to the sample median value for bank i in year t (based on the last quarter values), and zero otherwise. Thus, $DELR$ captures loan loss provisions with a considerable delay.

We then use $DELR$ as the outcome variable and re-estimate the baseline model (column (1) of Table 4). The coefficient on CS is negative (−0.0146) and significant at the 10% level. This suggests that banks with greater stakeholder orientation recognise loan losses in a timelier manner.

4.2.2 Earnings-Based Measures

Managers failing to meet earnings expectations are more likely to be replaced.[13] Consequently, managers face incentives to meet-or-exceed profitability reported in prior years and avoid conveying bad news to bank stakeholders (Altamuro and Beatty, 2010). To analyse the impact of stakeholder orientation on the avoidance of earnings declines, we construct a binary variable for small positive earnings changes, $SPEC$, which equals one for banks reporting a change in income before taxes normalised by total assets (from prior to the current year) staying between 0 and 0.001, and zero otherwise (Kanagaretnam et al., 2014). The results in column (2) of Table 4 suggest that the enactment of constituency statutes decreases the likelihood of banks recording small positive changes in earnings.

We next examine the predictability of earnings. When reporting reflects underlying performance rather than discretionary adjustment, current fundamentals map more closely into future earnings, so that reported figures are more informative to the debtholders and shareholders who rely on them to value their claims on the bank (Dechow et al., 2010; Altamuro and Beatty, 2010). A common way to capture this property is to test how well current cash flows predict future earnings. Stronger predictability indicates that reported earnings are less distorted by discretionary smoothing. Following Delis et al. (2018), we estimate the following regression:

[13] Beatty et al. (2002) document that banks manage reported earnings to avoid declines, so that the distribution of annual changes in earnings exhibits a kink at zero with an unusual concentration of small positive changes.

$$EBT_{i,t+1} = \gamma_1 EBTLLP_{i,t} + \gamma_2\left(EBTLLP_{i,t} \times CS_{s_{,}t}\right) + \gamma_3 CS_{s_i,t} + \varphi X_{i,t} + f_i + \delta_{r(l_i),t} + \varepsilon_{i,t} \quad (6)$$

where EBT is the ratio of income before taxes to total assets, while $EBTLLP$ is a proxy for cash flows, defined as the ratio of income before taxes and provisions to total assets. CS is the usual treatment term, which captures the shift in stakeholder orientation following the enactment of constituency statutes. The coefficient of interest (γ_2) captures the extent to which the enactment of constituency statutes alters the relationship between future earnings and contemporaneous cash flows. The interaction term is positive (+0.0994) and significant at the 1% level (column (3) of Table 4), indicating that current cash flows predict future earnings more strongly following statute enactment, consistent with a reduction in the discretionary smoothing of reported income.

4.2.3 Securities-Based Measures

Banks are equipped with means other than provisions and earnings-based methods to modify financial reporting information. Short-term securities accounts carried in bank financial statements are categorised into trading, held-to-maturity and available-for-sale (AFS). AFS items are subject to fair value accounting. Any change in the fair value of AFS items is recognised in other comprehensive income, but excluded from regulatory capital until realised. This allows banks discretion to determine when to realise such gains and losses in bank earnings and capital by opportunistically selling securities (Barth et al., 2017). Following the implementation of FAS 115 in 1993, the accounting treatment of income sources stemming from AFS item has become a popular way to smooth earnings, given that this is not intensely audited and does not impose considerable compliance costs

(Cohen et al., 2014; Barth et al., 2017). In this context, we estimate the following model:

$$Realised_AFS_{i,t} = \gamma_0 + \gamma_1 Size_{i,t} + \gamma_2 Unrealised_AFS_{i,t} + \gamma_3 CS_{s_{i,t}} + \varepsilon_{i,t} \quad (7)$$

where $Realised_AFS_{i,t}$ and $Unrealised_AFS_{i,t}$ denote the ratios of realised and unrealised gains and losses on AFS to total assets, respectively. The estimation of this model yields residuals whose absolute values, $DRGSL$, represent the discretionary use of AFS item to manage earnings (Barth et al., 2017; Fan et al., 2020). In the second stage, we replace the dependent variable in Equation (3) with $DRGSL$. The coefficient on CS is negative (−0.0043) and significant at the 5% level, indicating that treated banks make less discretionary use of AFS gains and losses for earnings and capital management.

4.2.4 Asset Composition-Based Measures

Following Danisewicz et al. (2021), we augment our analysis using asset composition-based measures as dependent variables. These comprise the ratio of real estate owned to total loans ($Real\ Estate$) in column (5) and the ratio of opaque assets to total loans ($Opaque\ Assets$) in column (6) of Table 4. Since these assets are difficult to value by outsiders, higher values of both are indicative of greater opacity (Flannery et al., 2013). In order to construct a group of opaque assets, we combine premises and fixed assets, investment in unconsolidated subsidiaries, intangible assets and other assets. The results presented in columns (5) and (6) of Table 4 suggest that both $Real\ Estate$ and $Opaque\ Assets$ decline following the enactment of constituency statutes, indicating that treated banks hold fewer assets that are difficult for outsiders to value.

Overall, the results suggest that a shift in stakeholder orientation reduces managerial discretion across several dimensions of bank reporting, as reflected in discretionary loan loss provisions and the additional proxies.

A natural question is whether these findings reflect the anti-takeover nature of constituency statutes rather than a broadening of managerial accountability. Given that constituency statutes reduced the threat of hostile acquisition, part of the estimated effect could operate through a weakened incentive to meet short-term earnings targets. The pattern of results across our measures does not corroborate this. Reduced takeover pressure is unlikely to explain our findings. Beyond measures linked to earnings targets, affected banks recognise loan losses more promptly and report cash flows that better predict future earnings. These improvements extend beyond what lower takeover pressure would predict.

4.3 Internal Validity of Empirical Design

We conduct a battery of tests to assess the internal validity of our baseline results, ensuring that they reflect the causal effect of stakeholder orientation on managerial discretion in financial reporting.

[Insert Table 5 Here]

4.3.1 Parallel Trends Assumption

An important assumption underlying the DiD research design is that of parallel trends. This posits that the outcome variable for treated and control units should evolve in a similar fashion in the absence of treatment (Roberts and Whited, 2013). Although the assumption cannot be tested directly, indirect evidence on its validity can be gathered by analysing dynamic treatment effects (Leung et al., 2019; Ni et

al., 2020). We therefore replace CS with a set of binary variables for years relative to statute enactment. We augment Equation (3) with $CS(-3)$, $CS(-2)$, $CS(-1)$, $CS(0)$, $CS(1)$, $CS(2)$, $CS(3)$, $CS(4)$, and $CS(5+)$, denoting three, two, and one year before treatment, the treatment year, and one through five (or more) years afterwards. Figure 1 presents the dynamic treatment effects graphically, showing the coefficient estimates and 95% confidence intervals for each year relative to enactment. The pre-treatment coefficients are small and statistically insignificant, consistent with the parallel trends assumption. Beginning in the enactment year, the treatment effect becomes significant, and it remains stable in magnitude through the fourth year following enactment, indicating a durable reduction in discretionary provisioning. Column (1) of Table 5 presents the corresponding regression results, confirming these patterns.[14]

[**Insert Figure 1 Here**]

To complement this analysis, we execute two placebo tests. In column (2) of Table 5, we retain constituency statute enactment dates, but randomise the enactment status across states to construct a $Placebo\ CS$ indicator. In column (3), we maintain the same enactment status across states, but reshuffle enactment years throughout the sample period to construct another version of $Placebo\ CS$. The results using both pseudo-treatment variables are insignificant. This further supports the notion that the parallel trends assumption is satisfied.

[14] Figure 1 provides a visual depiction of coefficient estimates relevant to dynamic terms.

4.3.2 Propensity Score Matching

Given that the state where banks choose to incorporate is not perfectly random, banks incorporated in statute-enacting states may differ from those in control states on observable characteristics. In order to alleviate such concerns, we employ a propensity score matching procedure (Rosenbaum and Rubin, 1983). We construct a pool of treated and control banks by retaining cross-sectional observations one year before the enactment of the first constituency statute (in 1983). We then estimate a probit model of treatment status on the continuous control variables (*Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth* and *Deposit Growth*) from the baseline model. Matching each treated bank to a control bank one-to-one without replacement on the estimated propensity score yields 570 matched pairs. We then expand the matched sample to cover the whole sample period (1980-2010), and re-estimate Equation (3). The results are presented in Column (4) of Table 5. The coefficient on CS is negative (−0.0497) and significant at the 1% level, consistent with our baseline estimate and indicating that the reduction in discretionary provisioning is not driven by observable differences between banks in adopting and non-adopting states.

4.3.3 Reverse Causality

Reverse causality presents another potential threat to the validity of our research design. Karpoff and Wittry (2018) show that studies exploiting anti-takeover legislation, including constituency statutes, may be confounded when the timing of adoption is correlated with pre-existing state conditions rather than being exogenous to firm behaviour. We address this concern directly. The introduction of

constituency statutes sought to minimise externalities imposed on stakeholders during the hostile takeover wave of the 1980s (Barzuza, 2009). Prior evidence suggests that the enactment of constituency statutes was not driven by: individual firm lobbying efforts; macroeconomic / industry-related conditions; or political conditions specific to individual states (Flammer and Kacperczyk, 2016; Conti and Novelli, 2022), thus making it unlikely that individual bank policies determine whether a state adopts a constituency statute. However, this evidence is indirect, so we undertake a formal statistical analysis within our own setting. We retain all pre-treatment observations for banks incorporated in adopting states before these laws were codified. Then, for each state and year, we compute state-average *DLLP* and state-average values of the control variables from Equation (3) and use a probit model to estimate the probability of statute enactment as a function of these ex-ante state-level characteristics. In column (5) of Table 5, the coefficient on ex-ante state-average provisioning is negative and statistically insignificant (−0.6887), indicating that state-level provisioning behaviour does not predict the timing of constituency statute adoption among adopting states.

4.3.4 Concurrent Accounting Change

A further concern is that our estimates capture the effect of a concurrent accounting change rather than the governance shift. The most relevant is the 1993 introduction of FAS 114, which required banks to measure impairment on individually identified problem loans using prescribed methods, such as the present value of expected cash flows, the observable market price, or the fair value of collateral, rather than the broader judgment-based estimation permitted under the pooled FAS 5 approach. In doing so, FAS 114 narrowed managerial discretion

in loan-loss recognition. By applying only to impaired loans, the standard constrained one element of provisioning discretion, while the general allowance continued to depend on managerial judgment. Given that FAS 114 applied nationally, its common effect is absorbed by our region by year fixed effects. The residual concern is therefore confined to the post-1993 adopters, whose treatment overlaps the accounting change and whose provisioning could reflect FAS 114 rather than the statute. To address this, we re-estimate the baseline model by restricting the sample to the pre-1993 period, so that identification rests entirely on observations predating FAS 114. The results are tabulated in column (6) of Table 5. The coefficient on CS is consistent with our baseline estimate, indicating that our findings are not an artefact of the FAS 114 transition.

5. Heterogeneous Effects of Constituency Statutes

Our baseline results show that constituency statutes reduce managerial discretion in financial reporting on average. However, this average effect may conceal meaningful variation across banks embedded in different stakeholder environments. Given that constituency statutes expand the set of interests that managers may consider, their impact is unlikely to be uniform. It should depend on which stakeholder groups already exert influence and through what channels. We focus on two such channels. The first is market discipline, exercised by stakeholders with direct economic exposure, such as uninsured depositors and public shareholders, who can impose immediate costs when reporting is perceived as misleading. The second is formal authority, exercised by institutional

stakeholders such as bank supervisors and tax authorities, whose influence stems from legal or regulatory standing rather than direct economic exposure and may be shaped by competing objectives or enforcement constraints. Examining these distinct environments allows us to assess whether constituency statutes substitute for, or complement, existing sources of stakeholder influence.

[Insert Table 6 here]

5.1 Market Discipline

Market discipline operates through stakeholders with direct financial exposure who can impose immediate costs when reporting is perceived as misleading. In banking, uninsured depositors and shareholders of publicly listed bank holding companies are especially relevant. Both bear direct losses when a bank's condition subsequently proves worse than reported. This provides them with strong incentives to scrutinise reporting, and if necessary act upon any information uncovered by repricing or reallocating funds. However, the mechanisms through which they impose discipline differ. Uninsured depositors can impose discipline through the repricing or withdrawal of funding, while shareholders do so through capital market scrutiny and governance channels. Ultimately, both uninsured depositors and shareholders have the capacity to translate concerns regarding reporting quality into economic consequences for managers.

5.1.1 Depositors and Market Discipline

Depositors provide core stable funding to banks and can exert market discipline when equipped with timely and reliable financial information (Bushman and

Williams, 2012; Flannery and Bliss, 2019). Depositor discipline manifests through demands for higher interest rates, deposit withdrawals, and potential bank runs (Davenport and McDill, 2006; Dang et al., 2017). Uninsured depositors are particularly salient, as they lack deposit insurance protection and thus scrutinise bank performance more closely than insured counterparts (Peria and Schmukler, 2001; Berger and Turk-Ariss, 2015).

Uninsured depositors combine a direct economic stake in the bank's financial condition with the ability to act on it. That is, bearing losses if a bank fails, they have strong incentives to assess reporting quality and they can respond by repricing or withdrawing funds (Flannery, 2001; Bliss and Flannery, 2002). Banks reliant on uninsured funding are therefore already constrained in their discretion, as managers must anticipate depositor reactions when setting provisioning and disclosure practices. Given that constituency statutes reduce discretion by broadening the constraints managers face, their incremental effect should be smaller where uninsured depositors already impose such constraints.

To examine this prediction, we construct a binary measure of uninsured depositors' discipline, *Uninsured Deposits*, equal to one if a bank's uninsured deposits-to-total deposits ratio exceeds the sample median in the pre-enactment period, and zero otherwise. This ensures the variable is predetermined and avoids endogeneity to subsequent policy adoption. Since higher discretionary loan loss provisions ($DLLP$) indicate greater reporting discretion, we expect the interaction between CS and Uninsured Deposits to enter positively, offsetting part of the negative main effect of CS. Column (1) of Table 6 confirms this expectation. The interaction is positive (+0.0198) and statistically significant, partially offsetting

the main effect of CS. This implies that the reduction in discretion following statute enactment is weaker, though still present, for banks with higher reliance on uninsured deposits.

5.1.2 Shareholders and Capital Market Discipline

Shareholders of publicly listed bank holding companies represent another important source of market discipline. These shareholders face reputational and financial costs from subsidiary misreporting, as poor subsidiary reporting can trigger costly restatements at the parent level and affect share prices (Palmrose et al., 2004). Recent evidence demonstrates that parent companies actively coordinate reporting strategies across their subsidiary networks, with headquarters exerting significant influence over subsidiary earnings management when integration is high (Beuselinck et al., 2019). Listed holding companies must include subsidiary financials in consolidated statements, creating incentives for accurate subsidiary reporting to avoid material misstatements (Bonacchi et al., 2018).

A subsidiary of a listed parent is exposed to the capital-market scrutiny the parent faces. Analyst coverage, share-price reactions, and the discipline exerted by shareholders can act on that information by repricing or reallocating capital (Flannery, 2001; Bliss and Flannery, 2002). Although shareholders are the central actors in this channel, the disciplining force operates through capital markets more broadly. Subsidiary banks embedded in such structures therefore already operate under continuous market scrutiny that constrains reporting discretion. Given that constituency statutes reduce discretion by broadening the constraints managers

face, their incremental effect should be smaller where this capital-market discipline is already present.

To test this idea, we construct a binary variable, *Public BHC*, equal to one if a bank is a subsidiary of a publicly traded bank holding company, and zero otherwise. We predict that the interaction of CS with *Public BHC* will attenuate the negative effect of CS on $DLLP$, since capital-market discipline substitutes for the disciplining role of stakeholder-oriented governance. Column (2) of Table 6 supports this hypothesis. The coefficient on the interaction term is positive (+0.0440) and significant, offsetting almost the entire main effect of CS. This indicates that constituency statutes have little incremental effect for banks embedded in publicly listed holding company structures, where market-based discipline is already strong.

5.2 Formal Authority

Tax authorities and bank supervisors hold formal authority over banks, but in contrast to market-based stakeholders they bear no direct financial exposure to the bank. Their influence stems from legal or regulatory standing rather than from a claim whose value depends on the bank's reporting and they operate under different objectives and different constraints. Whether this difference matters for how constituency statutes affect reporting discretion is an empirical question. On one hand, these stakeholders wield real enforcement power, and banks already facing close regulatory scrutiny may have limited scope for discretion, in which case constituency statutes would add little. On the other hand, regulators may be

a weaker substitute, as enforcement is periodic and constrained by competing objectives.

5.2.1 Tax Authority Oversight

Aggressive tax planning primarily benefits shareholders, but is considered unethical bybreaching the implicit trust between firms and non-investing stakeholders (Weisbach, 2002; Dowling, 2014). Managers can engage in earnings manipulation to reduce tax liabilities and maximise after-tax income. Aggressive tax planning can lower transparency (Desai and Dharmapala, 2006; Balakrishnan et al., 2019). Banks, in particular, may use instruments such as derivatives, securitizations, or special-purpose entities to shift profits and lessen tax liabilities. Tax regulators, meanwhile, seek accurate and transparent disclosures to curtail such practices. Prior literature suggests that transparent reporting requirements deter bank managers from engaging in aggressive tax management incentives (Joshi et al., 2020; Overesch and Wolff, 2021).

Tax authorities can constrain managers' reporting discretion through the threat of audit and enforcement, but they hold no financial position in the bank and act periodically rather than continuously. Whether their oversight already constrains reporting discretion, leaving little for constituency statutes to add, is an open question. If banks facing greater tax scrutiny have less scope for discretion, the incremental effect of the statutes should be smaller for those banks.

To test this, we construct a binary variable, *High ETR,* equal to one if a bank's adjusted effective tax rate (the ratio of total tax expenses to pre-tax income minus the state-level corporate income tax) exceeds the pre-treatment sample

median, and zero otherwise. Following Overesch and Wolff (2021), we exclude bank observations with negative and zero taxable income to ensure the ratio is well defined. Column (3) of Table 6 shows that the interaction of CS with *High ETR* is positive but statistically insignificant. We do not detect that interactions with tax regulators shape how constituency statutes affect managerial discretion in financial reporting.

5.2.2 Bank Supervisory Oversight

An important function of financial reporting is to disseminate accurate information to allow bank supervisors to assess financial position and risk (Bushman and Williams, 2015; Acharya and Ryan, 2016). Through on-site examinations and periodic reviews, supervisors use accounting-based inputs to identify problematic lending practices, enforce capital requirements, and (if necessary) impose sanctions. However, banks sometimes engage in aggressive earnings management (for example, under-provisioning) to conceal poor performance and avoid disciplinary action (Huizinga and Laeven, 2012), potentially undermining supervisory objectives of minimising systemic risk and protecting bank customers. While strict enforcement can limit discretionary provisioning (Delis et al., 2018; Costello et al., 2019), regulatory forbearance and resource constraints may weaken supervisors' willingness or ability to enforce it (Gallemore, 2023).

Like tax authorities, supervisors hold formal authority but no financial position in the bank, and they act through periodic examination whose intensity may be limited by competing objectives, such as ensuring credit availability and financial stability (Rezende and Wu, 2014; Wheeler, 2019). Whether supervisory

oversight already constrains reporting discretion, leaving little for constituency statutes to add, is an open question. If banks facing weaker supervisory discipline retain more scope for discretion, the statutes would have greater scope to reduce discretion for those banks.

We follow Yue et al. (2022) in using U.S. Senate Banking Committee membership as a proxy for supervisory leniency. Using Congressional Directories and C-SPAN data spanning the 96th to 111th Congress, we identify banks located in states with senators serving on the committee. Prior work shows that banks in these states tend to report higher discretionary provisions and face fewer enforcement actions, consistent with weaker effective supervision (Yue et al., 2022). We construct a binary variable, *Lenient Supervision*, equal to one if a bank is headquartered in such a state, and zero otherwise. If weaker supervisory scrutiny leaves more scope for constituency statutes to constrain discretion, we expect a negative interaction ($CS \times Lenient\ Supervision$).

Column (4) of Table 6 shows the interaction term is statistically insignificant. Thus, even among banks facing weaker supervisory discipline, for which we would expect the statutes to matter most, we do not detect a different effect on reporting discretion. We find no evidence that (strict or lenient) supervisory discipline shapes the incremental effect of constituency statutes.

5.3 Market Discipline versus Formal Authority

Finally, we estimate the four stakeholder groups jointly (column (5) of Table 6). What separates the moderating stakeholders from the rest is the channel through which they exert influence. Both stakeholders that operate through market

discipline continue to matter. Specifically, the interactions for uninsured depositors and public shareholders remain positive and significant, while neither stakeholder operating through formal authority is significant. The fact that the two market-discipline coefficients do not differ from one another in a statistical sense (Wald $F(1, 50) = 1.59$, $p = 0.21$) suggests that the specific stakeholder within this channel appears to matter less than the mode of influence through which discipline is exerted.[15] Therefore, constituency statutes bind most where market monitoring is weak, while formal authority alone shows little sign of substituting for them.

6. Conclusion

Managerial discretion is inherent to bank financial reporting, particularly when estimating credit risk and future loan losses. This discretion affects reported performance and the extent to which managers can influence outcomes and stakeholders can monitor their behaviour. A large body of work has examined how boards, ownership, and regulation influence banks' reporting practices, but evidence on how stakeholder orientation shapes managerial discretion remains scarce. In this paper, we fill this gap by exploiting the adoption of constituency statutes to investigate how managerial discretion in financial reporting responds to a legal shift in fiduciary duties toward stakeholders.

Our empirical analysis indicates that stakeholder-oriented governance curtails discretionary loan loss provisions, and that the reduction extends to other

[15] The main effect of CS is somewhat larger here (−0.0574), as it now reflects the statutes' impact on banks facing none of these disciplining forces.

forms of discretionary reporting. These findings are robust to a range of additional tests. The results of our heterogeneity analysis show that the effect is not uniform. It is concentrated among banks where market-based discipline is weak, and is substantially attenuated where uninsured depositors or public shareholders already discipline managers. In contrast, stakeholders (tax authorities and bank supervisors) whose influence rests on formal authority without direct financial exposure exhibit no detectable moderating effect. These findings suggest that constituency statutes matter most where existing market discipline is weak. Where economically exposed stakeholders already constrain managers, the statutes add little. However, where such discipline is weak, they have a larger effect. Therefore, incorporating stakeholder orientation into corporate governance frameworks may therefore reduce managerial discretion in financial reporting, particularly where market discipline mechanisms are underdeveloped and private monitoring is weak.

Our findings have relevance for the regulation of bank reporting. The reduction in discretion is concentrated among banks where market discipline is weak, while formal authority alone has little moderating influence. Policymakers seeking to constrain managerial discretion may therefore benefit from strengthening the incentives of economically exposed stakeholders and the market discipline they exert rather than relying on statutory frameworks alone. More generally, the effectiveness of stakeholder-oriented governance appears to depend less on the formal allocation of authority than on the presence of stakeholders with credible incentives to monitor and discipline managerial conduct.

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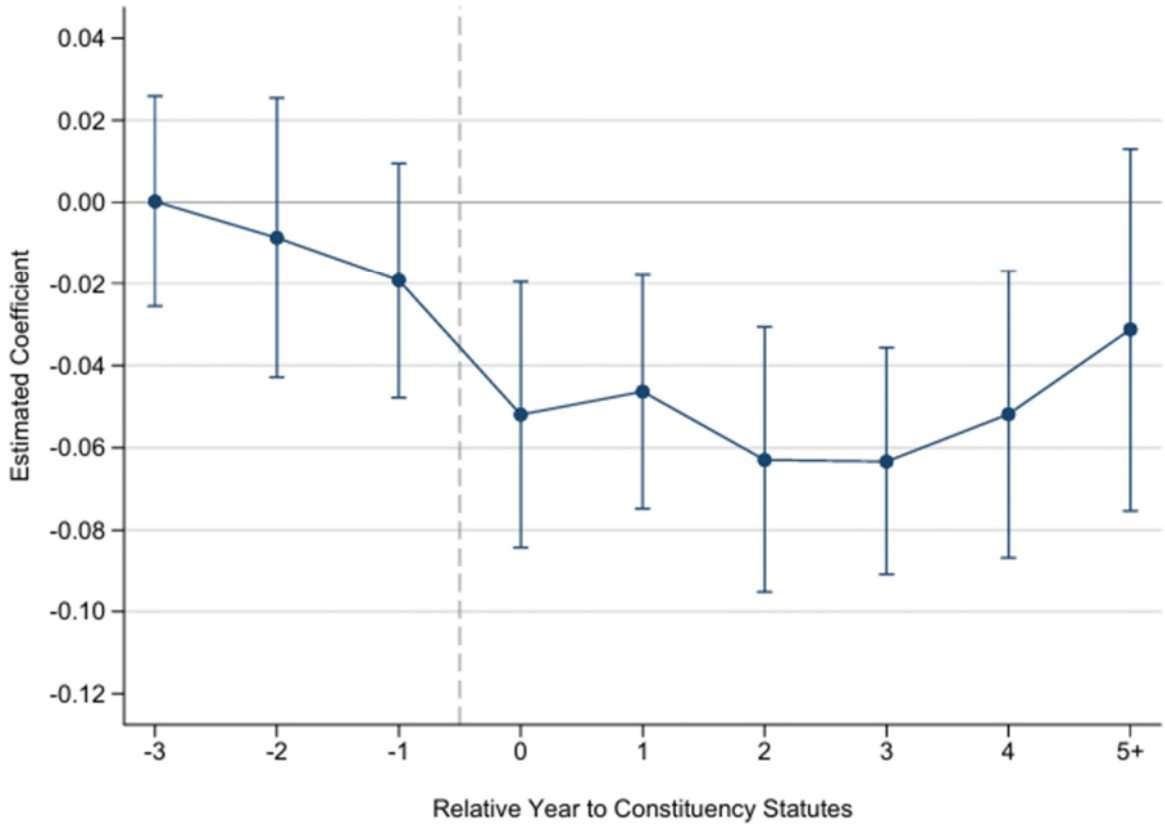
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Figure 1: Dynamic Treatment Effects



Notes: This figure shows the estimated coefficients and 95% confidence intervals from the event study analysis. The treatment is the adoption of the constituency statute in year t=0.

Table 1: Variable Definitions

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) (negative residuals attached to Equation (1))
DLLP_Plus	The absolute value of the positive discretionary portion of loan loss provisions (x100) (positive residuals attached to Equation (1))
CS	An indicator variable taking the value of one after the enactment of constituency statutes for the banks incorporated in the U.S. 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 normalised 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
ΔUnemp	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 (5) (relative to that of Equation (4) 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 normalised 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 realised gains and losses on available-for-sale securities (x100) (residuals attached to Equation (7))
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 (6))
EBTLLP	The ratio of income before taxes and provisions to total assets (Equation (6))

Notes: This table reports the detailed definitions used in the regressions. Panel A provides the descriptions of dependent and control variables employed in the main regressions in line with Equation (3), while Panel B covers the control variables used in Equation (1) to create the residual terms whose absolute values are taken as *DLLP*. Panel C provides definitions for alternative bank financial reporting proxies used in the consequent analyses.

Table 2: Summary Statistics

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

Notes: This table reports the summary statistics for dependent and control variables used in the main regressions in line with Equation (3). The sample includes observations of 3,014 commercial banks over the period 1980-2010. Bank financials are retrieved from Call Report filings. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1.

Table 3: Baseline Estimations

	(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

Notes: This table presents the estimation results of the baseline model specified in Equation (3). The sample covers the observations over the period 1980-2010 and the staggered enactment of constituency statutes. In column (1), the dependent variable is the absolute value of discretionary provisions (*DLLP*) derived from Equation (1). Columns (2) and (3) indicate the regressions involving negative and positive discretionary provisions, *DLLP_Minus* and *DLLP_Plus*, respectively. All regressions control for bank and region-by-year fixed effects. The main independent variable is *CS* taking the value of one if the incorporation state of a bank has enacted constituency statutes, otherwise assuming the value of zero. The dependent variables are multiplied by 100 for ease of interpretation. The full set of independent variables is included in columns (1), (2) and (3), which consists of *Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth*, *Deposit Growth* and *Loss*. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. Standard errors clustered at the state-of-incorporation level are reported in parentheses. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

Table 4: Alternative Dimensions of Financial Reporting Discretion

	(1) DELR	(2) SPEC	(3) EBT_{t+1}	(4) DRGSL	(5) Real Estate	(6) Opaque Assets
CS	-0.0146*	-0.0093**	-0.0016**	-0.0043**	-0.0013*	-0.0059***
	(0.0077)	(0.0045)	(0.0006)	(0.0021)	(0.0007)	(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

Notes: This table presents the estimations concerning other dimensions of bank financial reporting discretion. In column (1), the dependent variable is the *DELR* measure created in line with Bushman and Williams (2015) via Equations (4) and (5). In column (2), the dependent variable is *SPEC*, a binary indicator capturing the avoidance of earnings declines through small positive changes in reported earnings, constructed following Kanagaretnam et al. (2014). In column (3), we use the one-period lead ratio of income before taxes to total assets (EBT_{t+1}) as the dependent variable while the policy variable *CS* is interacted with contemporaneous value of the ratio of income before taxes and provisions to total assets (as a proxy for bank cash flows) ($EBTLLP_t$). In column (4), the dependent variable is *DRGSL* representing the absolute value of the residuals derived from Equation (7). Columns (5) and (6) use the ratios describing the share of opaque items including *Real Estate* and *Opaque Assets* to total loans, respectively. All regressions control for bank and region-by-year fixed effects. The main independent variable is *CS* taking the value of one if the incorporation state of a specific bank has enacted constituency statutes, otherwise assuming the value of zero. All columns include bank-level control variables *Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth*, *Deposit Growth* and *Loss*. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. Standard errors clustered at the state-of-incorporation level are reported in parentheses. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

Table 5: Internal Validity of Empirical Design

	(1) DLLP	(2) DLLP	(3) DLLP	(4) DLLP	(5) CS(0)	(6) DLLP
CS(-3)	0.0002					
	(0.0131)					
CS(-2)	-0.0087					
	(0.0174)					
CS(-1)	-0.0192					
	(0.0146)					
CS(0)	-0.0519***					
	(0.0165)					
CS(1)	-0.0463***					
	(0.0145)					
CS(2)	-0.0629***					
	(0.0165)					
CS(3)	-0.0633***					
	(0.0141)					
CS(4)	-0.0518***					
	(0.0178)					
CS(5+)	-0.0312					
	(0.0225)					
Placebo CS		0.0132	-0.0020			
		(0.0142)	(0.0155)			
CS				-0.0497***		-0.0456***
				(0.0178)		(0.0145)
State-Average DLLP					-0.6887	
					(0.7022)	
Observations	74,643	74,643	74,643	31,755	334	27,437
Estimation Method	OLS	OLS	OLS	OLS	Probit	OLS
Estimation Sample	All	All	All	PSM	Pre-Treatment	Restricted
Estimation Level	Bank	Bank	Bank	Bank	State	Bank
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Bank FE	Yes	Yes	Yes	Yes	No	Yes
Region x Year FE	Yes	Yes	Yes	Yes	No	Yes
Adj. R-Squared	0.281	0.281	0.280	0.279		0.307
Pseudo R-Squared					0.018	

Notes: This table presents estimation results relevant to the internal validity of our empirical design. In column (1), we replace the policy variable CS with a set of dummy variables indicating time relative to statute enactment in a bank's state of incorporation. $CS(-3)$, $CS(-2)$, and $CS(-1)$ equal one for observations three, two, and one year before

enactment; $CS(0)$ equals one in the enactment year; and $CS(1)$ through $CS(5+)$ denote one through five or more years afterwards. In columns (2) and (3), we perform placebo estimations by replacing the policy variable CS with pseudo treatment series, *Placebo CS*. In column (2), we randomise the assignment of CS across states-of-incorporation by keeping the years same, while, in column (3), we conduct the randomisation across years by keeping the states-of-incorporation same. Column (4) repeats the baseline estimations with propensity score-matched sample involving data for 570 treated and 570 control banks. Column (5) conducts the reverse causality test by using $CS(0)$ as the dependent variable representing the "failure event" as the enactment of constituency statutes in a particular state. We begin the analysis by calculating the averages of *DLLP* and other control variables at the state of incorporation level. State observations are dropped from the sample following the "failure event". Then, probit model is utilised to estimate the impact of state-level *DLLP* on the probability of statute enactment with other controls. Column (6) repeats the baseline estimations using a restricted sample that excludes observations after 1992, the year FAS 114 was introduced, which replaced the more permissive FAS 5 framework and reduced managerial discretion in loan impairment recognition. All regressions presented in column (1) to (4) and (6) control for bank and region-by-year fixed effects as well as bank-level control variables *Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth*, *Deposit Growth* and *Loss*. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. Standard errors clustered at the state-of-incorporation level are reported in parentheses. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

Table 6: Stakeholder Groups

	(1) DLLP	(2) DLLP	(3) DLLP	(4) DLLP	(5) DLLP
CS	-0.0492***	-0.0415***	-0.0449***	-0.0420**	-0.0573***
	(0.0132)	(0.0141)	(0.0165)	(0.0158)	(0.0159)
Uninsured Deposits x CS	0.0198**				0.0194**
	(0.0089)				(0.0090)
Uninsured Deposits	-0.0135**				-0.0135**
	(0.0061)				(0.0055)
Public BHC x CS		0.0440***			0.0411***
		(0.0160)			(0.0140)
Public BHC		-0.0312*			-0.0269*
		(0.0167)			(0.0146)
High ETR x CS			0.0019		0.0017
			(0.0092)		(0.0089)
High ETR			-0.0081		-0.0083
			(0.0057)		(0.0054)
Lenient Supervision x CS				0.0063	0.0030
				(0.0151)	(0.0138)
Lenient Supervision				-0.0061	-0.0029
				(0.0131)	(0.0121)
Observations	74,643	74,643	70,758	74,643	70,758
Controls	Yes	Yes	Yes	Yes	Yes
Bank FE	Yes	Yes	Yes	Yes	Yes
Region x Year FE	Yes	Yes	Yes	Yes	Yes
Adj. R-Squared	0.281	0.281	0.227	0.281	0.226
Uninsured Deposits x CS= Public BHC x CS					F=1.59 (p=0.21))

Notes: This table presents estimation results on how different stakeholder groups moderate the effect of constituency statutes on managerial reporting discretion. Estimations presented in all columns retain *DLLP* as the dependent variable. In column (1), we interact policy variable *CS* with the binary variable *Uninsured Deposits* taking the value of one for banks whose uninsured deposits to total deposits ratio was above the sample median in the pre-constituency statute period, and zero otherwise. In column (2), we interact policy variable *CS* with the binary variable *Public BHC* taking the value of one for banks that are subsidiaries of publicly-traded bank holding companies, and zero otherwise. In column (3), we interact policy variable *CS* with the binary variable *High ETR* that equals one for banks whose pre-enactment adjusted ratio of tax expenses to pre-tax income exceeded the sample median, and zero otherwise. In column (4), we interact policy variable *CS* with the binary variable *Lenient Supervision* which takes the value of one if banks' headquarters are located in a state which is the home state of a senator actively sitting in the Banking, Housing and Urban Affairs Committee of the U.S. Senate, otherwise assuming the value of zero. In column (5), we estimate the moderating role of each stakeholder group conditional on the others by including all four interaction terms simultaneously. The p-value reported beneath the estimates corresponds to a Wald test of the null hypothesis that the coefficients on the interactions of *CS* with *Uninsured Deposits* and *Public BHC* are equal. All regressions control for bank and region-by-year fixed effects. The main independent variable is *CS* taking the value of one if the incorporation state of a specific bank has enacted constituency statutes, otherwise assuming the value of zero. All regression include the full set of independent variables which consists of *Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth*, *Deposit Growth* and *Loss*. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. Standard errors clustered at the state-of-incorporation level are reported in parentheses. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

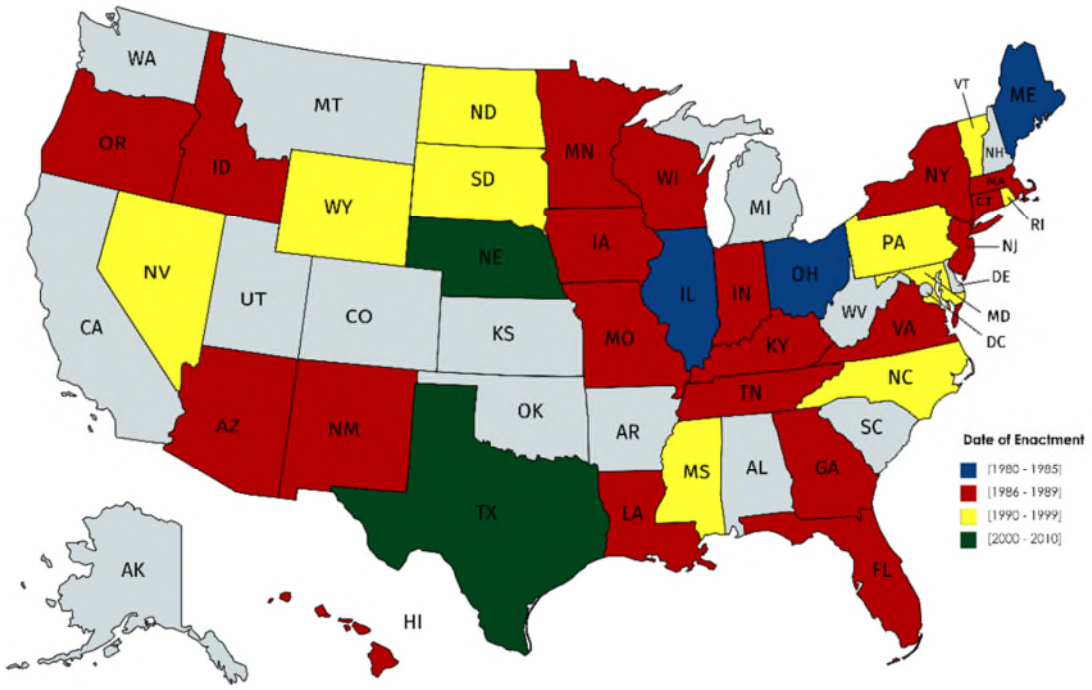
Online Appendix

When Many Govern: Stakeholder Orientation and Managerial Discretion in Banking

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Appendix A1 – Constituency Statutes and Sample Banks

Figure A1: Geographical Distribution of Constituency Statutes across U.S. States



Notes: This chart displays the geographical distribution and timeline of statute adoption across U.S. states for the period 1984-2007. The blue-coloured states are the initial adopters of the laws in 1984 and 1985. The states depicted with red colour are the ones with effective adoption dates around the late 1980s. The yellow-coloured and green-coloured states enacted statutes during 1990s and 2000s, respectively. The states highlighted in grey had not implemented constituency statutes, as of 2010. The chart is created via https://mapchart.net/usa.html

Table A1: The Enactment of Constituency Statutes 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

Notes: This table lists the staggered adoption of constituency statutes in 35 treated states between 1984 and 2007. The effective enactment dates are taken from Karpoff and Wittry (2018). In total, 2,266 commercial banks had been subject to treatment in 35 states at some point.

Appendix A2 – Determinants of Loan Loss Provisions

In this appendix, we present and discuss estimation results for Equation (1). The results are tabulated in Table A2, and the findings are in line with results reported in the prior bank financial reporting discretion literature. The current and past ΔNPL terms enter the regression positively and significantly, which confirms the expectation that banks consider contemporaneous loan portfolio quality and prior information regarding impaired loans as key inputs to decisions regarding the level of provisions (Bushman and Williams, 2012; Beck and Narayanamoorthy, 2013). Bank size ($Size$) also influences provisioning (in line with Bhat et al. (2019) and Tomy (2019) among others). Larger banks implement more extensive loan loss provisioning policies. This aligns with evidence presented by Jiang et al. (2016) who contend that a rapid expansion of the loan portfolio reduces loan quality and forces managers to set aside more provisions for loan losses. The positive and significant coefficient on $\Delta Loans$ verifies this. In terms of macroeconomic variables, state-level growth in economic activity ($Growth$) and house prices (HP) serve as useful predictors of overall provisioning (Andries et al., 2017; McIntyre and Zhang, 2020; Jin et al., 2021). Loan loss allowances (ALW) are linked negatively to the current level of provisions. Banks recording sizeable loan loss allowances in previous periods are likely to record smaller changes in current provisions (Beatty and Liao, 2014; McIntyre and Zhang, 2020). Higher loan write-offs (CO) are a significant predictor of higher loan loss provisions. Furthermore, the treatment variable (CS) enters positively and significantly, implying that banks incorporated in adopting states set aside larger provisions on average once constituency statutes take effect.

Table A2: First-Stage Regression Results

	(1) LLP_t
ΔNPL_{t+1}	0.0029 (0.0054)
ΔNPL_t	0.0502*** (0.0112)
ΔNPL_{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)
$\Delta Unemp_t$	-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

Notes: This table reports the estimation results for the Equation (1) used to obtain the discretionary component of banks' earnings management in the form of $DLLP$. The dependent variable LLP_t is the ratio of loan loss provisions normalised by the beginning period total loans. ΔNPL_{t+1}, ΔNPL_t and ΔNPL_{t-1} denote forward, contemporaneous and lagged values of change in non-performing loans divided by lagged total loans. $Size_{t-1}$ is defined as the natural logarithm of lagged total assets. $\Delta Loans_t$ represents the change in total loans divided by lagged total loans. $Growth_t$ stands for change in state-level per-capita income, HP_t denotes the return on state-level house price index and $\Delta Unemployment$ represents the change in state-level unemployment rate. ALW_{t-1} stands for the lagged value of loan loss allowances-to-total loans ratio. CO_t is the the ratio of charge-offs to total loans. To alleviate the impact of outliers, we winsorise all continuous bank-specific variables at 1st and 99th percentiles. The policy variable CS and its interactions with other control variables are also added to the specification. The model is estimated with pooled OLS method. Detailed variable definitions are available in Table 1. Robust standard errors are reported in parentheses. ***, **, and * denote statistical significance at 1%, 5%, and 10% levels, respectively.

Appendix A3 – Robustness Checks

The robustness results for the main variable of interest (CS) based on the column (1) of Table 3 are given in the rows (instead of columns) of Table A3 for the sake of brevity.

Time Fixed Effects and Standard Error Clustering

In our baseline case, we augment the model with region-by-year fixed effects to control for broad local economic forces. However, regional classifications may mask broad national shocks or important within-region economic heterogeneity. As an alternative, rows (1) and (2) present results from two different specifications of the baseline model. The first includes only year fixed effects alongside bank fixed effects to capture nationwide shocks. The second refines the geographic control by replacing region-by-year fixed effects with division-by-year fixed effects.[16] This finer classification allows us to capture more localized economic conditions within each region, ensuring that differences in reporting discretion are not driven by economic variations within broader Census regions. We observe that our results are invariant to fixed effects choice. The baseline specification follows standard error clustering at the state-of-incorporation level. For robustness purposes, we re-estimate our baseline model with clustering at the bank-level (row (3)) and two-way clustering with state-of-incorporation and year dimensions (row (4)). We find that the significance level of the original estimation does not change.

Sample Period

For most states, the adoption timeline of constituency statutes coincides with the 1980s and 1990s (Karpoff and Wittry, 2018). In the case of an extended post-adoption sample, such a timeline might complicate the assessment of earlier legal changes' impact (Serfling, 2016). Ni (2020) shows that the effect of constituency statutes on non-financial firm earnings management might be

[16] US Census Bureau categorises US states into nine divisions which are New England, Middle Atlantic, East North Central, West North Central, South Atlantic, East South Central, West South Central, Mountain and Pacific. The guidelines for divisional categorization can be accessed at https://www.census.gov/geographies/reference-maps/2010/geo/2010-census-regions-and-divisions-of-the-united-states.html

shaped by different event windows around adoption dates. Since our sample period also covers the global financial crisis phase and banks tend to alter earnings management practices, worsen the opaqueness of financial disclosure and delay the recognition of loan losses during the crisis episodes, our inferences might be spuriously driven by sample period coverage (Acharya and Ryan, 2016; Bischof et al., 2021). The post-2000 period is also characterised by a heightened level of awareness about accounting scandals and firm financial reporting. Cohen et al. (2005) emphasise that earnings management activities rose consistently during the late 1990s and peaked during the early 2000s. To alleviate such concerns, we repeat the baseline estimations by using sample data between 1980 and 2000 (row (5)) as well as between 1980 and 2006 (row (6)). Our results continue to hold under alternative sample periods.

Data Transformation and Covariates

Next, we focus on issues related to data transformation and covariates handling. In row (7), we examine the robustness of our findings when considering the non-winsorised version of our variables (instead of winsorising them at the 1% level as in the baseline model). In row (8), we replace the contemporaneous control variables with their one-year lagged counterparts to handle any simultaneity issues. Moreover, we also estimate a parsimonious model without any control variables (row (9)) to ensure that our estimated treatment effect is not biased by their inclusion in the baseline model (Atanasov and Black, 2016). The accrual accounts tend to display a reversal behaviour that is aimed to be controlled with the lagged values of total provisions by the prior literature in second-stage regressions (Kanagaretnam et al., 2010; Jiang et al., 2016). In row (10), we extend the covariate list by including Lag_LLP among the baseline set of controls and show that the main relationship remains robust. Considering the unbalanced nature of the data, in row (11), we discard all the banks without 15 years of consecutive observations to ensure that we observe bank reporting behaviour before and after constituency statutes sufficiently. We do not observe significant changes in the coefficient attached to CS term with these considerations.

State-Level Characteristics Related to Constituency Statutes

In the following step, we consider confounding effects due to unique state-level characteristics (related to governance issues and constituency statutes). Row (12) ignores all the banks incorporated in Delaware. The governance principles stemming from shareholder primacy have been traditionally embedded in corporate law and practices in Delaware (Danielson and Karpoff, 1998). Therefore, banks having decided to choose Delaware as the state-of-incorporation are likely to diverge from other banks in terms of how to approach firm governance and how to integrate stakeholder needs in managerial decision-making. Although it was not a common trend, anecdotal evidence shows that a few states witnessed lobbying efforts by a handful of firms to initiate statutes.[17] In row (13), we discard lobbying states from our empirical analysis to contain self-selection bias (Ni, 2020). We further put the scope of statutes' applicability issue into consideration. Some states had imposed opt-in and opt-out clauses for constituency statutes which have the potential to reduce applicability (Bebchuk et al., 2020).[18] In row (14), we drop such states from the sample. To compose CS, we acknowledge the enactment years for individual states from Karpoff and Wittry (2018). Having said that, there exist minor disparities in enactment dates among prior literature (Leung et al., 2019). In row (15), we conclude that this issue is trivial for our findings by using alternative coding provided in Barzuza (2009). As a final exercise, we consider the years of adoption of statutes as transition periods and exclude those bank-year observations in these years (row (16)) (Basu and Liang, 2019).

Controlling for Confounding Legal Factors

It is possible that the interaction between constituency statutes and financial reporting tendencies might be confounded by other coincident revisions in the legal framework. With a similar timeline, US states had passed other antitakeover statutes. Cheng et al. (2017) document that the state antitakeover

[17] These states can be listed as Arizona, Indiana, Massachusetts, Minnesota, and Pennsylvania.

[18] Opt-in states can be listed as Georgia, Maryland and Tennessee, whereas Arizona is the only state with an opt-out clause.

laws have a downward impact on accounting conservatism for U.S. non-financial firms. To deal with such potential effects, we create binary indicators (BC, CSA, FP, PP) taking the value of one in the adoption years of business combination, control share acquisition, fair price and poison pill laws, otherwise zero (Karpoff and Wittry, 2018). When we augment the baseline model with these indicator variables, the improving effect of stakeholder orientation on managerial reporting discretion is still attained (row (17)).

The risk of litigation initiated by stakeholders is an important legal factor in disciplining managerial decision-making and reporting policies (Houston et al., 2019). Any legal changes confining litigation threats can increase the probability of managerial entrenchment and limit accuracy of accounting disclosure. As an example, the adoption of universal demand laws elevated the hurdles against derivative lawsuits filed by shareholders (in the adopting states where firms are incorporated) by requiring plaintiffs to seek corrective actions by company boards before such lawsuits can be pursued. Chen et al. (2021) and Manchiraju et al. (2021) report that the accounting conservatism of U.S. non-financial firms declined following the enactment of these laws. In row (18), we add a binary variable, UD, marking the adoption years of universal demand laws to the baseline model. On the other hand, in 1999, the U.S. Ninth Circuit Court of Appeals reached a well-known verdict putting additional obstacles for litigation processes directed to firms headquartered in that jurisdiction which consequently decreased class action lawsuits compared to other circuits. Huang et al. (2020) argue that real earnings management tendencies increased on the back of reduced litigation risk due to the Ninth Circuit ruling. To account for this element, we create a binary variable, $Ninth\ Circuit$, taking the value of one for banks located in the aforementioned jurisdiction after 1999, otherwise zero. Row (19) incorporates this variable into the baseline model and continues to indicate a negative and significant effect.

In terms of pressures from other stakeholders, Gao et al. (2018) document that employee turnover can determine firms' accounting decisions by using staggered court decisions termed as inevitable disclosure doctrine. These rulings can impose restrictions on employees switching jobs in case such situations

inevitably reveal sensitive company information located in those states. In row (20), we augment the model with *IDD* variable taking value of the one for the states after the court rulings which embrace the doctrine, otherwise zero. As the final consideration of the legal confounders, we control for the adoption of state-level depositor preference laws revising the priority structure of bank liabilities by making non-depositors more vulnerable to losses in the case of bank failure. Danisewicz et al. (2021) show that the introduction of such laws diminished the bank earnings opacity. In row (21), our findings remain unaltered with respect to the inclusion of depositor preference laws.

Coincident Banking Deregulation

Over our sample period, U.S. states progressively lifted restrictions on intrastate branching and interstate banking, reshaping the competitive environment in which banks operate. Given that competition is itself a determinant of bank opacity (Jiang et al., 2016), and because the timing of these deregulatory reforms may correlate with the staggered adoption of constituency statutes, our estimates could be confounded by coincident changes in banking competition. Following Leung et al. (2019), we address this concern directly. In row (22), we augment the baseline model with an indicator equal to one from the year a state first permitted intrastate branching via mergers and acquisitions onward, and in row (23) with an indicator equal to one from the year a state first permitted interstate banking onward, with deregulation dates drawn from Jayaratne and Strahan (1996) and Strahan (2003). In row (24), we further control for the Rice–Strahan index of interstate branching restrictions (Rice and Strahan, 2010), which captures each state's choice to erect or remove barriers to entry following the 1994 Riegle–Neal Act. The coefficient on *CS* remains negative and statistically significant across all three specifications suggesting that the improving effect of stakeholder orientation on managerial reporting discretion is not driven by contemporaneous banking deregulation.

Bank Ownership Structure and Size

Although our sample is dominated by privately held commercial banks, it also includes a few publicly traded ones. Earnings management and bank opacity

might be structurally different in public banks relative to private counterparties (Nichols et al., 2009). Public banks might be inclined to manage earnings and exacerbate information asymmetry under dominant investor expectations / capital market pressures and institutional ownership as well as around important capital market transactions such as public offerings and buyouts. In row (25), we eliminate the observations belonging to public banks and observe that our results are robust.

The historical regulatory framework witnesses the tiered application of certain rules based on bank size which potentially influences bank reporting practices. To exemplify, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) imposed differential auditing, internal control, reporting and governance requirements on financial intermediaries with total assets larger than $500 million (Jin et al., 2021). Similarly, the Tax Reform Act of 1986 had altered the timing of the provisions' deductibility for tax purposes depending on whether the bank size exceeds the $500 million threshold (Andries et al., 2017).[19] In row (26), we discard all sample banks with asset sizes staying below $500 million level to ensure that our results are invariant to the existence of tiered bank regulation.

Dealing with Estimation Bias: An Alternative DiD Estimator and Correction Method

Baseline regressions employ the commonly preferred two-way fixed effects (TWFE) technique to isolate treatment effects. Nevertheless, recently emerging literature raises concerns about the implementation of TWFE in the case of staggered research design due to the potential estimation bias caused by heterogenous treatment effects between units and over time (Goodman-Bacon, 2021; De Chaisemartin and D'Haultfoeuille, 2023). In row (27), we utilise an alternative imputation-based robust and efficient DiD estimator developed by Borusyak et al. (2024). The role of stakeholder orientation for bank reporting is still apparent with an alternative estimation method.

[19] Policymakers had compelled banks with larger than $500 million assets to employ the charge-off method whereas other banks had been allowed to continue using the reserve method which makes it possible to deduct provisions immediately for tax purposes.

The two-step methodology to initially isolate the abnormal component of accruals (and provisions) and later employ extracted component with other corporate policies for further inference is well-established and conventional in empirical accounting literature (Beaver, 1987; Dechow and Dichev, 2002). However, a recent study by Chen et al. (2018) opposed the validity of this method by arguing that second-step coefficient estimates (which associate the unexplained portion of accounting measures with firm characteristics) are likely to be biased with misleading standard errors. Chen et al. (2018) also find that such an attenuation bias might be evident for the investigation of financial reporting discretion through accruals. To alleviate this problem in our setting, we follow the recommendation of Chen et al. (2018), and re-estimate Equation (3) after saturating with control variables from Equation (1), when analysing the impact of stakeholder orientation on bank earnings management. The results provided in row (28) potentially account for the aforementioned inference problem and still demonstrate the negative and significant impact of stakeholderism.

Table A3: 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-winsorised 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
(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 intrastate branching deregulation	-0.0379***	74,643
(23) Controlling for interstate banking deregulation	-0.0355***	74,643
(24) Controlling for 1994 Riegle–Neal Act	-0.0386***	74,643
(25) Excluding publicly traded banks	-0.0390***	74,456
(26) Excluding banks below $500 million asset size threshold	-0.0408***	70,442
(27) Borusyak et al. (2024) DiD estimator	-0.0621***	41,931
(28) Chen et al. (2018) correction for two-step methodology	-0.1521***	74,643

Notes: This table shows the robustness check of the effect of stakeholder orientation on the bank financial reporting discretion. The dependent variable is the absolute value of discretionary provisions ($DLLP$) derived from Equation (1). The main independent variable CS taking the value of one if the incorporation state of a specific bank has enacted constituency statutes, otherwise assuming the value of zero. The full set of control variables includes $Size$, $Solvency$, $Liquidity$, $Payouts$, $Loan\ Growth$, $Deposit\ Growth$ and $Loss$. Detailed variable definitions are available in Table 1. In all rows, we use different variants of the baseline specification in column (1) of Table 3, and exactly that one if not explicitly stated otherwise. In rows (1) and (2), we replace the region-by-year fixed effects with the only year and division-by-year fixed effects. The division classification is based on U.S. Census Bureau which separates the individual US states into nine geographical districts under four regions. State locations are determined according to the headquarters information available in regulatory reporting. In rows (3) and (4), we alter the baseline clustering choice for standard errors by using bank-level and two-way (year and state of incorporation levels) clustering. In rows (5) and (6), we repeat the estimations over sub-samples 1980-2000 and 1980-2006 to analyse the persistence of treatment effects across different sample periods. Row (7) repeats the estimations with raw data without performing any winsorisation. In row (8), we utilise lagged values of the control variables to account for the possible simultaneity issues. In row (9), we estimate the parsimonious version of Equation (3) by excluding bank-level covariates. In row (10), we extend Equation (3) by including lagged values of total provisions (LLP) as an additional covariate. In row (11), we refine the sample bank list by retaining only banks with observations spanning more than or equal to 15-years long time interval. In row (12), we omit the banks incorporated in Delaware from the sample. Row (13) demonstrates the estimation results by excluding five states in which some firms had engaged in lobbying activities for the passage of constituency statutes. The results presented in row (14) are obtained from the sample ignoring four states which had provided opt-in and opt-out clauses to the firms incorporated in those states for the coverage of the law. In row (15), we create an alternative coding of the policy variable CS based on enactment dates provided by Barzuza (2009). In row (16), we remove the observations belonging to the exact years of enactment from the sample for treated banks to alleviate the transition effects. Row (17) shows the robustness of baseline results to the adoption of other anti-takeover statutes. We construct variables BC, CSA, FP and PP taking the value of one only at the effective enactment dates of business combination, control share acquisition, fair price and poison pill laws, respectively, otherwise assuming the value of zero. The coding of the laws is retrieved from Karpoff and Wittry (2018), similar to the construction of policy variable CS. In row (18), we add the variable $UD\ Laws$ taking the value of one at the effective enactment date of universal demand laws. In row (19), we expand the set of controls with a binary variable $Ninth\ Circuit$ taking the value of one if banks are located in the jurisdiction after 1999 affected by the US Ninth Circuit Court of Appeals verdict about litigation process of class action lawsuits. As further legal confounders of bank reporting discretion during our sample period, row (20) controls for IDD variable taking the value of one for certain states witnessing court rulings which embrace Inevitable Disclosure Doctrine, whereas row (21) controls for state-level adoption of depositor preference laws revising the priority structure of bank creditors. In row (22) we control for intrastate branching deregulation by adding an indicator equal to one from the year in which a state first permitted branching via mergers and acquisitions onward, and zero otherwise. In row (23) we control for interstate banking deregulation by including an indicator equal to one from the year in which a state first permitted interstate banking onward, and zero otherwise (deregulation dates are obtained from Jayaratne and Strahan (1996) and Strahan (2003)). In row (24) we control for States' choice in placing barriers to entry following the 1994 Riegle–Neal Act (using the Rice and Strahan (2010) index). Row (25) excludes publicly traded commercial banks form our sample, while row (26) excludes observations with bank asset sizes smaller than the threshold of $500 million. Row (27) uses an alternative DiD estimator based on the imputation approach of Borusyak et al. (2024) via the Stata command "did_imputation". In row (28), we follow the correction methodology of Chen et al. (2018) for two-step framework by including control variables covered by Equation (1) in the estimations performed in Equation (3). Unless otherwise stated, all bank-level continuous variables are winsorised at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

Appendix A4 – Alternative Discretionary Provisions Indicators

In the baseline case, we derive $DLLP$ from the residuals of the most saturated model mentioned in Beatty and Liao (2014). However, the informative nature of $DLLP$ may depend on the predictive power of auxiliary regressions. To evaluate the robustness of discretionary provisions, we create additional proxies. Beatty and Liao (2014) also list alternative model formations to predict the equilibrium course of bank provisioning policy as follows:

$$\begin{aligned} LLP_{i,t} = {} & \gamma_0 + \gamma_1 \Delta NPL_{i,t+1} + \gamma_2 \Delta NPL_{i,t} + \gamma_3 \Delta NPL_{i,t-1} + \gamma_4 Size_{i,t-1} + \gamma_5 \Delta Loans_{i,t} \\ & + \gamma_8 Growth_{l_i,t} + \gamma_9 HP_{l_i,t} + \gamma_{10} \Delta Unemp_{l_i,t} + \theta_0 CS_{s_i,t} \\ & + \sum_{k=1}^{10} \theta_k \left(CS_{s_i,t} \times Controls_k \right) + \eta_{i,t} \end{aligned} \tag{A4.1}$$

$$\begin{aligned} LLP_{i,t} = {} & \gamma_0 + \gamma_1 \Delta NPL_{i,t+1} + \gamma_2 \Delta NPL_{i,t} + \gamma_3 \Delta NPL_{i,t-1} + \gamma_4 Size_{i,t-1} + \gamma_5 \Delta Loans_{i,t} \\ & + \gamma_8 Growth_{l_i,t} + \gamma_9 HP_{l_i,t} + \gamma_{10} \Delta Unemp_{l_i,t} + \gamma_9 ALW_{i,t-1} + \theta_0 CS_{s_i,t} \\ & + \sum_{k=1}^{10} \theta_k \left(CS_{s_i,t} \times Controls_k \right) + \eta_{i,t} \end{aligned} \tag{A4.2}$$

$$\begin{aligned} LLP_{i,t} = {} & \gamma_0 + \gamma_1 \Delta NPL_{i,t+1} + \gamma_2 \Delta NPL_{i,t} + \gamma_3 \Delta NPL_{i,t-1} + \gamma_4 Size_{i,t-1} + \gamma_5 \Delta Loans_{i,t} \\ & + \gamma_8 Growth_{l_i,t} + \gamma_9 HP_{l_i,t} + \gamma_{10} \Delta Unemp_{l_i,t} + \gamma_9 CO_{i,t} + \theta_0 CS_{s_i,t} \\ & + \sum_{k=1}^{10} \theta_k \left(CS_{s_i,t} \times Controls_k \right) + \eta_{i,t} \end{aligned} \tag{A4.3}$$

where the absolute value of model residuals from Equations (A4.1), (A4.2) and (A4.3) are taken as $DLLP_Alt2$, $DLLP_Alt3$ and $DLLP_Alt4$, respectively. In columns (1), (2) and (3) of Table A4, main variable CS enters the regressions predicting the aforementioned variables in a negative and significant way which confirms that a shift in managerial attitudes towards stakeholders reduces managerial discretion.

To complement this analysis, we return to the original $DLLP$ series obtained from Equation (1) but apply two different transformation methods. The residual terms designating discretionary provisioning behaviour are unlikely to be normally distributed. Therefore, we perform a logarithmic transformation to create the indicator $DLLP_Ln$ and repeat the estimations in column (4) (Danisewicz et al., 2021). Additionally, studies like Cornett et al. (2009) and Fan et al. (2019) consider

the structural composition of the balance sheet with respect to loans in transforming *DLLP*. In this context, we synthesise *DLLP_Trans* by multiplying *DLLP* with the assets-to-loans ratio (column (5)). We continue to observe that stakeholder orientation reduces managerial discretion under these alternative definitions of the dependent variable. Near-term DLLP records might also influence the intention to smooth earnings and the decision on current DLLP. Following McIntyre and Zhang (2020), in column (6), we construct the dependent variable *ADLLP* consisting of accumulated values of DLLP from year $t-3$ to year t. Our results continue to hold.

Table A4: Alternative Discretionary Provisions Indicators

	(1) DLLP_Alt 2	(2) DLLP_Alt 3	(3) DLLP_Alt 4	(4) DLLP_Ln	(5) DLLP_Trans	(6) ADLLP
CS	-0.1323*** (0.0306)	-0.1324*** (0.0305)	-0.0293** (0.0134)	-0.1930*** (0.0441)	-0.1316*** (0.0404)	-0.1614*** (0.0401)
Observations	74,643	74,643	74,643	74,643	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	0.401	0.401	0.382	0.187	0.341	0.472

Notes: This table presents the estimation results of the baseline difference-in-differences model with alternative discretionary provisions indicators. In columns (1), (2) and (3), alternative *DLLP* measures are used as dependent variables which are extracted as absolute values of the residual terms from Equations (A4.1), (A4.2) and (A4.3), respectively. Column (4) employs the natural logarithm of *DLLP*, while column (5) utilises the transformed version of *DLLP* through multiplication by assets-to-loans ratio. Column (6) employs *ADLLP* which is the accumulated values of original *DLLP* over three years period. All regressions control for bank and region-by-year fixed effects. The main independent variable is *CS* taking the value of one if the incorporation state of a specific bank has enacted constituency statutes, otherwise assuming the value of zero. All columns include bank-level control variables *Size*, *Solvency*, *Liquidity*, *Payouts*, *Loan Growth*, *Deposit Growth* and *Loss*. To alleviate the impact of outliers, we winsorise all continuous variables at 1st and 99th percentiles. Detailed variable definitions are available in Table 1. Standard errors clustered at the state of incorporation level are reported in parentheses. ***, ** and * denote statistical significance at 1%, 5% and 10% levels, respectively.

Appendix A5 – Correlation Matrix

Table A5: Correlation Coefficients

	DLLP	Size	Solvency	Liquidity	Payouts	Loan Growth	Deposit Growth	Loss
DLLP	1							
Size	-0.127	1						
Solvency	-0.323	0.162	1					
Liquidity	0.121	-0.216	-0.151	1				
Payouts	-0.099	-0.117	0.066	-0.055	1			
Loan Growth	-0.009	0.099	0.027	-0.059	-0.038	1		
Deposit Growth	0.037	0.130	-0.060	0.018	-0.074	0.603	1	
Loss	0.315	-0.048	-0.411	0.074	-0.146	-0.102	-0.029	1

Notes: This table presents the correlation matrix between the main variables used in the regressions.

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