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Shareholder power and income smoothing in banks

We study the process of using loan loss provisions to smooth bank net income in the context of corporate governance structures. Using financial and shareholder data for above 200 banks from Central Europe in the period 2004-2014, we confirm that corporate governance matters for loan loss provision policy. In particular, we find that banks where the primary shareholder is a full owner are more prone to engage in income smoothing than their peers. The mere fact of having one primary shareholder does not provide sufficient incentives for banks to smooth earnings. Once the shareholder stake exceeds the full ownership benchmark, the smoothing process intensifies. Our results have significant policy implications, especially in regions such as Central Europe, where majority and full ownership are a prevailing corporate governance structure in banking systems.