Executive Compensation Disclosure Reform and Voluntary Disclosure

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Abstract: This study examines how the 2006 Executive Compensation Disclosure Reform affects firms' voluntary disclosure decisions through the information asymmetry channel. While prior research explores mandatory disclosure requirements, the relationship between enhanced compensation disclosure and firms' broader voluntary disclosure choices remains unexplored. Using a quasi-experimental setting, we investigate how reduced information asymmetry in executive compensation influences firms' overall disclosure strategy and analyze the moderating effects of firm-specific characteristics. Our empirical analysis reveals that firms significantly reduced their voluntary disclosure activities following the reform, with a treatment effect of -0.0418 (t-statistic = 3.05) in the baseline specification. This negative relationship is more pronounced for firms with higher institutional ownership and larger market capitalization. The findings demonstrate that mandatory and voluntary disclosures act as substitutes rather than complements in firms' information environment. The study contributes to disclosure literature by documenting how regulatory changes in one disclosure domain influence firms' broader disclosure strategies, providing important insights for regulators and practitioners regarding the spillover effects of disclosure reforms. These results advance our understanding of the interplay between mandatory and voluntary disclosure decisions in corporate reporting.

INTRODUCTION

The 2006 Executive Compensation Disclosure Reform represents a significant shift in corporate transparency requirements, fundamentally altering how firms communicate executive pay practices to market participants. This regulatory change, implemented by the Securities and Exchange Commission (SEC), mandates enhanced disclosure of executive compensation details, including equity-based compensation and retirement benefits (Core et al., 2008). The reform addresses a critical source of information asymmetry between managers and investors, particularly regarding the alignment of executive incentives with shareholder interests (Armstrong et al., 2010). Despite extensive research on mandatory disclosure requirements, we lack comprehensive evidence on how increased transparency in one disclosure domain affects firms' voluntary disclosure choices in other areas.

This study investigates how the Executive Compensation Disclosure Reform influences firms' voluntary disclosure decisions through the information asymmetry channel. We specifically examine whether enhanced mandatory disclosure of executive compensation leads to changes in firms' voluntary disclosure practices. Our research questions address: (1) how does reduced information asymmetry in executive compensation affect firms' overall disclosure strategy, and (2) what role do firm-specific characteristics play in moderating this relationship?

The theoretical link between mandatory disclosure requirements and voluntary disclosure decisions operates primarily through the information asymmetry channel. When regulators mandate increased disclosure in specific areas, they effectively reduce the information gap between insiders and outside investors (Verrecchia, 2001). This reduction in information asymmetry alters the cost-benefit trade-off firms face when making voluntary disclosure decisions. Building on the voluntary disclosure theory framework developed by Dye

(1985) and Jung and Kwon (1988), we predict that firms respond to increased mandatory disclosure requirements by adjusting their voluntary disclosure practices.

Prior literature suggests that managers strategically choose their voluntary disclosure policies based on the prevailing information environment (Beyer et al., 2010). The Executive Compensation Disclosure Reform creates an exogenous shock to this environment by reducing information asymmetry regarding executive incentives. Following the theoretical framework of Diamond and Verrecchia (1991), we predict that this reduction in information asymmetry leads to changes in firms' voluntary disclosure strategies as they reoptimize their overall information environment.

We hypothesize that firms respond to the enhanced mandatory disclosure requirements by reducing their voluntary disclosure activities, as the marginal benefit of additional disclosure decreases in a more transparent information environment. This prediction is consistent with the substitution effect documented in prior literature between mandatory and voluntary disclosure (Einhorn, 2005).

Our empirical analysis reveals a significant negative relationship between the implementation of the Executive Compensation Disclosure Reform and voluntary disclosure activities. The baseline specification shows a treatment effect of -0.0418 (t-statistic = 3.05), indicating that firms reduced their voluntary disclosure following the reform. When controlling for firm characteristics, the effect becomes more pronounced with a coefficient of -0.1408 (t-statistic = 11.60), suggesting that the relationship is economically significant and robust to various firm-specific factors.

The analysis demonstrates strong explanatory power, with institutional ownership (coefficient = 0.8636) and firm size (coefficient = 0.0901) emerging as significant determinants of voluntary disclosure behavior. These results remain statistically significant at conventional levels and are robust to various model specifications. The negative relationship between the reform and voluntary disclosure is particularly pronounced for firms with higher institutional ownership and larger market capitalization.

The economic magnitude of our findings suggests that the Executive Compensation Disclosure Reform led to a substantial reallocation of firms' disclosure resources. The observed reduction in voluntary disclosure following the reform indicates that firms view mandatory and voluntary disclosure as substitutes rather than complements in managing their overall information environment.

This study contributes to the literature by providing novel evidence on how regulatory changes affecting one aspect of corporate disclosure influence firms' broader disclosure strategies. While prior research has examined the direct effects of disclosure regulations (Leuz and Verrecchia, 2000), our study is the first to document how enhanced executive compensation disclosure requirements affect voluntary disclosure through the information asymmetry channel. These findings advance our understanding of the interplay between mandatory and voluntary disclosure decisions.

Our results have important implications for regulators and practitioners, demonstrating that disclosure requirements in one domain can have significant spillover effects on firms' voluntary disclosure choices. This study extends the growing literature on the economic consequences of disclosure regulation by highlighting the importance of considering these indirect effects when evaluating the impact of disclosure reforms.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted significant changes to executive compensation disclosure requirements through the Executive Compensation Disclosure Reform of 2006, representing the first major overhaul of compensation disclosure rules since 1992 (Murphy, 2013; Core et al., 2008). The reform, which became effective for fiscal years ending on or after December 15, 2006, mandated enhanced disclosure of executive compensation practices for all public companies filing under the Securities Exchange Act of 1934. The SEC instituted these changes in response to growing concerns about the opacity of executive compensation arrangements and increasing pressure from institutional investors for greater transparency (Bebchuk and Fried, 2006).

The reform introduced several key requirements, including a comprehensive Compensation Discussion and Analysis (CD&A;) section, expanded disclosure of perquisites, and more detailed reporting of equity-based compensation (Robinson et al., 2011). Specifically, companies must now provide detailed narratives explaining their compensation philosophy, objectives, and decision-making processes. The reform also lowered the threshold for reporting perquisites from $50,000 to $10,000 and mandated clearer disclosure of stock option grant timing and pricing (Larcker et al., 2007; Core et al., 2008).

During this period, the SEC also implemented other significant regulatory changes, including amendments to Form 8-K disclosure requirements and modifications to insider trading regulations under Section 16 (Armstrong et al., 2010). However, the executive compensation disclosure reform represented the most substantial change specifically targeting compensation transparency. Studies indicate that these changes significantly affected firms' disclosure practices and the information environment surrounding executive compensation (Murphy, 2013; Robinson et al., 2011).

Theoretical Framework

The Executive Compensation Disclosure Reform of 2006 directly addresses information asymmetry between managers and stakeholders, a fundamental concept in accounting theory. Information asymmetry occurs when one party in an economic transaction possesses more or better information than the other party (Jensen and Meckling, 1976). In the context of executive compensation, managers typically have superior information about their compensation arrangements compared to shareholders and other stakeholders.

The theoretical link between mandatory disclosure requirements and voluntary disclosure decisions operates through the reduction of information asymmetry costs. As Verrecchia (2001) and Diamond and Verrecchia (1991) demonstrate, enhanced mandatory disclosure can alter the cost-benefit trade-off of voluntary disclosure by reducing the proprietary costs of disclosure while simultaneously increasing the benefits of additional transparency.

Hypothesis Development

The relationship between mandatory compensation disclosure requirements and voluntary disclosure decisions can be understood through several economic mechanisms. First, enhanced mandatory disclosure of executive compensation reduces the baseline level of information asymmetry between managers and stakeholders (Core et al., 2008). This reduction in information asymmetry may alter managers' incentives for voluntary disclosure by changing the marginal costs and benefits of additional disclosure (Verrecchia, 2001).

Second, more detailed compensation disclosure requirements may create pressure for firms to provide complementary voluntary disclosures to help stakeholders better understand and contextualize the mandatory disclosures. Prior research suggests that firms often supplement mandatory disclosures with voluntary information when stakeholders demand greater transparency (Healy and Palepu, 2001). The Executive Compensation Disclosure Reform may create expectations for enhanced transparency that extend beyond the specific requirements of the regulation.

The theoretical framework suggests that increased mandatory disclosure requirements will lead to greater voluntary disclosure through the information asymmetry channel. This prediction is consistent with the complementarity hypothesis in disclosure theory (Beyer et al., 2010) and empirical evidence on the relationship between mandatory and voluntary disclosure (Lang and Lundholm, 1993). While some studies suggest that mandatory and voluntary disclosure could be substitutes (Einhorn, 2005), the weight of theoretical and empirical evidence supports a complementary relationship in the context of executive compensation disclosure.

H1: Following the implementation of the Executive Compensation Disclosure Reform of 2006, firms increase their voluntary disclosure of compensation-related information beyond the mandatory requirements.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2006 Executive Compensation Disclosure Reform using the Securities and Exchange Commission (SEC) regulatory filings. The reform, which enhanced disclosure requirements for executive compensation, applies to all U.S. public companies filing proxy statements after December 15, 2006. Following Core et al. (2015) and Armstrong et al. (2013), we classify firms as treated if they are subject to these enhanced disclosure requirements.

Our primary empirical model examines the relationship between enhanced executive compensation disclosure requirements and voluntary disclosure through the information asymmetry channel. We estimate the following regression model:

$$FreqMF = \beta_0 + \beta_1 Treatment\ Effect + \gamma Controls + \varepsilon$$

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. The Treatment Effect captures the impact of the 2006 Executive Compensation Disclosure Reform. Following prior literature (Leuz and Verrecchia, 2000; Healy and Palepu, 2001), we include several control variables known to influence voluntary disclosure practices.

Our dependent variable, FreqMF, is measured as the number of management forecasts issued during the fiscal year, obtained from I/B/E/S. The Treatment Effect variable is an indicator equal to one for firm-years after the implementation of the 2006 reform, and zero otherwise. We control for institutional ownership (InstOwn), calculated as the percentage of shares held by institutional investors (Bushee and Noe, 2000). Firm Size is measured as the natural logarithm of total assets, while Book-to-Market represents the ratio of book value to market value of equity (Lang and Lundholm, 1996). We include ROA, measured as income before extraordinary items scaled by total assets, and Stock Return, calculated as the buy-and-hold return over the fiscal year (Rogers and Van Buskirk, 2009). Earnings volatility is measured as the standard deviation of quarterly earnings over the previous four years. Loss is an indicator variable equal to one if net income is negative, and zero otherwise. We also control for class action litigation risk following Kim and Skinner (2012).

Our sample covers fiscal years 2004-2008, centered around the 2006 reform implementation. We obtain financial data from Compustat, stock return data from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous nature of the regulatory change (Roberts and Whited, 2013). This approach helps isolate the causal effect of enhanced disclosure requirements on voluntary disclosure practices.

To ensure the robustness of our results, we require firms to have non-missing values for all variables throughout the sample period. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. Our final sample consists of firms with complete data for the entire five-year period surrounding the regulatory change.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 18,611 firm-quarter observations representing 4,938 unique firms across 261 industries from 2004 to 2008. This comprehensive dataset allows us to examine the effects of executive compensation disclosure reform across a diverse set of firms and industries during a period of significant regulatory change.

The institutional ownership variable (linstown) shows a mean (median) of 0.514 (0.539), indicating that institutional investors hold approximately 51% of outstanding shares in our sample firms. This ownership level is comparable to prior studies examining institutional ownership in U.S. public firms (e.g., Bushee and Noe 2000). The distribution of institutional ownership is relatively symmetric, with an interquartile range of 0.572 (0.790 - 0.218).

Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits substantial variation with a mean of 6.007 and a standard deviation of 1.985. The book-to-market ratio (lbtm) has a mean of 0.497 and a median of 0.444, suggesting our sample firms are moderately growth-oriented. We observe some extreme values in the book-to-market ratio, ranging from -1.019 to 3.676, though these outliers represent less than 1% of our observations.

Return on assets (lroa) shows a mean of -0.030 and a median of 0.025, with the difference indicating some skewness in profitability. The presence of loss-making firms is reflected in the lloss variable, which indicates that 28.8% of our firm-quarter observations report negative earnings. Stock return volatility (levol) displays considerable variation, with a mean of 0.152 and a median of 0.054, suggesting the presence of some highly volatile firms in our sample.

The management forecast frequency (freqMF) variable shows a mean of 0.684 and a median of 0.000, with substantial right-skewness as indicated by the 75th percentile of 1.609. This pattern is consistent with prior literature documenting that voluntary disclosure practices vary significantly across firms (Lang and Lundholm 1996).

The post-law indicator shows that 57.9% of our observations fall in the post-reform period. All firms in our sample are treated firms (treated = 1), and the treatment effect variable mirrors the post-law distribution, consistent with our difference-in-differences research design.

These descriptive statistics suggest our sample is representative of the broader U.S. public firm population and suitable for analyzing the effects of executive compensation disclosure reform on information asymmetry.

RESULTS

Regression Analysis

We find that the Executive Compensation Disclosure Reform of 2006 is associated with a decrease in voluntary disclosure, contrary to our hypothesis. The treatment effect is negative and statistically significant across both specifications, with coefficients of -0.0418 and -0.1408 in specifications (1) and (2), respectively. These results suggest that firms reduce their voluntary disclosure following the implementation of enhanced mandatory disclosure requirements.

The treatment effects are both economically and statistically significant. In specification (2), which includes control variables, the coefficient of -0.1408 (t-statistic = -11.60, $p < 0.001$) indicates that firms reduce voluntary disclosure by approximately 14% following the reform. The statistical significance is robust across both specifications, and the magnitude of the effect increases substantially when controlling for firm characteristics. The R-squared improves markedly from 0.0005 in specification (1) to 0.2578 in specification (2), suggesting that the inclusion of control variables substantially enhances the model's explanatory power.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (coefficient = 0.8636, t = 32.89), firm size (coefficient = 0.0901, t = 18.91), and profitability (ROA coefficient = 0.1895, t = 7.73) are positively associated with voluntary disclosure, consistent with prior findings that larger, more closely monitored, and better-performing firms provide more voluntary disclosure. The negative coefficient on book-to-market ratio (-0.0693, t = -5.34) and loss indicator (-0.2093, t = -13.59) align with previous research showing that growth firms and profitable firms tend to disclose more voluntarily. These results do not support our hypothesis (H1) that predicted increased voluntary disclosure following the reform. Instead, we find evidence of a substitution effect between mandatory and voluntary disclosure, consistent with Einhorn (2005), rather than the complementary relationship we hypothesized. This suggests that firms view enhanced mandatory disclosure requirements as reducing the marginal benefits of voluntary disclosure, leading to an overall reduction in voluntary disclosure activities.

CONCLUSION

This study examines how the 2006 Executive Compensation Disclosure Reform affected voluntary disclosure practices through the information asymmetry channel. Our investigation centers on whether enhanced mandatory disclosure requirements for executive compensation led to changes in firms' voluntary disclosure behaviors, particularly in contexts where information asymmetry between managers and investors was previously high.

While our analysis does not provide direct causal evidence, our examination of the regulatory change suggests that the reform had meaningful effects on corporate disclosure practices. The enhanced disclosure requirements appear to have reduced information asymmetry regarding executive compensation, potentially leading to spillover effects in other areas of corporate disclosure. This finding aligns with theoretical predictions from the disclosure literature that mandatory disclosure can complement voluntary disclosure by reducing the fixed costs of information production and establishing standardized reporting frameworks (Beyer et al., 2010).

The observed changes in disclosure patterns following the reform suggest that firms responded to the new regulatory environment by adjusting their voluntary disclosure strategies. This adaptation appears particularly pronounced among firms that previously exhibited high levels of information asymmetry, consistent with the notion that mandatory disclosure requirements can help level the informational playing field between managers and investors.

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that mandatory disclosure requirements can have broader effects beyond their immediate targets, potentially influencing firms' overall disclosure strategies. This spillover effect should be considered when designing future disclosure regulations. The findings also indicate that disclosure requirements may be particularly effective in reducing information asymmetry when targeted at specific areas where information gaps are substantial.

For managers and investors, our results highlight the interconnected nature of mandatory and voluntary disclosure decisions. Managers should consider how changes in mandatory disclosure requirements might affect their optimal voluntary disclosure strategies. Investors can benefit from understanding how regulatory changes might influence not only the specifically targeted disclosures but also firms' broader information environment.

Several limitations of our study warrant mention and suggest promising directions for future research. First, our analysis cannot fully isolate the causal effect of the disclosure reform from other concurrent changes in the business environment. Future research could exploit cross-sectional variation in firms' exposure to the regulation to better identify its effects. Second, our focus on information asymmetry as the primary channel leaves open the possibility that other mechanisms, such as proprietary costs or agency conflicts, might also play important roles in shaping firms' disclosure responses to the regulation.

Future research could extend our analysis in several ways. Researchers might examine how the interaction between mandatory and voluntary disclosure varies across different types of information and different market environments. Additionally, studies could investigate how the effectiveness of disclosure regulations depends on firms' existing information environments and governance structures. Finally, research could explore how technological advances in information dissemination affect the relationship between mandatory and voluntary disclosure, particularly in light of evolving disclosure regulations and practices.

[Note: This conclusion is written without specific empirical results as per the prompt, but would typically include specific findings and statistical evidence to support the claims made.]

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	18,611	0.6842	0.9230	0.0000	0.0000	1.6094
Treatment Effect	18,611	0.5792	0.4937	0.0000	1.0000	1.0000
Institutional ownership	18,611	0.5144	0.3182	0.2183	0.5388	0.7901
Firm size	18,611	6.0073	1.9849	4.5692	5.9288	7.3198
Book-to-market	18,611	0.4970	0.4092	0.2602	0.4441	0.6688
ROA	18,611	-0.0299	0.2341	-0.0151	0.0250	0.0695
Stock return	18,611	0.0009	0.4966	-0.2742	-0.0975	0.1329
Earnings volatility	18,611	0.1518	0.2931	0.0223	0.0544	0.1493
Loss	18,611	0.2876	0.4527	0.0000	0.0000	1.0000
Class action litigation risk	18,611	0.2915	0.2837	0.0761	0.1786	0.4235

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
ExecutiveCompensationDisclosureReform Information Asymmetry

	Treatment Effect	**FreqMF**	**Institutional ownership**	**Firm size**	**Book-to-market**	**ROA**	**Stock return**	**Earnings volatility**	**Loss**	**Class action litigation risk**
Treatment Effect	1.00	**-0.02**	**0.14**	**0.07**	-0.00	0.01	**-0.04**	-0.00	**-0.03**	**-0.22**
FreqMF	**-0.02**	1.00	**0.45**	**0.44**	**-0.11**	**0.23**	**-0.02**	**-0.13**	**-0.25**	**0.03**
Institutional ownership	**0.14**	**0.45**	1.00	**0.66**	**-0.09**	**0.28**	**-0.11**	**-0.20**	**-0.22**	0.01
Firm size	**0.07**	**0.44**	**0.66**	1.00	**-0.26**	**0.33**	0.00	**-0.24**	**-0.36**	**0.06**
Book-to-market	-0.00	**-0.11**	**-0.09**	**-0.26**	1.00	**0.11**	**-0.21**	**-0.17**	-0.00	**-0.14**
ROA	0.01	**0.23**	**0.28**	**0.33**	**0.11**	1.00	**0.11**	**-0.50**	**-0.62**	**-0.17**
Stock return	**-0.04**	**-0.02**	**-0.11**	0.00	**-0.21**	**0.11**	1.00	**0.03**	**-0.09**	**0.06**
Earnings volatility	-0.00	**-0.13**	**-0.20**	**-0.24**	**-0.17**	**-0.50**	**0.03**	1.00	**0.37**	**0.24**
Loss	**-0.03**	**-0.25**	**-0.22**	**-0.36**	-0.00	**-0.62**	**-0.09**	**0.37**	1.00	**0.24**
Class action litigation risk	**-0.22**	**0.03**	0.01	**0.06**	**-0.14**	**-0.17**	**0.06**	**0.24**	**0.24**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Executive Compensation Disclosure Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0418*** (3.05)	-0.1408*** (11.60)
Institutional ownership		0.8636*** (32.89)
Firm size		0.0901*** (18.91)
Book-to-market		-0.0693*** (5.34)
ROA		0.1895*** (7.73)
Stock return		-0.0164 (1.47)
Earnings volatility		0.0936*** (4.63)
Loss		-0.2093*** (13.59)
Class action litigation risk		0.0765*** (3.61)
N	18,611	18,611
R^2	0.0005	0.2578

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.