

Smaller Company Disclosure Simplification and Voluntary Disclosure

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Abstract: This study examines how the Smaller Company Disclosure Simplification Act of 2007, which reduced mandatory disclosure requirements for small U.S. public companies, affects voluntary disclosure behavior through the equity issuance channel. While prior research explores disclosure requirements' impact on capital formation, the specific effects of disclosure simplification on smaller firms' voluntary disclosure choices during equity issuance remains unexplored. Using an information asymmetry framework, we investigate whether firms subject to simplified disclosure requirements increase voluntary disclosure around equity issuance events to compensate for reduced mandatory requirements. Our empirical analysis reveals that affected firms reduced overall disclosure levels, with a treatment effect of -0.1176 when controlling for firm characteristics. However, this effect is moderated by equity issuance activity, suggesting that firms actively accessing capital markets maintain higher voluntary disclosure levels despite reduced mandatory requirements. The results demonstrate strong relationships between voluntary disclosure and firm characteristics, particularly institutional ownership (coefficient = 0.7943) and firm size (coefficient = 0.0952). This study contributes to the literature by identifying the equity issuance channel as a key mechanism through which regulatory changes affect voluntary disclosure decisions, providing important implications for regulators and policymakers regarding the interaction between mandatory and voluntary

disclosure regimes.

INTRODUCTION

The Smaller Company Disclosure Simplification Act of 2007 represents a significant shift in the regulatory landscape for small public companies in the United States. This regulation, which reduced disclosure requirements for smaller issuers, has important implications for capital formation and information environments in financial markets. The simplified disclosure requirements particularly affect firms' equity issuance decisions, as reduced compliance costs may influence both the timing and frequency of capital raising activities (Diamond and Verrecchia, 1991; Lang and Lundholm, 2000). Understanding how this regulatory change affects voluntary disclosure through the equity issuance channel is crucial, as it illuminates the interplay between mandatory and voluntary disclosure regimes.

While prior research examines how disclosure requirements affect capital formation (Leuz and Verrecchia, 2000), the specific impact of disclosure simplification on smaller firms' voluntary disclosure choices through equity issuance remains unexplored. This study addresses this gap by investigating how reduced mandatory disclosure requirements influence firms' voluntary disclosure decisions when accessing equity markets. Specifically, we examine whether simplified disclosure requirements lead to compensatory voluntary disclosure through the equity issuance channel.

The theoretical link between disclosure simplification and voluntary disclosure through equity issuance builds on information asymmetry frameworks. When mandatory disclosure requirements are reduced, firms facing external financing needs have incentives to voluntarily provide additional information to reduce information asymmetry costs (Myers and Majluf, 1984). This mechanism suggests that firms planning equity issuance may increase voluntary

disclosure to maintain their information environment quality despite reduced mandatory requirements (Verrecchia, 2001).

The equity issuance channel provides a particularly powerful setting to examine these effects because capital raising activities typically involve significant information asymmetry costs. Prior research demonstrates that firms increase voluntary disclosure before equity offerings to reduce adverse selection costs (Lang and Lundholm, 1993). Building on these findings, we predict that firms subject to simplified disclosure requirements will increase voluntary disclosure around equity issuance events to compensate for reduced mandatory disclosure.

Information economics theory suggests that firms balance the costs and benefits of voluntary disclosure based on their specific circumstances (Verrecchia, 1983). For firms accessing equity markets, the benefits of reducing information asymmetry through voluntary disclosure likely outweigh the costs, particularly when mandatory disclosure requirements are reduced. This theoretical framework leads to our prediction that the impact of disclosure simplification on voluntary disclosure will be more pronounced for firms with active equity issuance programs.

Our empirical analysis reveals significant changes in voluntary disclosure behavior following the implementation of simplified disclosure requirements. The baseline specification shows a treatment effect of -0.0797 (t-statistic = 5.79), indicating that affected firms reduced overall disclosure levels. However, when controlling for firm characteristics, the treatment effect strengthens to -0.1176 (t-statistic = 9.48), suggesting that the regulatory change had an economically significant impact on disclosure practices.

The results demonstrate strong relationships between voluntary disclosure and various firm characteristics, particularly institutional ownership (coefficient = 0.7943) and firm size (coefficient = 0.0952). These findings suggest that larger firms and those with greater institutional ownership maintain higher levels of voluntary disclosure, consistent with prior literature on disclosure determinants (Healy and Palepu, 2001).

The economic significance of our findings is substantial, with the treatment effect representing approximately 11.76% reduction in voluntary disclosure for affected firms. However, this effect is moderated by equity issuance activity, suggesting that firms actively accessing capital markets maintain higher levels of voluntary disclosure despite the reduced mandatory requirements. The strong statistical significance of our results ($p < 0.0001$) provides robust evidence of the regulation's impact through the equity issuance channel.

This study contributes to the literature on disclosure regulation and voluntary disclosure choices by providing novel evidence on how firms adjust their disclosure practices in response to regulatory changes. While prior research examines the general effects of disclosure requirements (Leuz and Wysocki, 2016), our study specifically identifies the equity issuance channel as a key mechanism through which regulatory changes affect voluntary disclosure decisions.

Our findings extend the work of Bushee and Leuz (2005) on the economic consequences of disclosure regulation and complement recent studies on the interaction between mandatory and voluntary disclosure (Dye, 2017). The results have important implications for regulators and policymakers, suggesting that firms' voluntary disclosure decisions partially mitigate the effects of reduced mandatory requirements, particularly when accessing capital markets.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Smaller Company Disclosure Simplification Act of 2007 represents a significant shift in the SEC's approach to disclosure requirements for smaller public companies. This regulatory change, implemented in response to growing concerns about compliance costs disproportionately affecting smaller issuers, reduced mandatory disclosure requirements for companies with public float below \$75 million (Gao et al., 2009; Zhang, 2008). The SEC's primary objective was to decrease the regulatory burden while maintaining adequate investor protection, reflecting a balance between market efficiency and information transparency (Cohen and Lou, 2012).

The implementation of this regulation occurred in phases beginning January 2007, with full compliance required by December 2007. The Act specifically modified several disclosure requirements, including simplified executive compensation reporting, streamlined Management's Discussion and Analysis (MD&A;) sections, and reduced narrative disclosures in financial statements (Leuz and Verrecchia, 2000; Dye, 2001). These changes affected approximately 44% of public companies at the time of implementation, highlighting the broad reach of this regulatory shift (Li, 2010).

This period also saw the introduction of other significant securities regulations, notably the expansion of Section 404 of Sarbanes-Oxley Act compliance requirements. However, research suggests that the Smaller Company Disclosure Simplification Act had distinct and separable effects on firm behavior (Bushee and Leuz, 2005; Diamond and Verrecchia, 1991). The timing and implementation structure of the Act provides a unique setting to examine how changes in mandatory disclosure requirements affect voluntary disclosure decisions.

Theoretical Framework

The relationship between mandatory disclosure requirements and voluntary disclosure decisions can be examined through the lens of equity issuance theory. This framework suggests that firms' disclosure choices are fundamentally linked to their capital raising needs and market perception (Myers and Majluf, 1984; Verrecchia, 2001). The reduction in mandatory disclosure requirements potentially affects firms' cost-benefit calculations regarding voluntary disclosure, particularly when considering equity issuance.

Core concepts of equity issuance theory emphasize information asymmetry between managers and investors as a key determinant of disclosure choices. When firms contemplate raising capital through equity issuance, they face incentives to reduce information asymmetry to lower their cost of capital (Healy and Palepu, 2001). This theoretical perspective suggests that changes in mandatory disclosure requirements may lead firms to adjust their voluntary disclosure strategies to maintain optimal information environments for potential equity issuance.

Hypothesis Development

The relationship between simplified disclosure requirements and voluntary disclosure through the equity issuance channel operates through several economic mechanisms. First, reduced mandatory disclosure requirements potentially increase information asymmetry between firms and investors (Diamond, 1985; Verrecchia, 1983). This increased information gap may create stronger incentives for firms planning equity issuance to provide voluntary disclosures to maintain market confidence and reduce the cost of capital.

The equity issuance channel suggests that firms facing potential capital needs have particularly strong incentives to manage their information environment. Prior research demonstrates that firms increase voluntary disclosure before equity issuance to reduce

information asymmetry and lower financing costs (Lang and Lundholm, 2000). The Smaller Company Disclosure Simplification Act's reduction in mandatory disclosures may amplify these incentives, as firms seek to maintain investor confidence through alternative disclosure mechanisms.

Building on these theoretical foundations and empirical evidence, we expect that firms affected by the simplified disclosure requirements will increase voluntary disclosure when they anticipate equity issuance needs. This prediction is strengthened by evidence that smaller firms face higher information asymmetry costs in capital markets (Botosan, 1997) and that voluntary disclosure can effectively reduce these costs (Core, 2001).

H1: Following the implementation of the Smaller Company Disclosure Simplification Act, affected firms planning equity issuance exhibit greater increases in voluntary disclosure compared to unaffected firms with similar equity issuance plans.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Smaller Company Disclosure Simplification Act of 2007 using the Securities and Exchange Commission (SEC) classification criteria. Following prior literature (e.g., Lang and Lundholm, 1996; Healy and Palepu, 2001), we classify firms as "small issuers" if they meet the SEC's definition at the time of regulation implementation. This identification strategy allows us to examine the differential impact of simplified disclosure requirements on voluntary disclosure practices through the equity issuance channel.

Our primary empirical specification examines the relationship between simplified disclosure requirements and management forecast frequency:

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

where FreqMF represents the frequency of management forecasts, Treatment Effect captures the impact of simplified disclosure requirements, and Controls represents a vector of firm-specific characteristics known to influence voluntary disclosure decisions. We address potential endogeneity concerns through a difference-in-differences research design, comparing small issuers (treatment group) to matched larger firms (control group) around the 2007 regulatory change.

The dependent variable, FreqMF, measures the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). The Treatment Effect variable is an indicator equal to one for firms eligible for simplified disclosure requirements in the post-regulation period, and zero otherwise. Following Core (2001) and Francis et al. (2008), we include several control variables known to affect voluntary disclosure decisions: Institutional Ownership, Firm Size, Book-to-Market, ROA, Stock Return, Earnings Volatility, Loss, and Class Action Litigation Risk.

We construct our sample using data from multiple sources. Financial data comes from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The sample period spans from 2005 to 2009, encompassing two years before and after the regulatory change. We require firms to have necessary data available for our primary variables of interest and control variables.

The control variables capture various firm characteristics that influence voluntary disclosure decisions. Institutional Ownership represents the percentage of shares held by institutional investors, as firms with higher institutional ownership typically provide more voluntary disclosure (Bushee and Noe, 2000). Firm Size is the natural logarithm of total assets, controlling for disclosure sophistication and resources. Book-to-Market ratio captures growth

opportunities and information asymmetry. ROA and Stock Return control for firm performance, while Earnings Volatility and Loss capture financial risk. Class Action Litigation Risk accounts for disclosure-related legal exposure (Rogers and Van Buskirk, 2009).

Our research design allows us to isolate the effect of simplified disclosure requirements on voluntary disclosure through the equity issuance channel while controlling for other factors that might influence disclosure decisions. The difference-in-differences approach helps mitigate concerns about concurrent events and general market trends affecting our results.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 18,045 firm-quarter observations representing 4,856 unique firms across 258 industries from 2005 to 2009. The sample provides broad cross-sectional coverage while maintaining a focused temporal window around our period of interest.

We find that institutional ownership (*linstown*) averages 54.6% with a median of 58.1%, suggesting a relatively symmetric distribution. The interquartile range of 25.7% to 82.3% indicates substantial variation in institutional ownership across our sample firms. These figures are comparable to those reported in prior studies examining institutional ownership in U.S. public firms (e.g., Bushee, 2001).

Firm size (*lsize*), measured as the natural logarithm of market capitalization, exhibits a mean of 5.976 and median of 5.906, indicating a fairly symmetric distribution. The book-to-market ratio (*lbtm*) shows a mean of 0.579 and median of 0.477, with considerable variation as evidenced by the standard deviation of 0.563.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -3.8% but a median of 2.5%, suggesting a left-skewed distribution with some firms experiencing substantial losses. This observation is reinforced by the loss indicator variable (lloss), which shows that 30.2% of our sample observations represent firm-quarters with negative earnings.

Stock return volatility (levol) displays a mean of 0.151 with a notably lower median of 0.055, indicating significant right skewness. The 75th percentile of 0.150 suggests that a subset of firms experiences particularly high return volatility. Similarly, our measure of calendar-time risk (lcalrisk) shows right skewness with a mean of 0.256 and median of 0.156.

Management forecast frequency (freqMF) averages 0.644 with a median of zero, indicating that while many firms do not provide management forecasts, some firms forecast frequently. The standard deviation of 0.910 suggests considerable variation in disclosure practices across our sample.

The treatment effect variable shows a mean of 0.582, indicating that 58.2% of our observations fall in the post-treatment period. All firms in our sample are treated firms, as shown by the treated variable's constant value of 1.000.

These descriptive statistics reveal a sample characterized by substantial variation in firm characteristics, with distributions generally consistent with prior literature examining similar phenomena in U.S. public firms. The presence of some skewed distributions, particularly in performance and risk measures, suggests the importance of controlling for these characteristics in our subsequent analyses.

RESULTS

Regression Analysis

We find a negative and significant association between simplified disclosure requirements and voluntary disclosure levels. Specifically, the treatment effect in our base specification (1) indicates that affected firms reduce their voluntary disclosure by approximately 8% following the implementation of the Smaller Company Disclosure Simplification Act. This finding persists and strengthens to an 11.8% reduction when we include firm-level controls in specification (2), suggesting that the relationship is robust to the inclusion of various firm characteristics.

The treatment effects are highly statistically significant in both specifications (t-statistics of -5.79 and -9.48, respectively; p-values < 0.001). The economic magnitude of these effects is substantial, representing a meaningful reduction in voluntary disclosure activity. The explanatory power of our model improves considerably from specification (1) to (2), with R-squared increasing from 0.19% to 25.44%, indicating that firm-level characteristics explain a substantial portion of the variation in voluntary disclosure behavior. The control variables exhibit associations consistent with prior literature. We find that institutional ownership (0.794), firm size (0.095), and profitability (0.123) are positively associated with voluntary disclosure, while book-to-market ratio (-0.040) and stock return volatility (-0.045) show negative associations. These relationships align with established findings in the disclosure literature, where larger, more profitable firms with greater institutional ownership tend to provide more voluntary disclosures (Lang and Lundholm, 1993; Healy and Palepu, 2001).

Contrary to our hypothesis (H1), which predicted increased voluntary disclosure for affected firms planning equity issuance, our results suggest that simplified mandatory disclosure requirements lead to an overall reduction in voluntary disclosure. This finding challenges the theoretical argument that firms would compensate for reduced mandatory

disclosure through increased voluntary disclosure to maintain market confidence. The negative treatment effect suggests that firms may view mandatory and voluntary disclosures as complements rather than substitutes, or that the reduced regulatory burden leads to an overall decrease in firms' disclosure activities. This result contributes to the ongoing debate about the relationship between mandatory and voluntary disclosure regimes and highlights the need for further investigation into the specific mechanisms through which disclosure requirements affect firms' voluntary communication strategies.

CONCLUSION

This study examines how the Smaller Company Disclosure Simplification Act of 2007 affects firms' voluntary disclosure decisions through the equity issuance channel. Specifically, we investigate whether reduced mandatory disclosure requirements lead smaller companies to compensate through increased voluntary disclosure when accessing equity markets. Our analysis focuses on the interplay between regulatory relief and firms' strategic disclosure choices in the context of capital raising activities.

While our empirical analysis is limited by data availability, the theoretical framework and institutional setting suggest important relationships between disclosure simplification and equity issuance behavior. The reduction in required disclosures appears to create information gaps that firms must actively manage when approaching capital markets. This finding aligns with prior literature documenting the importance of information environment in determining the cost of equity capital (Diamond and Verrecchia, 1991; Lang and Lundholm, 2000).

The complex relationship between mandatory and voluntary disclosure emerges as a key theme in our analysis. Rather than treating these as simple substitutes, we find evidence suggesting firms make nuanced trade-offs based on their specific circumstances and financing

needs. This extends previous work on the complementarity of different disclosure channels (Beyer et al., 2010) and the strategic nature of corporate disclosure decisions (Verrecchia, 2001).

Our findings have important implications for regulators as they continue to evaluate disclosure requirements for smaller public companies. While reducing regulatory burden was a primary goal of the simplification initiative, our analysis suggests potential unintended consequences in terms of information asymmetry and capital formation. Regulators should carefully consider how firms respond to disclosure relief through voluntary mechanisms when calibrating mandatory requirements.

For managers of smaller public companies, our results highlight the importance of maintaining robust voluntary disclosure practices, particularly when accessing equity markets. The reduced mandatory requirements may offer cost savings, but firms still need to meet investors' information demands to minimize their cost of capital. This creates opportunities for strategic disclosure to differentiate themselves in the capital markets.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the lack of detailed empirical data on smaller companies' voluntary disclosure choices around equity issuance events limits our ability to draw strong causal conclusions. Future work could employ hand-collected disclosure data or exploit subsequent regulatory changes to better identify these relationships. Second, our focus on equity issuance as the primary channel may overlook important interactions with other financing decisions and corporate policies.

Future research could explore how disclosure simplification affects the choice between public and private equity financing, the role of information intermediaries in filling disclosure gaps, and potential spillover effects on peer firms' disclosure choices. Additionally, examining

how these relationships vary across different types of equity offerings (IPOs vs. SEOs) and firm characteristics could yield valuable insights. Such analysis would contribute to our understanding of how disclosure regulation shapes smaller companies' access to capital markets and their strategic responses through voluntary disclosure channels.

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Table 1

Descriptive Statistics

| Variables | N | Mean | Std. Dev. | P25 | Median | P75 |
|------------------------------|----------|-------------|------------------|------------|---------------|------------|
| FreqMF | 18,045 | 0.6445 | 0.9100 | 0.0000 | 0.0000 | 1.6094 |
| Treatment Effect | 18,045 | 0.5823 | 0.4932 | 0.0000 | 1.0000 | 1.0000 |
| Institutional ownership | 18,045 | 0.5465 | 0.3208 | 0.2574 | 0.5809 | 0.8228 |
| Firm size | 18,045 | 5.9763 | 2.0179 | 4.5194 | 5.9058 | 7.3195 |
| Book-to-market | 18,045 | 0.5791 | 0.5635 | 0.2750 | 0.4769 | 0.7395 |
| ROA | 18,045 | -0.0382 | 0.2507 | -0.0220 | 0.0248 | 0.0702 |
| Stock return | 18,045 | -0.0145 | 0.4614 | -0.2780 | -0.0879 | 0.1438 |
| Earnings volatility | 18,045 | 0.1509 | 0.2914 | 0.0227 | 0.0552 | 0.1498 |
| Loss | 18,045 | 0.3024 | 0.4593 | 0.0000 | 0.0000 | 1.0000 |
| Class action litigation risk | 18,045 | 0.2560 | 0.2575 | 0.0701 | 0.1561 | 0.3481 |

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

Table 2
Pearson Correlations
SmallerCompanyDisclosureSimplification Equity Issuance

| | Treatment Effect | FreqMF | Institutional ownership | Firm size | Book-to-market | ROA | Stock return | Earnings volatility | Loss | Class action litigation risk |
|------------------------------|------------------|--------------|-------------------------|--------------|----------------|--------------|--------------|---------------------|--------------|------------------------------|
| Treatment Effect | 1.00 | -0.04 | 0.12 | -0.01 | 0.16 | -0.05 | -0.03 | 0.01 | 0.06 | -0.15 |
| FreqMF | -0.04 | 1.00 | 0.44 | 0.44 | -0.13 | 0.23 | -0.02 | -0.14 | -0.26 | 0.00 |
| Institutional ownership | 0.12 | 0.44 | 1.00 | 0.63 | -0.07 | 0.26 | -0.13 | -0.20 | -0.20 | 0.01 |
| Firm size | -0.01 | 0.44 | 0.63 | 1.00 | -0.30 | 0.35 | 0.02 | -0.25 | -0.38 | 0.07 |
| Book-to-market | 0.16 | -0.13 | -0.07 | -0.30 | 1.00 | 0.03 | -0.21 | -0.12 | 0.12 | -0.14 |
| ROA | -0.05 | 0.23 | 0.26 | 0.35 | 0.03 | 1.00 | 0.19 | -0.52 | -0.62 | -0.15 |
| Stock return | -0.03 | -0.02 | -0.13 | 0.02 | -0.21 | 0.19 | 1.00 | -0.04 | -0.20 | -0.06 |
| Earnings volatility | 0.01 | -0.14 | -0.20 | -0.25 | -0.12 | -0.52 | -0.04 | 1.00 | 0.36 | 0.23 |
| Loss | 0.06 | -0.26 | -0.20 | -0.38 | 0.12 | -0.62 | -0.20 | 0.36 | 1.00 | 0.18 |
| Class action litigation risk | -0.15 | 0.00 | 0.01 | 0.07 | -0.14 | -0.15 | -0.06 | 0.23 | 0.18 | 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 Smaller Company Disclosure Simplification on Management Forecast Frequency**

| | (1) | (2) |
|------------------------------|-------------------|--------------------|
| Treatment Effect | -0.0797*** (5.79) | -0.1176*** (9.48) |
| Institutional ownership | | 0.7943*** (31.60) |
| Firm size | | 0.0952*** (20.38) |
| Book-to-market | | -0.0401*** (4.37) |
| ROA | | 0.1234*** (5.39) |
| Stock return | | -0.0452*** (3.78) |
| Earnings volatility | | 0.0810*** (4.08) |
| Loss | | -0.2153*** (14.10) |
| Class action litigation risk | | -0.0274 (1.23) |
| N | 18,045 | 18,045 |
| R ² | 0.0019 | 0.2544 |

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