

Smaller Reporting Company Regulatory Relief and Voluntary Disclosure

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Abstract: This study examines how the SEC's 2007 Smaller Reporting Company (SRC) Regulatory Relief, which reduced mandatory disclosure requirements for qualifying firms, affects voluntary disclosure practices through the information asymmetry channel. While existing theory suggests firms might either increase voluntary disclosure to compensate for reduced mandatory requirements or decrease overall disclosure due to cost considerations, empirical evidence on this relationship remains limited. Using a difference-in-differences design, we analyze changes in voluntary disclosure practices following the regulatory change. Results indicate that affected firms significantly decreased their voluntary disclosure relative to control firms, with a treatment effect of -0.0797 that strengthens to -0.1176 when controlling for firm characteristics. The effect is economically significant and robust across specifications, with institutional ownership and firm size emerging as key determinants of disclosure decisions. These findings demonstrate that simplified disclosure requirements can lead to reduced overall disclosure rather than compensatory voluntary disclosure. The study contributes to disclosure regulation literature by providing novel evidence on how regulatory relief influences voluntary disclosure through the information asymmetry channel, offering important implications for future disclosure simplification initiatives.

INTRODUCTION

The Securities and Exchange Commission's Smaller Reporting Company (SRC) Regulatory Relief of 2007 represents a significant shift in disclosure requirements for smaller public companies, fundamentally altering the information environment in capital markets. This regulatory change reduced mandatory disclosure obligations for qualifying firms, potentially affecting information asymmetry between managers and investors (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The regulation's impact on voluntary disclosure decisions remains theoretically ambiguous, as firms may either increase voluntary disclosure to compensate for reduced mandatory requirements or decrease overall disclosure due to lower compliance costs and competitive pressures.

While prior research examines how regulatory changes affect mandatory disclosure (Leuz and Wysocki, 2016), we lack systematic evidence on how simplified disclosure requirements influence firms' voluntary disclosure choices through the information asymmetry channel. This study addresses this gap by investigating whether and how the SRC Regulatory Relief affects voluntary disclosure practices, particularly focusing on the role of information asymmetry as the primary economic mechanism driving disclosure choices.

Information asymmetry theory suggests that managers possess superior information about firm value and performance compared to outside investors (Myers and Majluf, 1984). When mandatory disclosure requirements decrease, theory predicts two competing effects on voluntary disclosure through the information asymmetry channel. First, firms may increase voluntary disclosure to reduce information asymmetry and associated capital market frictions (Verrecchia, 2001). Alternatively, reduced mandatory disclosure requirements may lower overall disclosure quality if firms prioritize proprietary cost concerns over capital market benefits (Verrecchia and Weber, 2006).

The relationship between regulatory relief and voluntary disclosure operates through changes in the information environment and associated agency costs. As mandatory disclosure

requirements decrease, information asymmetry between managers and investors likely increases, potentially raising the cost of capital (Lambert et al., 2007). Firms then face incentives to voluntarily disclose information to mitigate these adverse effects, particularly when the benefits of reduced information asymmetry outweigh proprietary costs of disclosure.

Building on analytical models of voluntary disclosure (Dye, 1985; Jung and Kwon, 1988), we predict that firms affected by the SRC Regulatory Relief will adjust their voluntary disclosure practices based on the relative costs and benefits of information asymmetry reduction. The empirical analysis tests this prediction by examining changes in voluntary disclosure following the regulatory change.

Our empirical analysis reveals that firms affected by the SRC Regulatory Relief significantly decreased their voluntary disclosure following the regulation. The baseline specification shows a treatment effect of -0.0797 (t-statistic = 5.79), indicating that affected firms reduced voluntary disclosure relative to control firms. This effect strengthens to -0.1176 (t-statistic = 9.48) when controlling for firm characteristics, suggesting the relationship is robust to potential confounding factors.

The economic magnitude of these effects is substantial, with institutional ownership (coefficient = 0.7943) and firm size (coefficient = 0.0952) emerging as significant determinants of voluntary disclosure decisions. The negative treatment effect persists across various specifications, supporting the hypothesis that reduced mandatory disclosure requirements lead to decreased voluntary disclosure through the information asymmetry channel.

These findings suggest that firms respond to regulatory relief by reducing overall disclosure rather than compensating for decreased mandatory requirements through voluntary

disclosure. The significant negative coefficients on loss indicators (-0.2153) and book-to-market ratio (-0.0401) further support the role of information asymmetry in shaping disclosure decisions.

This study contributes to the literature on disclosure regulation by providing novel evidence on how regulatory relief affects voluntary disclosure through the information asymmetry channel. While prior research focuses primarily on mandatory disclosure effects (Leuz and Wysocki, 2016), we demonstrate that simplified disclosure requirements can lead to unintended consequences in firms' voluntary disclosure practices.

Our findings extend recent work on disclosure regulation (Dyer et al., 2017) by documenting how changes in mandatory requirements affect voluntary disclosure decisions through information asymmetry. The results have important implications for regulators considering disclosure simplification initiatives and highlight the need to consider potential spillover effects on firms' voluntary disclosure practices.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Smaller Reporting Company Regulatory Relief and Simplification (SRC) rule, adopted by the Securities and Exchange Commission (SEC) in 2007, represents a significant shift in disclosure requirements for smaller public companies (SEC, 2007). This regulatory change aimed to reduce compliance costs while maintaining investor protection by implementing scaled disclosure requirements for companies with public float below \$75 million (Gao et al., 2009). The SEC's decision was motivated by evidence suggesting that smaller companies face disproportionate regulatory burdens, potentially affecting their ability to access public capital markets (Leuz and Wysocki, 2016).

The implementation of SRC became effective on February 4, 2008, replacing the previous "small business issuer" definition with more comprehensive criteria based on public float and revenue thresholds (Iliev, 2010). Under the new framework, eligible companies could benefit from simplified executive compensation disclosure, reduced financial statement requirements, and streamlined Management Discussion and Analysis (MD&A;) sections. These modifications represented a significant departure from the one-size-fits-all approach to securities regulation, acknowledging the unique challenges faced by smaller public companies (Dey and Sullivan, 2012).

The adoption of SRC occurred during a period of significant regulatory change in U.S. securities markets. Notable contemporaneous regulatory developments included the implementation of internal control requirements under Section 404 of the Sarbanes-Oxley Act and amendments to executive compensation disclosure rules (Zhang, 2007). However, the SRC initiative was distinct in its focus on smaller companies and its comprehensive approach to disclosure simplification (Leuz, 2007).

Theoretical Framework

Information asymmetry theory provides a natural lens through which to examine the effects of the SRC rule on voluntary disclosure decisions. The fundamental premise of information asymmetry, as established by Akerlof (1970) and developed in accounting literature by Verrecchia (2001), suggests that managers possess superior information about their firms compared to outside investors. This information gap creates agency costs and affects firms' disclosure choices.

The relationship between regulatory requirements and voluntary disclosure decisions is particularly relevant in the context of information asymmetry. Diamond and Verrecchia (1991) demonstrate that reduced mandatory disclosure requirements can lead to increased information

asymmetry between firms and investors, potentially affecting firms' cost of capital and market liquidity. When mandatory disclosure requirements are relaxed, firms must weigh the costs and benefits of voluntary disclosure to manage information asymmetry (Beyer et al., 2010).

Hypothesis Development

The implementation of SRC creates a natural tension in firms' voluntary disclosure decisions through the information asymmetry channel. On one hand, reduced mandatory disclosure requirements under SRC may increase information asymmetry between firms and investors, potentially creating incentives for increased voluntary disclosure to maintain market confidence and reduce cost of capital (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). This perspective suggests that firms might compensate for reduced mandatory disclosure through enhanced voluntary disclosure.

However, competing theoretical arguments suggest that firms might reduce voluntary disclosure following SRC implementation. First, the cost savings from reduced mandatory disclosure requirements might make firms less inclined to incur additional costs associated with voluntary disclosure (Verrecchia, 2001). Second, if investors interpret the reduced disclosure requirements as a signal of lower information quality, firms might find voluntary disclosure less credible or effective in reducing information asymmetry (Dye, 1998).

The balance of theoretical arguments suggests that the information asymmetry effects of reduced mandatory disclosure requirements are likely to dominate cost considerations, particularly for smaller firms where information asymmetry concerns are more acute (Lang and Lundholm, 1993). Smaller firms typically face greater information asymmetry challenges and higher costs of capital, making them more sensitive to changes in their information environment. Therefore, we expect that affected firms will increase voluntary disclosure to mitigate the potential increase in information asymmetry resulting from reduced mandatory

disclosure requirements.

H1: Following the implementation of the Smaller Reporting Company Regulatory Relief rule, affected firms increase their voluntary disclosure relative to unaffected firms.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Smaller Reporting Company Regulatory Relief (SRCRR) using the Securities and Exchange Commission's (SEC) criteria established in 2007. Following Leuz and Verrecchia (2000), we classify firms as eligible for simplified disclosure requirements if they have public float less than \$75 million. We obtain public float data from SEC filings through Audit Analytics and match it with financial data from Compustat.

To examine the impact of SRCRR on voluntary disclosure through the information asymmetry channel, we employ the following regression model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure following Ajinkya et al. (2005). Treatment Effect is an indicator variable equal to one for firms eligible for SRCRR in the post-period, and zero otherwise. Controls represents a vector of firm characteristics known to influence voluntary disclosure decisions.

We include several control variables established in prior literature. Institutional Ownership controls for sophisticated investor presence (Bushee and Noe, 2000). Firm Size, measured as the natural logarithm of total assets, accounts for disclosure economies of scale

(Lang and Lundholm, 1993). Book-to-Market ratio captures growth opportunities and information asymmetry (Core et al., 2015). ROA and Stock Return control for firm performance (Rogers and Van Buskirk, 2009). Earnings Volatility and Loss indicator address information uncertainty (Kothari et al., 2009). We also control for Class Action Litigation Risk following Kim and Skinner (2012).

Our sample spans from 2005 to 2009, encompassing two years before and after the 2007 SRCRR implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of firms eligible for SRCRR, while the control group includes similar-sized firms above the regulatory threshold.

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous regulatory shock of SRCRR implementation. This approach helps control for unobserved time-invariant firm characteristics and common time trends that might affect voluntary disclosure decisions (Roberts and Whited, 2013). We also conduct various robustness tests including placebo tests and alternative specifications of the treatment effect to ensure our results are not driven by concurrent events or sample selection.

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 statistics are comparable to those reported in prior studies examining similar-sized firms (e.g., Chen et al., 2020).

Firm size (*lsize*), measured as the natural logarithm of market capitalization, exhibits a mean of 5.976 and a median of 5.906, indicating a relatively normal distribution. The book-to-market ratio (*lbtm*) shows a mean of 0.579 and a median of 0.477, with considerable right-skew as evidenced by the maximum value of 3.676.

Profitability metrics reveal interesting patterns. Return on assets (*lroa*) displays a mean of -3.8% but a median of 2.5%, suggesting that while most firms are profitable, the distribution is left-skewed due to some firms with substantial losses. This observation is reinforced by the loss indicator variable (*lloss*), which shows that 30.2% of our sample observations represent loss-making periods.

Stock return volatility (*levol*) exhibits substantial right-skew with a mean of 0.151 but a median of 0.055, indicating that while most firms have moderate volatility, some experience extremely high volatility levels. Calendar-based risk (*lcalrisk*) shows similar patterns with a mean of 0.256 and median of 0.156.

Management forecast frequency (*freqMF*) averages 0.644 with a median of zero, suggesting that while many firms do not provide forecasts, those that do tend to forecast multiple times per period. The treatment effect variable shows that 58.2% of our observations fall in the post-treatment period.

These descriptive statistics reveal several notable characteristics of our sample. First, we observe considerable variation in institutional ownership and firm size, suggesting our

results should be generalizable across different firm types. Second, the profitability metrics indicate that our sample includes both financially healthy and distressed firms. Finally, the skewed distributions of volatility measures suggest the presence of some extreme cases, which we address in our robustness tests.

RESULTS

Regression Analysis

We find that firms affected by the Smaller Reporting Company Regulatory Relief (SRC) rule significantly decrease their voluntary disclosure relative to unaffected firms, contrary to our hypothesis. The treatment effect is negative and statistically significant at the 1% level across both specifications, with coefficients of -0.0797 and -0.1176 in specifications (1) and (2), respectively. This suggests that firms respond to reduced mandatory disclosure requirements by also reducing their voluntary disclosure activities.

The economic magnitude of the effect is substantial. In our preferred specification with control variables (2), the treatment effect indicates an 11.76% reduction in voluntary disclosure for affected firms relative to unaffected firms. The results are highly statistically significant, with t-statistics of -5.79 and -9.48 in specifications (1) and (2), respectively. The inclusion of control variables substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.19% to 25.44%.

The control variables exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (*linstown*) and firm size (*lsize*) are positively associated with voluntary disclosure, consistent with Lang and Lundholm (1993). The positive coefficient on return on assets (*lroa*) and negative coefficient on loss indicator (*lloss*) suggest that better-performing firms provide more voluntary disclosure. The

book-to-market ratio (lbtm) is negatively associated with voluntary disclosure, indicating that growth firms disclose more. These results do not support our hypothesis (H1), which predicted increased voluntary disclosure following SRC implementation. Instead, the findings suggest that cost considerations and potential reduced benefits of voluntary disclosure dominate the information asymmetry concerns. This aligns more closely with Verrecchia's (2001) arguments about disclosure costs and Dye's (1998) predictions regarding disclosure credibility than with the information asymmetry perspective of Diamond and Verrecchia (1991). The results indicate that firms view mandatory and voluntary disclosure as complements rather than substitutes in their overall disclosure strategy.

CONCLUSION

This study examines how the 2007 Smaller Reporting Company (SRC) Regulatory Relief affects voluntary disclosure through the information asymmetry channel. We investigate whether reduced mandatory disclosure requirements lead smaller reporting companies to adjust their voluntary disclosure practices to maintain optimal information environments. Our analysis contributes to the ongoing debate about the trade-offs between regulatory burden reduction and market transparency.

While our empirical analysis is limited by data availability, our theoretical framework suggests that firms face competing incentives following regulatory relief. On one hand, reduced mandatory disclosure requirements lower compliance costs, potentially freeing resources for voluntary disclosure. On the other hand, the relaxed requirements may increase information asymmetry between managers and investors, potentially affecting firms' cost of capital and creating pressure for compensatory voluntary disclosure. This tension aligns with prior literature documenting how firms strategically adjust voluntary disclosure in response to changes in their information environment (Leuz and Verrecchia, 2000; Diamond and

Verrecchia, 1991).

Our conceptual analysis suggests that the impact of SRC regulatory relief on voluntary disclosure likely varies based on firm characteristics and market conditions. Firms with greater external financing needs or higher proprietary costs may be more likely to increase voluntary disclosure to maintain market confidence. This heterogeneity in responses highlights the importance of considering firm-specific factors when evaluating the effects of disclosure regulation, consistent with recent work by Dye (2020) and Verrecchia (2001).

These findings have important implications for regulators and policymakers. While reducing regulatory burdens may benefit smaller companies through cost savings, regulators should consider potential unintended consequences for market transparency and information asymmetry. Our analysis suggests that some firms may voluntarily maintain higher disclosure levels, potentially mitigating concerns about reduced transparency. However, this response may not be uniform across all affected firms, potentially creating disparities in market information environments.

For managers and investors, our study highlights the strategic importance of voluntary disclosure decisions in response to regulatory changes. Managers must carefully weigh the benefits of reduced compliance costs against potential increases in cost of capital due to greater information asymmetry. Investors should be aware that changes in mandatory disclosure requirements may lead to variations in voluntary disclosure practices across firms, affecting their ability to evaluate investment opportunities.

Our study has several limitations that suggest promising directions for future research. First, empirical validation of our theoretical predictions would provide valuable insights into how firms actually respond to regulatory relief. Second, future studies could examine the long-term effects of reduced disclosure requirements on market efficiency and firm outcomes.

Third, researchers could investigate how the interaction between mandatory and voluntary disclosure varies across different institutional settings and market conditions.

Future research could also explore how technological advances and changes in information dissemination channels affect the relationship between regulatory requirements and voluntary disclosure. Additionally, studies could examine how the COVID-19 pandemic and other major market disruptions influence firms' disclosure strategies under different regulatory regimes. These extensions would contribute to our understanding of how firms optimize their disclosure policies in evolving market environments.

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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
SmallerReportingCompanyRegulatoryRelief 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	-0.04	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 Reporting Company Regulatory Relief 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.