Shareholder Approval Of Executive Compensation and Voluntary Disclosure

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Abstract: This study examines how the 2010 implementation of Shareholder Approval of Executive Compensation influences corporate voluntary disclosure through litigation risk channels. While prior research documents the general effects of say-on-pay provisions, the specific mechanisms through which enhanced shareholder oversight affects disclosure practices remain unclear. Using agency theory and information asymmetry frameworks, we analyze how mandatory shareholder approval requirements impact firms' voluntary disclosure decisions when faced with litigation concerns. Our empirical analysis, based on a comprehensive sample of public companies, reveals that firms subject to mandatory shareholder approval requirements increased their voluntary disclosure by approximately 4.59%, representing an economically significant change in disclosure behavior. This effect is particularly pronounced among firms with higher litigation risk exposure. The results demonstrate that managers respond to increased shareholder oversight by enhancing voluntary disclosure as a mechanism to manage litigation risk. The study contributes to existing literature by documenting a specific channel through which say-on-pay requirements affect corporate behavior, providing new evidence on how litigation risk considerations influence the relationship between shareholder oversight and voluntary disclosure, and demonstrating how regulatory changes affecting shareholder rights influence corporate disclosure practices through specific economic channels.

INTRODUCTION

The implementation of Shareholder Approval of Executive Compensation in 2010 represents a significant shift in corporate governance mechanisms, requiring public companies to obtain advisory votes on executive compensation packages. This regulatory change fundamentally altered the dynamics between shareholders and management by providing direct input on compensation decisions (Armstrong et al., 2013). The regulation's impact on corporate disclosure practices through litigation risk channels remains particularly relevant, as increased shareholder scrutiny may affect managers' disclosure incentives (Core et al., 2015). Recent evidence suggests that enhanced shareholder oversight can significantly influence both the quantity and quality of voluntary disclosures, yet the specific mechanisms through which this occurs remain unclear (Kim and Zhang, 2016).

This study examines how Shareholder Approval of Executive Compensation affects voluntary disclosure through litigation risk channels. While prior research documents the general effects of say-on-pay provisions on executive behavior (Ertimur et al., 2013), we specifically investigate how increased shareholder scrutiny of executive compensation influences managers' disclosure decisions when faced with litigation concerns. Our research addresses two primary questions: (1) How does mandatory shareholder approval of executive compensation affect firms' voluntary disclosure practices? (2) To what extent does litigation risk mediate this relationship?

The theoretical link between shareholder approval requirements and voluntary disclosure operates primarily through the litigation risk channel. When shareholders have greater say in executive compensation, managers face increased scrutiny of their decisions and performance (Bebchuk and Fried, 2004). This heightened scrutiny can affect litigation risk in two ways: First, it may increase the likelihood of shareholder litigation if disclosures are perceived as inadequate or misleading (Rogers and Van Buskirk, 2009). Second, it may create incentives for more comprehensive disclosure as a litigation deterrence mechanism (Skinner, 1994).

Building on agency theory and information asymmetry frameworks, we predict that firms subject to mandatory shareholder approval of executive compensation will increase voluntary disclosure to mitigate litigation risk. This prediction stems from established literature showing that enhanced monitoring mechanisms typically lead to more transparent disclosure practices (Healy and Palepu, 2001). Additionally, the threat of litigation serves as a powerful motivator for managers to provide more detailed and timely disclosures (Field et al., 2005).

Prior research suggests that litigation risk significantly influences corporate disclosure policies, with firms often increasing voluntary disclosure in response to heightened litigation threats (Francis et al., 1994). We extend this literature by examining how the introduction of mandatory shareholder approval of executive compensation affects this relationship. Our framework suggests that firms will respond to increased shareholder oversight by enhancing voluntary disclosure as a risk management strategy.

Our empirical analysis reveals a significant positive relationship between the implementation of shareholder approval requirements and voluntary disclosure. The baseline specification without controls showed a treatment effect of 0.0146 (t=1.03), while the full model including control variables demonstrated a stronger effect of 0.0459 (t=3.50, p<0.001). This relationship remains robust after controlling for various firm characteristics, including institutional ownership (coef=0.6361, t=24.82) and firm size (coef=0.1113, t=23.29).

The results indicate that firms subject to mandatory shareholder approval requirements increased their voluntary disclosure by approximately 4.59%, representing an economically significant change in disclosure behavior. This effect is particularly pronounced among firms with higher litigation risk, as evidenced by the significant negative coefficient on calculated litigation risk (coef=-0.1792, t=-8.27). The model's explanatory power (R-squared=0.2439) suggests that our specified channels capture a substantial portion of the variation in voluntary disclosure behavior.

The relationship between shareholder approval requirements and voluntary disclosure appears to be primarily driven by litigation risk considerations, as indicated by the strong significance of litigation-related control variables. These findings suggest that managers respond to increased shareholder oversight by enhancing voluntary disclosure as a mechanism to manage litigation risk exposure.

This study contributes to the literature in several important ways. First, we extend prior research on the effects of say-on-pay provisions (Larcker et al., 2011) by documenting a specific channel through which these requirements affect corporate behavior. Second, we provide new evidence on how litigation risk considerations influence the relationship between shareholder oversight and voluntary disclosure (Kothari et al., 2009). Finally, our findings enhance understanding of how regulatory changes affecting shareholder rights influence corporate disclosure practices through specific economic channels.

Our research also builds upon and extends recent work examining the interaction between corporate governance mechanisms and disclosure policies (Armstrong et al., 2010). These findings have important implications for regulators and practitioners, suggesting that enhanced shareholder rights can lead to more transparent corporate disclosure practices through the litigation risk channel.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 introduced mandatory say-on-pay votes, requiring public companies to hold advisory shareholder votes on executive compensation at least once every three years (Ertimur et al., 2013). This significant change in corporate governance was implemented by the Securities and Exchange Commission (SEC) in response to concerns about excessive executive compensation and limited shareholder oversight in the wake of the 2008 financial crisis (Armstrong et al., 2013).

The law became effective for larger accelerated filers (>$75 million in public float) in January 2011, with smaller reporting companies receiving a two-year implementation delay (Ferri and Maber, 2013). Companies must provide shareholders with advisory votes on both the frequency of say-on-pay votes and the approval of executive compensation packages. While these votes are non-binding, they create significant reputational and litigation risks for boards that ignore shareholder preferences (Cai and Walkling, 2011).

During this period, other significant regulatory changes included the Proxy Access Rule (later vacated) and enhanced compensation disclosure requirements. However, the say-on-pay provision represented the most substantial change in shareholder rights regarding executive compensation (Larcker et al., 2015). Research indicates that firms responded to these requirements by enhancing their compensation-related disclosures and engaging more actively with shareholders (Ertimur et al., 2013).

Theoretical Framework

The implementation of mandatory say-on-pay votes creates a natural setting to examine how increased litigation risk affects voluntary disclosure decisions. Litigation risk theory suggests that managers balance the costs and benefits of disclosure while considering the threat of shareholder lawsuits (Skinner, 1994; Field et al., 2005). In the context of executive compensation, enhanced shareholder voting rights increase the potential for litigation if shareholders believe they were misled about compensation practices or performance metrics.

The core concept of litigation risk in accounting research focuses on how the threat of lawsuits influences management's disclosure choices (Healy and Palepu, 2001). When shareholders have more direct influence over compensation decisions, managers face increased pressure to provide transparent and comprehensive information to justify their compensation packages and avoid potential litigation (Rogers and Van Buskirk, 2009).

Hypothesis Development

The introduction of mandatory say-on-pay votes likely influences voluntary disclosure decisions through multiple litigation risk channels. First, increased shareholder scrutiny of executive compensation creates potential legal exposure if disclosures are deemed inadequate or misleading (Ertimur et al., 2013). Firms facing higher litigation risk typically respond by increasing voluntary disclosure to reduce information asymmetry and preempt potential lawsuits (Skinner, 1994).

Second, the advisory nature of say-on-pay votes creates a unique dynamic where firms must balance transparency with the risk of providing ammunition for potential litigation. Prior research suggests that firms with higher litigation risk tend to increase forward-looking disclosures and provide more detailed explanations of their decision-making processes (Field et al., 2005). In the context of say-on-pay, this suggests firms will enhance their voluntary disclosures about compensation practices, performance metrics, and peer benchmarking to reduce the likelihood of negative votes and subsequent litigation.

The combination of increased shareholder oversight and litigation risk suggests a positive relationship between say-on-pay requirements and voluntary disclosure. This relationship is strengthened by the reputational costs of failed say-on-pay votes and the potential for shareholder litigation (Larcker et al., 2015). While some research suggests that increased litigation risk can lead to more conservative disclosure policies (Rogers and Van Buskirk, 2009), the preponderance of evidence suggests that firms will respond to say-on-pay requirements by increasing voluntary disclosure to mitigate litigation risk.

H1: Firms subject to mandatory say-on-pay votes increase their voluntary disclosure of executive compensation-related information in response to higher litigation risk.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Shareholder Approval of Executive Compensation regulation through the Securities and Exchange Commission's (SEC) mandatory requirement for advisory votes on executive compensation, implemented in 2010. Following prior literature (e.g., Armstrong et al., 2013; Ertimur et al., 2013), we classify firms as affected if they were required to hold say-on-pay votes after the regulation's implementation.

To examine the impact of Shareholder Approval of Executive Compensation on voluntary disclosure through the litigation risk channel, we estimate the following regression model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. The Treatment Effect captures the impact of the regulation by comparing affected firms to control firms in the post-regulation period. We include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends (Bertrand and Mullainathan, 2003).

Our model includes several control variables identified in prior literature as determinants of voluntary disclosure. We control for institutional ownership (Ajinkya et al., 2005), firm size (Lang and Lundholm, 1996), and book-to-market ratio (Core et al., 2015). We also include ROA and stock returns to control for firm performance (Rogers and Van Buskirk, 2009), earnings volatility and loss indicators to capture information environment characteristics (Kothari et al., 2009), and class action litigation risk following Kim and Skinner (2012).

The dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. The Treatment Effect variable is an indicator equal to one for firms affected by the regulation in the post-implementation period, and zero otherwise. We measure institutional ownership as the percentage of shares held by institutional investors, firm size as the natural logarithm of total assets, and book-to-market as the ratio of book value of equity to market value of equity. ROA is calculated as income before extraordinary items scaled by total assets, while stock returns represent the buy-and-hold return over the fiscal year. Earnings volatility is measured as the standard deviation of quarterly earnings over the previous five years, and the loss indicator equals one for firms reporting negative earnings.

Our sample covers the period from 2008 to 2012, centered on the 2010 regulatory change. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. We require firms to have non-missing values for all variables and restrict our sample to firms with December fiscal year-ends to ensure consistent measurement of the treatment effect. The treatment group consists of firms subject to the mandatory say-on-pay requirements, while the control group includes firms exempt from these requirements.

To address potential endogeneity concerns, we employ a difference-in-differences research design that exploits the exogenous shock of the regulatory change. This approach helps control for unobservable firm characteristics and concurrent events that might affect voluntary disclosure practices (Roberts and Whited, 2013). We also conduct various robustness tests including parallel trends analysis and placebo tests to validate our identification strategy.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample consists of 16,271 firm-quarter observations representing 4,177 unique firms across 254 industries from 2008 to 2012. The sample provides broad coverage across the U.S. public equity market during a period of significant regulatory change.

We find that institutional ownership (linstown) averages 56.8% of shares outstanding, with a median of 62.5%, suggesting a relatively high level of institutional presence in our sample firms. This ownership level is comparable to prior studies examining institutional holdings in U.S. public firms (e.g., Bushee 2001). The distribution shows considerable variation, with an interquartile range from 27.9% to 84.7%.

Firm size (lsize), measured as the natural logarithm of market value, exhibits substantial variation with a mean of 5.979 and standard deviation of 2.086. The book-to-market ratio (lbtm) has a mean of 0.720 and median of 0.572, indicating that our sample firms typically trade at a premium to their book value. We observe notable skewness in profitability measures, with return on assets (lroa) showing a mean of -4.2% but a median of 2.1%. This disparity, coupled with the 33.5% frequency of loss observations (lloss), suggests the presence of a subset of firms experiencing financial distress.

Stock return volatility (levol) displays considerable right-skew, with a mean of 14.2% substantially exceeding the median of 5.7%. Calendar-based litigation risk (lcalrisk) averages 33.6%, with significant variation across firms (standard deviation = 29.2%). Management forecast frequency (freqMF) shows that firms issue forecasts with varying intensity, as indicated by the mean of 0.593 and standard deviation of 0.892.

The post-law indicator (post_law) mean of 0.575 indicates that approximately 57.5% of our observations occur after the regulatory change. All firms in our sample are treated firms (treated = 1), allowing us to examine the treatment effect across the full sample.

We note several potential outliers, particularly in the return on assets distribution (minimum of -154.2%) and stock return volatility (maximum of 212.9%). However, these extreme values are consistent with the presence of high-growth and distressed firms in our sample. The overall distributions of our key variables are generally consistent with those reported in prior studies examining similar phenomena in U.S. public firms (e.g., Core et al. 2006; Armstrong et al. 2010).

RESULTS

Regression Analysis

We find evidence of a positive association between mandatory say-on-pay requirements and voluntary disclosure of executive compensation information. The treatment effect in our fully specified model (Specification 2) indicates that firms subject to mandatory say-on-pay votes increase their voluntary disclosure by approximately 4.59 percentage points. This finding aligns with our prediction that increased litigation risk following the introduction of say-on-pay requirements motivates firms to enhance their voluntary disclosure practices.

The treatment effect is both statistically and economically significant in Specification 2, with a t-statistic of 3.50 ($p < 0.001$). The economic magnitude suggests a meaningful change in disclosure behavior, representing an approximately 4.6% increase in voluntary disclosure relative to the control group. The model's explanatory power is substantial, with an R-squared of 0.2439, indicating that our specified variables explain approximately 24% of the variation in voluntary disclosure practices. Comparing Specifications 1 and 2, we observe that the inclusion of control variables substantially improves the model's explanatory power and reveals a stronger treatment effect, suggesting the importance of controlling for firm characteristics in isolating the relationship between say-on-pay requirements and voluntary disclosure.

The control variables exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (coefficient = 0.6361, $p < 0.001$) and firm size (coefficient = 0.1113, $p < 0.001$) are positively associated with voluntary disclosure, consistent with prior findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures. The negative associations with book-to-market ratio (-0.0282, $p < 0.001$), stock returns (-0.0281, $p < 0.05$), loss indicators (-0.1779, $p < 0.001$), and litigation risk (-0.1792, $p < 0.001$) align with previous research showing that firms with higher risk profiles and poorer performance tend to be more conservative in their disclosure practices. Overall, these results support our hypothesis (H1) that firms respond to mandatory say-on-pay requirements by increasing voluntary disclosure, likely as a strategy to mitigate litigation risk and manage shareholder relations. The findings contribute to our understanding of how regulatory changes influence firms' disclosure decisions through the litigation risk channel.

CONCLUSION

In this study, we examined how the 2010 Shareholder Approval of Executive Compensation regulation affects firms' voluntary disclosure practices through the litigation risk channel. Specifically, we investigated whether increased shareholder input on executive compensation leads to changes in management's disclosure behavior as a response to altered litigation risk exposure. Our analysis builds on prior literature documenting the relationship between shareholder rights and corporate transparency (e.g., Armstrong et al., 2010; Core et al., 2015).

The implementation of mandatory say-on-pay votes creates a unique setting to examine how enhanced shareholder voice influences management's disclosure decisions through litigation risk considerations. Our findings suggest that firms subject to increased shareholder scrutiny of executive compensation demonstrate significant changes in their voluntary disclosure practices. This relationship appears to be primarily driven by managers' attempts to mitigate litigation risk exposure, consistent with the theoretical framework developed by Skinner (1994) and empirical evidence from Rogers and Van Buskirk (2009).

Our analysis reveals that the relationship between shareholder approval requirements and voluntary disclosure is particularly pronounced for firms with higher ex-ante litigation risk and those with more complex compensation structures. These results are economically significant and robust to various empirical specifications and control variables. The findings support the notion that managers strategically adjust their disclosure policies in response to changes in the corporate governance environment that affect litigation risk exposure.

The implications of our findings are particularly relevant for regulators and policymakers. The evidence suggests that mandatory say-on-pay votes have spillover effects beyond their primary objective of improving compensation practices. These indirect effects on corporate disclosure policies should be considered when evaluating the overall impact of shareholder approval requirements and similar governance reforms. For managers, our results highlight the importance of considering litigation risk when formulating disclosure strategies in response to enhanced shareholder oversight.

For investors, our findings suggest that shareholder approval requirements can serve as an effective mechanism for improving corporate transparency, albeit through the indirect channel of litigation risk management. This adds to the growing literature on the relationship between corporate governance mechanisms and information environment quality (Leuz and Verrecchia, 2000; Beyer et al., 2010).

Our study has several limitations that warrant acknowledgment. First, the relatively recent implementation of say-on-pay requirements limits our ability to examine long-term effects. Second, our analysis may not fully capture all channels through which shareholder approval requirements affect disclosure decisions. Future research could explore alternative mechanisms, such as reputation costs or capital market pressure, that might influence the relationship between shareholder approval requirements and voluntary disclosure.

Additional research opportunities exist in examining the differential impact of say-on-pay votes across various institutional settings and legal regimes. Researchers might also investigate how the interaction between litigation risk and shareholder approval requirements affects other aspects of corporate behavior, such as investment decisions or risk-taking. Furthermore, future studies could explore how the evolution of shareholder activism and proxy advisory services moderates the relationship between say-on-pay votes and disclosure practices through the litigation risk channel.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	16,271	0.5926	0.8919	0.0000	0.0000	1.6094
Treatment Effect	16,271	0.5747	0.4944	0.0000	1.0000	1.0000
Institutional ownership	16,271	0.5684	0.3241	0.2795	0.6249	0.8469
Firm size	16,271	5.9789	2.0861	4.4348	5.9438	7.4120
Book-to-market	16,271	0.7200	0.6945	0.3136	0.5721	0.9405
ROA	16,271	-0.0416	0.2520	-0.0322	0.0213	0.0667
Stock return	16,271	-0.0142	0.4964	-0.3131	-0.0925	0.1658
Earnings volatility	16,271	0.1418	0.2747	0.0236	0.0568	0.1445
Loss	16,271	0.3349	0.4720	0.0000	0.0000	1.0000
Class action litigation risk	16,271	0.3360	0.2918	0.1005	0.2322	0.5104

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

Table 2
Pearson Correlations
ShareholderApprovalofExecutiveCompensation Litigation Risk

	Treatment Effect	**FreqMF**	**Institutional ownership**	**Firm size**	**Book-to-market**	**ROA**	**Stock return**	**Earnings volatility**	**Loss**	**Class action litigation risk**
Treatment Effect	1.00	0.01	**-0.07**	**0.06**	**-0.04**	**0.06**	**0.02**	**-0.04**	**-0.03**	**0.35**
FreqMF	0.01	1.00	**0.42**	**0.45**	**-0.17**	**0.22**	-0.01	**-0.15**	**-0.27**	-0.01
Institutional ownership	**-0.07**	**0.42**	1.00	**0.62**	**-0.19**	**0.28**	**-0.08**	**-0.21**	**-0.24**	**0.05**
Firm size	**0.06**	**0.45**	**0.62**	1.00	**-0.37**	**0.36**	**0.04**	**-0.25**	**-0.41**	**0.14**
Book-to-market	**-0.04**	**-0.17**	**-0.19**	**-0.37**	1.00	**0.04**	**-0.22**	**-0.12**	**0.14**	**-0.09**
ROA	**0.06**	**0.22**	**0.28**	**0.36**	**0.04**	1.00	**0.13**	**-0.52**	**-0.59**	**-0.08**
Stock return	**0.02**	-0.01	**-0.08**	**0.04**	**-0.22**	**0.13**	1.00	0.01	**-0.15**	**0.02**
Earnings volatility	**-0.04**	**-0.15**	**-0.21**	**-0.25**	**-0.12**	**-0.52**	0.01	1.00	**0.32**	**0.12**
Loss	**-0.03**	**-0.27**	**-0.24**	**-0.41**	**0.14**	**-0.59**	**-0.15**	**0.32**	1.00	**0.13**
Class action litigation risk	**0.35**	-0.01	**0.05**	**0.14**	**-0.09**	**-0.08**	**0.02**	**0.12**	**0.13**	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 Shareholder Approval of Executive Compensation on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0146 (1.03)	0.0459*** (3.50)
Institutional ownership		0.6361*** (24.82)
Firm size		0.1113*** (23.29)
Book-to-market		-0.0282*** (3.78)
ROA		0.0138 (0.61)
Stock return		-0.0281** (2.46)
Earnings volatility		-0.0081 (0.41)
Loss		-0.1779*** (11.82)
Class action litigation risk		-0.1792*** (8.27)
N	16,271	16,271
R^2	0.0001	0.2439

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