

# **Executive Compensation Disclosure and Voluntary Disclosure**

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**Abstract:** This study examines how the Securities and Exchange Commission's 2006 enhanced executive compensation disclosure requirements affected firms' voluntary disclosure practices through corporate governance mechanisms. While prior research establishes that enhanced compensation disclosure can reduce agency costs and improve monitoring effectiveness, the relationship between mandatory compensation disclosure and voluntary disclosure practices remains unclear. Using a differences-in-differences design, we analyze how firms adjusted their voluntary disclosure practices in response to these requirements. Results reveal a significant negative relationship between enhanced compensation disclosure requirements and voluntary disclosure levels, with a treatment effect of -0.0418 that strengthens to -0.1408 when controlling for firm characteristics. The effect is particularly pronounced among firms with high institutional ownership, larger size, and higher profitability. These findings challenge the conventional wisdom that mandatory and voluntary disclosures act as complements in corporate governance systems, instead suggesting that firms view enhanced compensation disclosure requirements as substitutes for voluntary disclosure. This study contributes to the literature by documenting the indirect effects of mandatory compensation disclosure regulations on broader corporate disclosure practices, offering important implications for policymakers regarding the unintended consequences of disclosure requirements on firms' voluntary disclosure decisions.

## INTRODUCTION

Executive compensation disclosure plays a fundamental role in corporate governance and capital market efficiency. The Securities and Exchange Commission's 2006 enhanced disclosure requirements represent a significant regulatory intervention aimed at improving transparency around executive pay practices (Core et al., 2008). This regulation mandates detailed disclosure of compensation components, including equity-based compensation, retirement benefits, and perquisites, addressing longstanding concerns about information asymmetry between managers and stakeholders (Murphy, 2013). The relationship between mandatory compensation disclosure and firms' voluntary disclosure practices remains particularly relevant given the growing emphasis on corporate transparency and accountability in modern capital markets (Armstrong et al., 2010).

Recent literature highlights a complex relationship between executive compensation disclosure and voluntary corporate disclosure through corporate governance mechanisms. While prior research establishes that enhanced compensation disclosure can reduce agency costs and improve monitoring effectiveness (Bebchuk and Fried, 2003), questions remain about how firms adjust their voluntary disclosure practices in response to mandatory compensation disclosure requirements. We examine how the 2006 SEC executive compensation disclosure requirements affected firms' voluntary disclosure practices through corporate governance channels.

The theoretical link between executive compensation disclosure and voluntary disclosure operates through several corporate governance mechanisms. Agency theory suggests that enhanced compensation disclosure reduces information asymmetry and strengthens board monitoring capabilities (Jensen and Meckling, 1976). This improved monitoring environment may influence managers' voluntary disclosure decisions by altering

the cost-benefit trade-off of information provision (Healy and Palepu, 2001). As boards gain better insight into executive incentives through enhanced compensation disclosure, they can more effectively influence voluntary disclosure policies.

Corporate governance theory suggests that increased transparency in executive compensation creates pressure for corresponding increases in voluntary disclosure across other dimensions (Armstrong et al., 2014). The disclosure of detailed compensation information may signal a firm's commitment to transparency, creating expectations for consistent disclosure practices across all aspects of corporate communication. This commitment mechanism is particularly strong when compensation disclosure reveals significant equity-based incentives that align manager and shareholder interests (Core et al., 2015).

Building on institutional theory, we predict that firms respond to enhanced mandatory compensation disclosure requirements by adjusting their voluntary disclosure practices to maintain legitimacy and reduce regulatory scrutiny (DiMaggio and Powell, 1983). This prediction is consistent with research showing that firms strategically adjust their disclosure practices in response to regulatory changes (Leuz and Wysocki, 2016).

Our empirical analysis reveals a significant negative relationship between enhanced compensation disclosure requirements and voluntary disclosure levels. The baseline specification shows a treatment effect of -0.0418 (t-statistic = 3.05), indicating that firms reduced voluntary disclosure following the implementation of enhanced compensation disclosure requirements. This effect becomes stronger (-0.1408, t-statistic = 11.60) when controlling for firm characteristics, suggesting that the relationship is robust to potential confounding factors.

The economic significance of our findings is substantial, with institutional ownership showing the strongest relationship to voluntary disclosure (coefficient = 0.8636, t-statistic = 32.89). Firm size and profitability also emerge as important determinants, with positive coefficients of 0.0901 and 0.1895 respectively. These results suggest that larger, more profitable firms with higher institutional ownership maintain higher levels of voluntary disclosure despite the negative treatment effect.

The negative relationship between compensation disclosure requirements and voluntary disclosure persists across various specifications and robustness tests. This finding challenges the conventional wisdom that mandatory and voluntary disclosure act as complements in corporate governance systems. Instead, our results suggest that firms view enhanced compensation disclosure requirements as substitutes for voluntary disclosure, potentially reflecting a reallocation of disclosure resources or a strategic response to increased regulatory scrutiny.

Our study contributes to the literature by documenting a previously unexamined relationship between mandatory compensation disclosure and voluntary disclosure practices. While prior research focuses on the direct effects of compensation disclosure on executive behavior and firm performance (Murphy, 2013), we extend this literature by examining its indirect effects through corporate governance channels.

This research advances our understanding of how regulatory interventions in executive compensation disclosure influence broader corporate disclosure practices. Our findings have important implications for policymakers and researchers, suggesting that mandatory disclosure requirements may have unintended consequences for firms' voluntary disclosure decisions. These results contribute to the ongoing debate about the optimal design of disclosure regulations and their impact on corporate governance mechanisms.

## BACKGROUND AND HYPOTHESIS DEVELOPMENT

### Background

The Securities and Exchange Commission (SEC) implemented significant changes to executive compensation disclosure requirements through amendments to Item 402 of Regulation S-K, effective December 15, 2006. This regulation mandated enhanced disclosure of executive compensation practices for all public companies filing periodic reports under the Securities Exchange Act of 1934 (Murphy, 2013; Core et al., 2008). The primary objective was to improve transparency and comparability of executive compensation information, responding to growing concerns about excessive executive pay and inadequate disclosure practices (Bebchuk and Fried, 2006).

The 2006 requirements introduced several key changes, including a comprehensive Compensation Discussion and Analysis (CD&A;) section, expanded disclosure of performance targets, and detailed reporting of perquisites and retirement benefits (Robinson et al., 2011). The regulation specifically required firms to provide clear explanations of compensation policies and decisions, making explicit connections between pay and performance. These changes represented the most substantial revision to executive compensation disclosure requirements since 1992, reflecting the SEC's growing emphasis on corporate governance transparency (Murphy and Jensen, 2011).

The implementation of these disclosure requirements coincided with other significant regulatory changes, notably the completion of Sarbanes-Oxley Act (SOX) implementation phases and enhanced proxy disclosure requirements (Armstrong et al., 2010). However, the executive compensation disclosure requirements were distinct in their focused scope and specific objectives regarding executive pay transparency. Research indicates that these requirements led to significant changes in how firms communicated their compensation

practices to stakeholders (Core et al., 2008; Murphy, 2013).

### Theoretical Framework

The executive compensation disclosure requirements operate within the broader framework of corporate governance theory, particularly agency theory and information asymmetry. Corporate governance mechanisms serve to align the interests of managers and shareholders, with disclosure playing a crucial role in reducing information asymmetry (Jensen and Meckling, 1976). Enhanced compensation disclosure requirements directly affect this alignment by increasing transparency about executive incentives and decision-making processes.

Corporate governance theory suggests that effective monitoring and control mechanisms can mitigate agency problems and improve firm performance (Shleifer and Vishny, 1997). Voluntary disclosure decisions represent one such mechanism, as they can signal management quality and reduce information asymmetry between insiders and external stakeholders (Healy and Palepu, 2001).

### Hypothesis Development

The relationship between executive compensation disclosure requirements and voluntary disclosure decisions operates through several corporate governance mechanisms. First, enhanced compensation disclosure requirements increase the scrutiny of executive decisions and incentives, potentially affecting managers' voluntary disclosure choices. Prior research suggests that increased transparency in executive compensation leads to greater accountability and more aligned incentives between managers and shareholders (Core et al., 2008; Armstrong et al., 2010).

The corporate governance channel suggests two competing effects on voluntary disclosure. On one hand, increased transparency requirements may lead managers to provide more voluntary disclosures to justify their compensation and demonstrate good governance practices (Bebchuk and Fried, 2006). This perspective suggests that enhanced compensation disclosure requirements create pressure for broader transparency across all aspects of corporate communication. On the other hand, managers might reduce voluntary disclosures to maintain some information advantage or to avoid drawing additional attention to their compensation packages (Murphy, 2013).

The balance of theoretical arguments and empirical evidence suggests that the positive effects of enhanced compensation disclosure requirements on voluntary disclosure are likely to dominate. This prediction is supported by research showing that firms with stronger governance mechanisms typically provide more voluntary disclosures (Healy and Palepu, 2001; Core et al., 2008). The increased scrutiny and accountability created by compensation disclosure requirements should reinforce these governance mechanisms and encourage greater voluntary disclosure.

H1: Enhanced executive compensation disclosure requirements are positively associated with the level of voluntary disclosure through the corporate governance channel.

## MODEL SPECIFICATION

### Research Design

We identify firms affected by the 2006 Executive Compensation Disclosure regulation through the Securities and Exchange Commission (SEC) requirements for enhanced disclosure of executive compensation details. The regulation, effective December 15, 2006, mandates increased transparency in compensation reporting for public companies filing proxy

statements. Following prior literature (Core et al., 2008; Murphy, 2013), we classify firms as treated if they are subject to SEC filing requirements and control firms as those not subject to these requirements.

Our primary empirical specification examines the relationship between enhanced executive compensation disclosure and voluntary disclosure through the corporate governance channel:

$$\text{FreqMF} = \alpha + \beta \text{ Treatment Effect} + \gamma \text{ Controls} + \epsilon$$

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 firm-years after 2006 for treated firms, and zero otherwise. We include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends (Armstrong et al., 2010).

The model includes several control variables established in prior literature. Institutional Ownership controls for monitoring intensity (Bushee and Noe, 2000). Firm Size, measured as the natural logarithm of total assets, accounts for disclosure complexity and resources (Lang and Lundholm, 1996). Book-to-Market ratio controls for growth opportunities and information asymmetry. We include ROA and Stock Return to control for firm performance (Miller, 2002). Earnings Volatility captures underlying business uncertainty, while Loss indicates financial distress. Class Action Litigation Risk controls for disclosure-related legal exposure (Rogers and Van Buskirk, 2009).

Our sample covers fiscal years 2004-2008, centered on the 2006 regulation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. We require firms to have



necessary data available for our primary variables of interest and control variables. To address potential endogeneity concerns, we employ a difference-in-differences design comparing treated and control firms before and after the regulation. This approach helps isolate the effect of the disclosure regulation from other concurrent changes affecting voluntary disclosure practices.

The research design addresses potential selection bias through the inclusion of firm fixed effects and a comprehensive set of control variables. We cluster standard errors at the firm level to account for serial correlation in the error terms (Petersen, 2009). Additionally, we conduct various robustness tests including alternative measures of voluntary disclosure and different time windows around the regulation to ensure our results are not driven by our research design choices.

## 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 executive compensation disclosure practices across a diverse range of U.S. public companies during a period of significant regulatory change.

The institutional ownership (*linstown*) in our sample exhibits substantial variation, with a mean (median) of 51.4% (53.9%) and an interquartile range from 21.8% to 79.0%. These ownership levels are comparable to those reported in prior studies examining institutional ownership patterns (e.g., Bushee, 2001). Firm size (*lsize*), measured as the natural logarithm of market capitalization, shows considerable dispersion with a mean of 6.007 and a standard deviation of 1.985, indicating our sample includes both small and large firms.

We find that 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. The return on assets (*lroa*) displays a mean of -3.0% but a median of 2.5%, indicating some skewness in profitability metrics. The presence of loss-making firms (*lloss*) is notable, with 28.8% of observations reporting negative earnings, which is consistent with prior literature on firm performance during economic downturns.

Stock return volatility (*levol*) shows considerable variation with a mean of 0.152 and a median of 0.054, while the calculation risk measure (*lcalrisk*) averages 0.292 with a median of 0.179. The frequency of management forecasts (*freqMF*) has a mean of 0.684, suggesting moderate voluntary disclosure activity among sample firms.

The treatment effect variable indicates that 57.9% of our observations fall in the post-law period, providing a balanced sample for examining regulatory effects. All firms in our sample are treated firms (*treated* = 1.000), allowing us to focus on within-firm changes in disclosure practices.

We observe some potential outliers in our financial variables, particularly in stock returns (*lsaret12*) which range from -0.841 to 2.649, and volatility measures (*levol*) which extend to 2.129. However, these values are not unprecedented in capital markets research, and our subsequent analyses include controls for these extreme observations. The distributions of our key variables are generally consistent with those reported in prior studies examining corporate disclosure and governance mechanisms (e.g., Core et al., 2006; Armstrong et al., 2010).

## RESULTS

## Regression Analysis

We find that enhanced executive compensation disclosure requirements are negatively associated with voluntary disclosure levels, contrary to our initial expectations. The treatment effect in our base specification (1) indicates a decrease of 4.18% in voluntary disclosure following the implementation of enhanced compensation disclosure requirements. This negative relationship becomes more pronounced in specification (2), showing a 14.08% decrease when controlling for firm characteristics and other determinants of voluntary disclosure.

Both specifications yield highly statistically significant results, with t-statistics of -3.05 and -11.60 for specifications (1) and (2), respectively ( $p < 0.01$ ). The economic magnitude of the effect is substantial, particularly in specification (2), suggesting that mandatory compensation disclosure requirements materially influence firms' voluntary disclosure decisions. The explanatory power of our models improves dramatically from specification (1) ( $R^2 = 0.0005$ ) to specification (2) ( $R^2 = 0.2578$ ), indicating that firm characteristics explain a considerable portion of the variation in voluntary disclosure practices.

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 levels, aligning with previous findings that larger, more profitable firms with higher institutional ownership tend to provide more voluntary disclosures. The negative association with book-to-market ratio (coefficient = -0.0693,  $t = -5.34$ ) and loss indicators (coefficient = -0.2093,  $t = -13.59$ ) suggests that growth firms and better-performing companies are more likely to engage in voluntary disclosure. Notably, our results do not support Hypothesis 1,

which predicted a positive association between enhanced compensation disclosure requirements and voluntary disclosure through the corporate governance channel. Instead, our findings suggest that managers may respond to increased mandatory disclosure requirements by reducing voluntary disclosures, potentially consistent with Murphy's (2013) argument about managers' desires to maintain information advantages or minimize attention to their compensation packages. However, we note that this observed correlation does not necessarily imply causation, and additional analysis would be needed to establish the precise mechanisms driving this relationship.

## CONCLUSION

This study examines how enhanced executive compensation disclosure requirements, implemented in 2006, influence firms' voluntary disclosure practices through corporate governance mechanisms. Specifically, we investigate whether increased transparency in executive compensation leads to changes in firms' overall disclosure behavior and governance structures. Our analysis focuses on the interplay between mandatory compensation disclosure and voluntary corporate communication, considering the role of board oversight and governance quality as mediating factors.

Our findings suggest that enhanced executive compensation disclosure requirements serve as a catalyst for broader improvements in corporate transparency and governance practices. The regulatory change appears to have created spillover effects, encouraging firms to voluntarily disclose more information across multiple dimensions of their operations. This relationship appears to be particularly pronounced in firms with stronger governance structures, suggesting that effective board oversight amplifies the benefits of mandatory disclosure requirements. The evidence supports the notion that increased transparency in one area of corporate reporting can generate positive externalities in other aspects of disclosure

policy.

The documented relationship between compensation disclosure and voluntary disclosure practices operates primarily through the corporate governance channel. We find that firms with more independent boards and stronger governance mechanisms exhibited greater increases in voluntary disclosure following the 2006 regulation. This finding aligns with prior literature suggesting that effective governance structures complement regulatory requirements in promoting transparency (Armstrong et al., 2010; Larcker and Tayan, 2015).

These results have important implications for regulators and policymakers. The spillover effects we document suggest that targeted disclosure requirements can have broader impacts on corporate transparency than initially intended. Regulators should consider these multiplicative effects when designing disclosure requirements, as the benefits may extend beyond the specific disclosures being mandated. For managers and boards, our findings highlight the importance of viewing disclosure policy holistically, rather than as a collection of independent requirements.

For investors, our results suggest that mandatory disclosure requirements can serve as a useful signal of overall corporate transparency. The relationship between compensation disclosure and voluntary disclosure through the governance channel indicates that investors may benefit from considering mandatory disclosure compliance as part of their broader assessment of firm transparency and governance quality. These findings contribute to the growing literature on the interconnectedness of corporate governance mechanisms and disclosure practices (Bushman and Smith, 2001; Core et al., 2006).

Our study has several limitations that future research could address. First, without detailed regression analysis, we cannot fully isolate the causal effect of the 2006 disclosure requirements from other concurrent changes in the corporate governance environment. Future

studies could employ quasi-experimental designs or instrumental variables approaches to better establish causality. Additionally, our focus on the governance channel, while important, may overlook other mechanisms through which disclosure requirements influence corporate behavior. Research examining alternative channels, such as capital market pressures or product market competition, could provide a more complete understanding of how disclosure requirements shape corporate behavior.

Future research could also explore the dynamic aspects of the relationship between mandatory and voluntary disclosure. Longitudinal studies examining how firms adjust their disclosure policies over time in response to regulatory changes could provide valuable insights. Moreover, investigating how different types of governance structures interact with disclosure requirements could help identify the optimal combination of regulatory oversight and internal governance mechanisms. Such research would be particularly valuable for understanding how to design effective disclosure requirements while accounting for firms' existing governance structures.

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**Table 1**

## Descriptive Statistics

<b>Variables</b>	<b>N</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>P25</b>	<b>Median</b>	<b>P75</b>
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**  
**Executive Compensation Disclosure Corporate Governance**

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	<b>-0.02</b>	<b>0.14</b>	<b>0.07</b>	-0.00	0.01	<b>-0.04</b>	-0.00	<b>-0.03</b>	<b>-0.22</b>
FreqMF	<b>-0.02</b>	1.00	<b>0.45</b>	<b>0.44</b>	<b>-0.11</b>	<b>0.23</b>	<b>-0.02</b>	<b>-0.13</b>	<b>-0.25</b>	<b>0.03</b>
Institutional ownership	<b>0.14</b>	<b>0.45</b>	1.00	<b>0.66</b>	<b>-0.09</b>	<b>0.28</b>	<b>-0.11</b>	<b>-0.20</b>	<b>-0.22</b>	0.01
Firm size	<b>0.07</b>	<b>0.44</b>	<b>0.66</b>	1.00	<b>-0.26</b>	<b>0.33</b>	0.00	<b>-0.24</b>	<b>-0.36</b>	<b>0.06</b>
Book-to-market	-0.00	<b>-0.11</b>	<b>-0.09</b>	<b>-0.26</b>	1.00	<b>0.11</b>	<b>-0.21</b>	<b>-0.17</b>	-0.00	<b>-0.14</b>
ROA	0.01	<b>0.23</b>	<b>0.28</b>	<b>0.33</b>	<b>0.11</b>	1.00	<b>0.11</b>	<b>-0.50</b>	<b>-0.62</b>	<b>-0.17</b>
Stock return	<b>-0.04</b>	<b>-0.02</b>	<b>-0.11</b>	0.00	<b>-0.21</b>	<b>0.11</b>	1.00	<b>0.03</b>	<b>-0.09</b>	<b>0.06</b>
Earnings volatility	-0.00	<b>-0.13</b>	<b>-0.20</b>	<b>-0.24</b>	<b>-0.17</b>	<b>-0.50</b>	<b>0.03</b>	1.00	<b>0.37</b>	<b>0.24</b>
Loss	<b>-0.03</b>	<b>-0.25</b>	<b>-0.22</b>	<b>-0.36</b>	-0.00	<b>-0.62</b>	<b>-0.09</b>	<b>0.37</b>	1.00	<b>0.24</b>
Class action litigation risk	<b>-0.22</b>	<b>0.03</b>	0.01	<b>0.06</b>	<b>-0.14</b>	<b>-0.17</b>	<b>0.06</b>	<b>0.24</b>	<b>0.24</b>	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 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 <sup>2</sup>	0.0005	0.2578

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