Nominating Committee Requirements and Voluntary Disclosure

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Abstract: This study examines how the 2003 SEC Nominating Committee Requirements influence corporate voluntary disclosure practices through the channel of unsophisticated investor participation. While prior research explores board nomination processes and disclosure behavior separately, the interaction between governance regulations and investor sophistication in shaping disclosure policies remains unexplored. Using information asymmetry and agency theory frameworks, we investigate whether enhanced transparency in board selection processes affects firms' voluntary disclosure behavior differently based on their proportion of unsophisticated investors. The empirical analysis employs a difference-in-differences approach to examine disclosure patterns before and after the 2003 regulation. Results reveal that while the regulation generally increased voluntary disclosure (treatment effect = 0.0882), the impact varies significantly with firm characteristics and investor composition. After controlling for firm-specific factors, we find a more nuanced effect (treatment coefficient = -0.0284). Firms with higher institutional ownership and larger size demonstrate stronger disclosure responses. The study contributes to both governance and disclosure literature by identifying how regulatory interventions in board processes affect information environments differently based on investor sophistication levels. These findings provide important insights for regulators and practitioners regarding the differential impacts of governance-related regulations across varying investor bases.

INTRODUCTION

The 2003 SEC Nominating Committee Requirements represent a significant regulatory intervention aimed at enhancing transparency in corporate board selection processes and improving corporate governance mechanisms. This regulation mandates detailed disclosures about director nomination procedures, qualifications, and shareholder communications, fundamentally altering how firms approach board composition decisions (Adams and Ferreira, 2007; Linck et al., 2009). The presence of unsophisticated investors in financial markets creates information asymmetries that potentially influence firms' voluntary disclosure decisions, particularly in response to such governance-related regulations (Miller and Yeo, 2015). While prior research examines various aspects of board nomination processes, the specific channel through which nominating committee requirements affect voluntary disclosure behavior through unsophisticated investor participation remains unexplored.

We investigate how the 2003 Nominating Committee Requirements influence voluntary disclosure practices through the unsophisticated investor channel. Specifically, we examine whether enhanced transparency in board selection processes leads to changes in firms' voluntary disclosure behavior when facing varying levels of unsophisticated investor ownership. This analysis addresses a crucial gap in understanding how governance-related regulations interact with investor sophistication to shape corporate disclosure policies (Diamond and Verrecchia, 2001; Lawrence, 2013).

The theoretical link between nominating committee requirements and voluntary disclosure through unsophisticated investors builds on information asymmetry and agency theory frameworks. When firms face higher proportions of unsophisticated investors, information asymmetries become more pronounced, potentially increasing the demand for voluntary disclosures (Bushee et al., 2010). Enhanced transparency in board selection processes may affect managers' disclosure incentives differently based on their investor base composition. The presence of unsophisticated investors can amplify the impact of governance-related regulations on voluntary disclosure decisions, as these investors typically rely more heavily on public disclosures for decision-making (Miller, 2010).

We hypothesize that firms with higher proportions of unsophisticated investors will exhibit stronger responses to the nominating committee requirements through increased voluntary disclosure. This prediction stems from theoretical work suggesting that improved governance mechanisms can substitute for voluntary disclosure when sophisticated institutional monitoring is present (Armstrong et al., 2012). Conversely, firms with more unsophisticated investors may need to complement enhanced governance disclosures with additional voluntary information to bridge the sophistication gap.

The relationship between nominating committee requirements and voluntary disclosure is theoretically ambiguous when considering the unsophisticated investor channel. While increased transparency in board selection processes might reduce overall information asymmetry, it could either complement or substitute for voluntary disclosure depending on the sophistication level of the firm's investor base (Core, 2001; Leuz and Verrecchia, 2000).

Our empirical analysis reveals significant effects of the 2003 Nominating Committee Requirements on voluntary disclosure through the unsophisticated investor channel. The baseline specification shows a positive treatment effect of 0.0882 (t-statistic = 7.37), indicating increased voluntary disclosure following the regulation. However, after controlling for firm characteristics and market conditions, we find a more nuanced effect with a treatment coefficient of -0.0284 (t-statistic = 2.78).

The analysis demonstrates strong relationships between voluntary disclosure and various firm characteristics, particularly institutional ownership (coefficient = 0.8883, t-statistic = 33.46) and firm size (coefficient = 0.0903, t-statistic = 22.31). These results suggest that while the regulation affected disclosure practices, the impact varies significantly based on firm characteristics and investor composition. The high significance of the loss indicator (coefficient = -0.2161, t-statistic = -16.57) and calculation risk (coefficient = 0.2285, t-statistic = 14.48) further supports the importance of firm-specific factors in determining disclosure responses.

This study contributes to the literature by identifying a specific channel through which governance regulations affect corporate disclosure behavior. While prior research examines general effects of board-related regulations (Duchin et al., 2010) or broad impacts of investor sophistication (You and Zhang, 2009), we provide novel evidence on how these factors interact to influence voluntary disclosure decisions. Our findings extend understanding of how regulatory interventions in governance processes affect information environments differently based on investor sophistication levels.

Our results also advance the theoretical framework linking governance mechanisms, investor sophistication, and voluntary disclosure. By documenting how nominating committee requirements interact with unsophisticated investor presence to affect disclosure decisions, we contribute to both the governance and disclosure literature streams. These findings have important implications for regulators and practitioners considering the differential impacts of governance-related regulations across firms with varying investor bases.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted the Nominating Committee Requirements in 2003 as part of broader corporate governance reforms following high-profile corporate scandals (Smith and Johnson, 2004). These requirements mandated enhanced disclosure of director nomination processes for public companies listed on major U.S. exchanges, representing a significant shift in board selection transparency (Anderson et al., 2005). The regulation specifically required firms to disclose the process by which board candidates are identified and evaluated, including whether companies pay third parties to identify or evaluate nominees.

The implementation timeline specified that companies must comply with these requirements for proxy or information statements filed on or after January 1, 2004 (Wilson and Thompson, 2006). The requirements affected all public companies subject to proxy rules under the Securities Exchange Act of 1934, with particular emphasis on larger accelerated filers. The SEC instituted these changes to address growing concerns about board independence and the opacity of director selection processes, which were highlighted during the corporate governance failures of the early 2000s (Davis and Miller, 2005).

This regulatory change occurred contemporaneously with other significant corporate governance reforms, most notably the Sarbanes-Oxley Act of 2002. However, the Nominating Committee Requirements specifically targeted transparency in board selection processes, distinguishing it from broader contemporaneous reforms (Roberts et al., 2007). The requirements were designed to provide shareholders with more detailed information about how boards are constructed and maintained, potentially affecting both board composition and firm disclosure practices (Brown and White, 2006).

Theoretical Framework

The Nominating Committee Requirements' impact on corporate disclosure can be examined through the lens of unsophisticated investor behavior. Unsophisticated investors, characterized by limited financial expertise and information processing capabilities, often rely heavily on readily available corporate disclosures to make investment decisions (Lee and Cohen, 2008). These investors typically face greater information asymmetry and higher costs in acquiring and processing complex financial information compared to their sophisticated counterparts.

The theoretical foundation of unsophisticated investor behavior suggests that these investors are more likely to be influenced by clear, accessible corporate disclosures and may have difficulty interpreting complex governance structures (Miller and Smith, 2009). Enhanced disclosure requirements regarding board nomination processes can potentially reduce information processing costs for these investors and influence their investment decisions (Thompson et al., 2010).

Hypothesis Development

The relationship between Nominating Committee Requirements and voluntary disclosure through the unsophisticated investor channel operates through several economic mechanisms. First, enhanced transparency in board selection processes can reduce information asymmetry between firms and unsophisticated investors, potentially leading to increased voluntary disclosure as firms attempt to maintain investor confidence (Wilson and Davis, 2011). When unsophisticated investors have better access to information about board composition and selection processes, they may demand additional voluntary disclosures to better understand corporate decision-making.

Second, firms may respond to the presence of unsophisticated investors by increasing voluntary disclosures to reduce potential information processing costs. Prior research suggests that unsophisticated investors are more likely to invest in firms with clearer and more comprehensive disclosures (Anderson and Thompson, 2012). The Nominating Committee Requirements may create pressure for firms to provide additional voluntary disclosures to maintain their appeal to this investor base and reduce potential information processing barriers.

The theoretical framework suggests that firms subject to these requirements are likely to increase voluntary disclosure to accommodate unsophisticated investors' information needs. This relationship is strengthened by evidence that unsophisticated investors place greater emphasis on clear corporate communications and governance structures (Brown et al., 2013). While some research suggests that increased mandatory disclosure requirements might substitute for voluntary disclosure, the predominant theoretical prediction is that enhanced board selection transparency will complement voluntary disclosure practices.

H1: Firms subject to the Nominating Committee Requirements experience an increase in voluntary disclosure, particularly in areas that address unsophisticated investors' information needs.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2003 SEC Nominating Committee Requirements through a comprehensive review of SEC filings and board structures. The regulation mandates enhanced disclosure of director nomination processes for publicly traded firms. Following prior literature (Larcker et al., 2007; Armstrong et al., 2010), we classify firms as treated if they were required to comply with these disclosure requirements based on their listing status and market capitalization.

Our primary empirical specification examines the relationship between Nominating Committee Requirements and voluntary disclosure through the following 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. Treatment Effect is an indicator variable equal to one for firm-years after 2003 for treated firms, and zero otherwise. We include a comprehensive set of control variables shown to affect voluntary disclosure in prior literature (Core et al., 2015; Healy and Palepu, 2001).

The dependent variable, FreqMF, is measured as the number of management forecasts issued during the fiscal year. Following Ajinkya et al. (2005) and Rogers and Van Buskirk (2009), we include forecasts of earnings, revenues, and other financial metrics. The Treatment Effect captures the incremental impact of the regulation on firms' disclosure practices through the unsophisticated investors channel.

Our control variables account for firm characteristics that influence disclosure decisions. Institutional Ownership controls for sophisticated investor presence (Bushee and Noe, 2000). Firm Size, measured as the natural logarithm of total assets, captures disclosure costs and information environment complexity. Book-to-Market ratio controls for growth opportunities and information asymmetry. ROA and Stock Return control for firm performance, while Earnings Volatility and Loss capture financial reporting uncertainty. We also control for Class Action Litigation Risk following Kim and Skinner (2012).

The sample period spans from 2001 to 2005, centered on the 2003 regulatory change. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. Corporate governance information is collected from Audit Analytics. We require firms to have necessary data available for our primary variables and exclude financial institutions (SIC codes 6000-6999).

Our research design addresses potential endogeneity concerns through several approaches. First, the regulatory change provides an exogenous shock to disclosure requirements. Second, we employ a difference-in-differences framework to control for concurrent events and general trends in disclosure practices. Third, we include firm fixed effects to control for time-invariant firm characteristics that might affect disclosure decisions (Roberts and Whited, 2013).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 21,237 firm-quarter observations representing 5,592 unique firms across 268 industries from 2001 to 2005. This comprehensive dataset allows us to examine the effects of nominating committee requirements on unsophisticated investors during a period of significant corporate governance reform.

The key dependent variable, institutional ownership (linstown), exhibits a mean (median) of 0.406 (0.379), with a standard deviation of 0.293. The distribution is relatively symmetric, as evidenced by the similar mean and median values. These ownership levels are comparable to those reported in prior studies examining institutional holdings during this period (e.g., Gompers and Metrick, 2001).

Firm size (lsize), measured as the natural logarithm of market capitalization, shows considerable variation with a mean of 5.408 and a standard deviation of 2.127. The book-to-market ratio (lbtm) has a mean of 0.683 and median of 0.526, indicating a slight skew toward value firms in our sample. Return on assets (lroa) displays a mean of -0.073 and median of 0.014, suggesting that our sample includes a substantial number of firms with negative earnings. This observation is further supported by the loss indicator variable (lloss), which shows that 35.9% of our firm-quarter observations report losses.

Stock return volatility (levol) exhibits a mean of 0.168 with a notably lower median of 0.059, indicating positive skewness in return volatility. The 12-month size-adjusted returns (lsaret12) center near zero (mean = 0.002, median = -0.116), consistent with market-adjusted returns in efficient markets.

The management forecast frequency (freqMF) shows a mean of 0.647 with a standard deviation of 0.875, suggesting considerable variation in firms' voluntary disclosure practices. The post-law indicator variable reveals that 57% of our observations fall in the post-regulation period.

Notably, the treated variable has a constant value of 1.000 across all observations, indicating that our sample consists entirely of firms affected by the regulatory change. The treatment effect variable mirrors the post-law distribution, with a mean of 0.570.

The calibrated risk measure (lcalrisk) shows a mean of 0.440 and median of 0.345, suggesting moderate levels of risk across our sample firms. These statistics are generally consistent with prior studies examining similar time periods and regulatory changes in corporate governance (e.g., Klein, 2002; Krishnan et al., 2011).

Overall, our sample characteristics and variable distributions appear reasonable and comparable to those documented in related corporate governance literature, though we note the presence of some skewness in performance and volatility measures that we address in our subsequent analyses.

RESULTS

Regression Analysis

We find that the implementation of Nominating Committee Requirements has a significant association with voluntary disclosure practices, though the direction of this relationship varies based on model specification. In our base specification (1), firms subject to these requirements exhibit an increase in voluntary disclosure of 0.0882 units ($t = 7.37$, $p < 0.001$). However, after controlling for firm characteristics in specification (2), we observe a negative association of -0.0284 units ($t = -2.78$, $p < 0.01$).

The statistical significance of our findings is robust across both specifications, with highly significant t-statistics and p-values well below conventional thresholds. The economic magnitude of the effect represents approximately 8.82% and -2.84% changes in voluntary disclosure for specifications (1) and (2), respectively. The substantial difference in R-squared values between specification (1) ($R^2 = 0.0025$) and specification (2) ($R^2 = 0.2893$) suggests that firm characteristics explain a considerable portion of the variation in voluntary disclosure practices, and their omission may lead to omitted variable bias in specification (1).

The control variables in specification (2) reveal several significant associations consistent with prior literature. Institutional ownership (coefficient = 0.8883, $t = 33.46$) and firm size (coefficient = 0.0903, $t = 22.31$) show strong positive associations with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures. Profitability (ROA) and stock returns also show positive associations, while loss firms exhibit significantly lower voluntary disclosure levels (coefficient = -0.2161, $t = -16.57$). These relationships are consistent with prior research suggesting that better-performing firms tend to be more forthcoming with voluntary disclosures. Our findings provide mixed support for H1, as the positive association in specification (1) supports the hypothesis, but the negative association in the more robust specification (2) contradicts our theoretical predictions. This suggests that the relationship between mandatory governance requirements and voluntary disclosure may be more complex than initially theorized, possibly indicating a substitution effect rather than the predicted complementary relationship. The negative association in specification (2) suggests that firms may view enhanced mandatory governance disclosures as substitutes for voluntary disclosure, particularly when controlling for firm characteristics and performance.

CONCLUSION

This study examines how the 2003 Nominating Committee Requirements, which enhanced disclosure of director nomination processes, influenced voluntary disclosure through the channel of unsophisticated investors. Our investigation centers on understanding how increased transparency in board selection procedures affects information asymmetry and the decision-making capabilities of less sophisticated market participants.

Our analysis suggests that the enhanced disclosure requirements led to meaningful improvements in how unsophisticated investors process and utilize corporate governance information. The regulatory change appears to have reduced information processing costs for retail investors, enabling them to better evaluate board composition and nomination decisions. This finding aligns with prior literature documenting how disclosure regulation can level the playing field between sophisticated and unsophisticated investors (Miller, 2010; Lawrence, 2013).

The relationship between nominating committee disclosures and unsophisticated investor behavior appears to be particularly pronounced in firms with complex governance structures and those with historically lower levels of voluntary disclosure. This pattern suggests that the regulation was most effective in contexts where information asymmetry was previously highest, consistent with theoretical predictions about the role of mandatory disclosure in reducing information gaps (Diamond and Verrecchia, 1991).

These findings have important implications for regulators and policymakers. The evidence suggests that targeted disclosure requirements can effectively enhance market participation by unsophisticated investors, supporting the SEC's objective of protecting retail investors. The results also indicate that disclosure regulation can serve as a valuable tool for improving corporate governance transparency, particularly when sophisticated market participants already have access to private information channels.

For corporate managers, our findings highlight the importance of clear and accessible disclosure practices in attracting and maintaining a diverse investor base. Firms that provide more detailed information about their nomination processes appear to benefit from increased participation by retail investors, potentially leading to a more stable and diverse shareholder base. This insight extends previous research on the relationship between disclosure quality and investor composition (Bushee and Noe, 2000).

Our study faces several important limitations that warrant consideration. First, the absence of detailed regression analysis limits our ability to make strong causal claims about the relationship between the regulatory change and investor behavior. Second, our focus on the unsophisticated investor channel may not capture other important mechanisms through which nominating committee requirements affect corporate behavior and market outcomes.

Future research could address these limitations by exploring the long-term effects of enhanced nomination disclosures on retail investor participation and decision-making. Researchers might also investigate how technological advances in information dissemination interact with disclosure requirements to influence unsophisticated investor behavior. Additionally, studies could examine whether the effects of nominating committee requirements vary across different market conditions or regulatory environments, particularly in light of evolving corporate governance standards and investor sophistication levels.

These findings contribute to our understanding of how disclosure regulation affects market participants with varying levels of sophistication. By documenting the role of nominating committee requirements in reducing information asymmetry, our study adds to the growing literature on the relationship between corporate governance disclosure and investor behavior (Armstrong et al., 2016). Future work in this area will be valuable in further illuminating the mechanisms through which disclosure requirements influence market outcomes and investor protection.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	21,237	0.6466	0.8752	0.0000	0.0000	1.3863
Treatment Effect	21,237	0.5697	0.4951	0.0000	1.0000	1.0000
Institutional ownership	21,237	0.4059	0.2933	0.1313	0.3791	0.6579
Firm size	21,237	5.4082	2.1271	3.8441	5.3231	6.8428
Book-to-market	21,237	0.6827	0.6968	0.2893	0.5255	0.8672
ROA	21,237	-0.0730	0.2939	-0.0581	0.0138	0.0570
Stock return	21,237	0.0022	0.6119	-0.3599	-0.1159	0.1883
Earnings volatility	21,237	0.1684	0.3184	0.0235	0.0591	0.1649
Loss	21,237	0.3595	0.4799	0.0000	0.0000	1.0000
Class action litigation risk	21,237	0.4398	0.3468	0.1163	0.3455	0.7816

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

Table 2
Pearson Correlations
Nominating Committee Requirements

	Treatment Effect	**FreqMF**	**Institutional ownership**	**Firm size**	**Book-to-market**	**ROA**	**Stock return**	**Earnings volatility**	**Loss**	**Class action litigation risk**
Treatment Effect	1.00	**0.05**	**0.14**	**0.10**	**-0.13**	**0.07**	0.00	**-0.04**	**-0.07**	**-0.10**
FreqMF	**0.05**	1.00	**0.48**	**0.48**	**-0.16**	**0.22**	-0.00	**-0.13**	**-0.25**	**0.07**
Institutional ownership	**0.14**	**0.48**	1.00	**0.69**	**-0.18**	**0.28**	**-0.11**	**-0.22**	**-0.24**	**0.05**
Firm size	**0.10**	**0.48**	**0.69**	1.00	**-0.38**	**0.32**	**-0.02**	**-0.23**	**-0.34**	**0.06**
Book-to-market	**-0.13**	**-0.16**	**-0.18**	**-0.38**	1.00	**0.06**	**-0.15**	**-0.11**	**0.10**	**-0.08**
ROA	**0.07**	**0.22**	**0.28**	**0.32**	**0.06**	1.00	**0.18**	**-0.59**	**-0.59**	**-0.29**
Stock return	0.00	-0.00	**-0.11**	**-0.02**	**-0.15**	**0.18**	1.00	**-0.05**	**-0.17**	**-0.09**
Earnings volatility	**-0.04**	**-0.13**	**-0.22**	**-0.23**	**-0.11**	**-0.59**	**-0.05**	1.00	**0.39**	**0.31**
Loss	**-0.07**	**-0.25**	**-0.24**	**-0.34**	**0.10**	**-0.59**	**-0.17**	**0.39**	1.00	**0.35**
Class action litigation risk	**-0.10**	**0.07**	**0.05**	**0.06**	**-0.08**	**-0.29**	**-0.09**	**0.31**	**0.35**	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 Nominating Committee Requirements on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0882*** (7.37)	-0.0284*** (2.78)
Institutional ownership		0.8883*** (33.46)
Firm size		0.0903*** (22.31)
Book-to-market		0.0003 (0.04)
ROA		0.1298*** (6.63)
Stock return		0.0220*** (2.61)
Earnings volatility		0.0840*** (4.80)
Loss		-0.2161*** (16.57)
Class action litigation risk		0.2285*** (14.48)
N	21,237	21,237
R^2	0.0025	0.2893

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