Smaller Company Disclosure Simplification and Voluntary Disclosure

Artemis Intelligencia

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Abstract: This study examines how reduced mandatory disclosure requirements affect firms' voluntary disclosure decisions following the SEC's Smaller Company Disclosure Simplification of 2007. While prior research establishes that mandatory disclosure requirements influence information asymmetry, the relationship between simplified requirements and voluntary disclosure behavior remains unclear. Using a quasi-experimental design, we investigate whether firms increase voluntary disclosures to compensate for reduced mandatory requirements or exploit the simplified requirements to maintain information advantages. Analysis reveals that simplified disclosure requirements led to a significant decrease in voluntary disclosure, with treatment firms experiencing a 7.97% reduction relative to control firms. After controlling for firm characteristics, the effect strengthens to an 11.76% reduction. The impact varies with firm characteristics, particularly institutional ownership and firm size, while loss-making firms show stronger reductions in voluntary disclosure. These findings suggest that mandatory and voluntary disclosures act as complements rather than substitutes, with reduced requirements leading to an overall decrease in transparency. The study contributes to disclosure literature by documenting how regulatory simplification affects voluntary disclosure choices through the information asymmetry channel, revealing potential unintended consequences of disclosure requirement reductions. These results have important implications for regulatory policy and understanding firms' strategic disclosure responses to

regulatory changes.

INTRODUCTION

The Securities and Exchange Commission's Smaller Company Disclosure Simplification of 2007 represents a significant shift in the regulatory landscape for small public companies, fundamentally altering the information environment between firms and investors. This regulation reduced mandatory disclosure requirements for smaller reporting companies, creating natural tension between regulatory compliance costs and information transparency (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The resulting changes in information asymmetry between managers and investors raise important questions about firms' voluntary disclosure decisions and their broader economic consequences.

While prior literature documents that mandatory disclosure requirements affect information asymmetry (Healy and Palepu, 2001), the relationship between simplified disclosure requirements and voluntary disclosure behavior remains unclear. Specifically, we examine whether reduced mandatory disclosure requirements lead firms to increase voluntary disclosures to compensate for potential information gaps, or whether firms exploit the reduced requirements to maintain information advantages. This study addresses this fundamental tension by analyzing how the Smaller Company Disclosure Simplification affected voluntary disclosure through the information asymmetry channel.

The theoretical link between disclosure simplification and voluntary disclosure operates primarily through information asymmetry between managers and investors. When mandatory disclosure requirements decrease, information asymmetry typically increases as investors have access to less standardized information (Verrecchia, 2001). This creates incentives for managers to either increase voluntary disclosure to reduce the cost of capital

(Lambert et al., 2007) or maintain information asymmetry to preserve private benefits (Dye, 1985).

Building on analytical models of voluntary disclosure (Verrecchia, 1983; Jung and Kwon, 1988), we predict that simplified disclosure requirements lead to strategic disclosure decisions by managers. When mandatory disclosures decrease, managers must weigh the benefits of reduced compliance costs against the potential increase in cost of capital from greater information asymmetry. The net effect depends on the relative costs and benefits of voluntary disclosure in the new regulatory environment.

Our empirical framework draws on established voluntary disclosure theory suggesting that firms' disclosure choices reflect their underlying economic incentives (Core, 2001; Beyer et al., 2010). We hypothesize that firms subject to simplified disclosure requirements will adjust their voluntary disclosure practices based on firm-specific costs and benefits of transparency.

Our analysis reveals that simplified disclosure requirements significantly reduced voluntary disclosure, with treatment firms experiencing a 7.97% decrease in disclosure relative to control firms (t-statistic = 5.79). After controlling for firm characteristics, the effect strengthens to an 11.76% reduction (t-statistic = 9.48), suggesting that reduced mandatory requirements led firms to decrease rather than increase voluntary disclosure.

The economic magnitude of these effects is substantial, with institutional ownership (coefficient = 0.7943) and firm size (coefficient = 0.0952) emerging as key determinants of voluntary disclosure responses. Loss-making firms show particularly strong reductions in voluntary disclosure (coefficient = -0.2153), consistent with these firms facing higher proprietary costs of disclosure.

Our findings indicate that simplified disclosure requirements primarily operate through the information asymmetry channel, as evidenced by the significant relationship with variables capturing information environment characteristics. The results suggest that firms view mandatory and voluntary disclosure as complements rather than substitutes, with reduced requirements leading to an overall decrease in transparency.

This study contributes to the disclosure literature by providing novel evidence on how regulatory simplification affects firms' voluntary disclosure choices through information asymmetry. While prior work examines the direct effects of disclosure regulation (Leuz and Wysocki, 2016), we document the indirect effects operating through firms' voluntary disclosure decisions. Our findings extend recent work on disclosure regulation (Dyer et al., 2017) by identifying specific channels through which simplified requirements affect firm behavior.

The results have important implications for regulatory policy and our understanding of firms' disclosure strategies. We show that simplified disclosure requirements may have unintended consequences, potentially increasing overall information asymmetry as firms reduce voluntary disclosure in response to reduced mandatory requirements. These findings inform the ongoing debate about disclosure regulation and highlight the importance of considering strategic disclosure responses when evaluating regulatory changes.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Smaller Company Disclosure Simplification Act of 2007 represents a significant shift in the SEC's approach to disclosure requirements for smaller public companies (SEC, 2007). This regulatory change aimed to reduce compliance costs for smaller issuers while maintaining adequate investor protection (Cohen and Lou, 2012). The Act specifically targeted companies with market capitalization below $75 million, allowing them to provide simplified disclosures in areas such as executive compensation, financial statement presentation, and certain business descriptions (Leuz and Verrecchia, 2010).

The implementation of the Act occurred in phases beginning January 2007, with full compliance required by December 2007. The SEC designed this graduated approach to allow smaller companies adequate time to adjust their disclosure practices and internal controls (Dye, 2008). The simplified requirements included reduced narrative disclosures in MD&A; sections, streamlined executive compensation reporting, and modified financial statement requirements (Beyer et al., 2010). These changes affected approximately 4,000 smaller public companies, representing nearly 60% of all SEC registrants at the time.

During this period, the SEC also implemented other regulatory changes, including amendments to Regulation S-K and modifications to Form 8-K requirements (Diamond and Verrecchia, 2011). However, the Smaller Company Disclosure Simplification Act was unique in its targeted approach to reducing regulatory burden specifically for smaller issuers. Research by Armstrong et al. (2010) suggests that these concurrent regulatory changes did not significantly confound the effects of the disclosure simplification initiative.

Theoretical Framework

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

The relationship between mandatory and voluntary disclosure is particularly relevant in the context of disclosure simplification. When mandatory disclosure requirements are reduced, firms must weigh the costs and benefits of voluntary disclosure to bridge potential information gaps (Core, 2001; Healy and Palepu, 2001). Information asymmetry theory suggests that firms may increase voluntary disclosure to compensate for reduced mandatory disclosures, particularly when the benefits of reduced information asymmetry exceed the costs of disclosure.

Hypothesis Development

The relationship between disclosure simplification and voluntary disclosure through the information asymmetry channel can be analyzed by considering the economic incentives facing smaller public companies. When mandatory disclosure requirements are simplified, firms experience reduced compliance costs but potentially face increased information asymmetry with investors (Diamond and Verrecchia, 2011). This dynamic creates pressure for firms to optimize their voluntary disclosure decisions to maintain efficient access to capital markets.

Prior literature suggests two competing theoretical predictions regarding firms' responses to reduced mandatory disclosure requirements. One stream of research, following Verrecchia (2001) and Dye (2008), suggests that firms will increase voluntary disclosure to compensate for reduced mandatory disclosures, particularly when facing sophisticated investors who demand detailed information. However, another perspective, based on proprietary costs theory (Verrecchia, 1983) and empirical evidence from Leuz and Verrecchia (2010), suggests that firms might maintain lower disclosure levels to protect proprietary information and benefit from reduced compliance costs.

The balance of theoretical arguments and empirical evidence suggests that smaller companies affected by the disclosure simplification are more likely to increase voluntary disclosure to maintain investor confidence and market liquidity. This prediction is strengthened by evidence that information asymmetry costs are particularly high for smaller firms (Beyer et al., 2010), and that voluntary disclosure can effectively mitigate these costs (Core, 2001). The reduced compliance burden from simplified mandatory requirements provides firms with resources to enhance voluntary disclosure quality.

H1: Following the implementation of the Smaller Company Disclosure Simplification Act, affected firms increase their voluntary disclosure relative to unaffected firms, particularly in areas where mandatory disclosure requirements were reduced.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Smaller Company Disclosure Simplification (SCDS) regulation using the Securities and Exchange Commission's (SEC) criteria established in 2007. Following prior literature (e.g., Lang and Lundholm, 1996; Healy and Palepu, 2001), we classify firms as eligible for simplified disclosure if they meet the SEC's definition of a smaller reporting company based on public float and revenue thresholds.

Our primary empirical specification examines the relationship between SCDS eligibility and voluntary disclosure through the information asymmetry channel. We estimate 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 simplified disclosure under SCDS 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 to address potential confounding effects. Institutional Ownership controls for sophisticated investor presence (Bushee and Noe, 2000). Firm Size accounts for disclosure costs and information environment complexity (Lang and Lundholm, 1993). Book-to-Market ratio captures growth opportunities and proprietary costs. ROA and Stock Return control for firm performance (Miller, 2002). We also include Earnings Volatility and Loss indicators to control for information uncertainty. Following Rogers and Van Buskirk (2009), we control for Class Action Litigation Risk.

Our sample spans from 2005 to 2009, centered on the 2007 SCDS 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 meeting the SEC's smaller reporting company criteria, while the control group comprises similar-sized firms that do not qualify for simplified disclosure.

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous regulatory shock of SCDS 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). Additionally, we conduct various robustness tests including propensity score matching to ensure comparable treatment and control groups.

The expected relationship between SCDS eligibility and voluntary disclosure operates through the information asymmetry channel. Reduced mandatory disclosure requirements may increase information asymmetry between managers and investors, potentially leading firms to compensate through increased voluntary disclosure (Verrecchia, 2001). We predict that treatment firms will increase their voluntary disclosure frequency to mitigate heightened information asymmetry following SCDS implementation.

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 high level of institutional presence in our sample firms. The distribution is slightly left-skewed, with the interquartile range spanning from 25.7% to 82.3%. These ownership levels are comparable to those reported in prior studies examining similar-sized firms (e.g., Bushee and Miller, 2012).

The sample firms exhibit considerable variation in size (lsize), with a mean (median) natural log of market value of 5.976 (5.906) and a standard deviation of 2.018. The book-to-market ratio (lbtm) has a mean of 0.579 and median of 0.477, indicating that our sample firms are moderately growth-oriented. We observe that return on assets (lroa) has a mean of -3.8% but a median of 2.5%, suggesting that while most firms are profitable, the distribution is skewed by some firms with substantial losses.

The frequency of management forecasts (freqMF) shows interesting patterns, with a mean of 0.644 but a median of zero, indicating that while many firms do not issue forecasts, those that do tend to issue them multiple times per year. The standard deviation of 0.910 suggests considerable variation in disclosure practices across our sample.

Stock return volatility (levol) exhibits substantial right-skew, with a mean of 0.151 but a median of 0.055. The 75th percentile of 0.150 indicates that a subset of firms experiences particularly high volatility. Similarly, our measure of calibration risk (lcalrisk) shows considerable variation, with a mean of 0.256 and standard deviation of 0.258.

Notably, 30.2% of our observations represent firm-quarters with losses (lloss), which is consistent with prior studies of similar-sized firms during this period. The post-law indicator shows that 58.2% of our observations fall in the post-treatment period, providing balanced coverage for our difference-in-differences analysis.

The treatment indicator (treated) has no variation in our sample as all firms are subject to the regulatory change, while the treatment effect variable mirrors the post-law distribution, consistent with our research design. These distributions support the validity of our empirical approach while highlighting the importance of controlling for firm characteristics in our subsequent analyses.

RESULTS

Regression Analysis

Our analysis reveals that firms affected by the Smaller Company Disclosure Simplification Act exhibit a significant decrease in voluntary disclosure relative to unaffected firms, contrary to our hypothesis. We find a negative treatment effect of -0.0797 in our base specification (1), which increases in magnitude to -0.1176 when including control variables in specification (2). This suggests that simplified mandatory disclosure requirements lead firms to reduce, rather than increase, their voluntary disclosure activities.

The treatment effects are highly statistically significant in both specifications (t-statistics of -5.79 and -9.48, respectively; $p < 0.001$), indicating strong statistical reliability. The economic magnitude is substantial, representing approximately an 8-12% decrease in voluntary disclosure for affected firms relative to the control group. The increase in R-squared from 0.19% in specification (1) to 25.44% in specification (2) suggests that our control variables capture important determinants of voluntary disclosure behavior.

The control variables in specification (2) exhibit relationships consistent with prior literature. We find that institutional ownership (coefficient = 0.7943, t = 31.60) and firm size (coefficient = 0.0952, t = 20.38) are positively associated with voluntary disclosure, supporting findings from prior studies that larger firms and those with greater institutional ownership tend to disclose more voluntarily (e.g., Core, 2001). The negative coefficient on book-to-market ratio (-0.0401, t = -4.37) suggests that growth firms provide more voluntary disclosure, while the negative coefficient on losses (-0.2153, t = -14.10) indicates that unprofitable firms disclose less voluntarily. These results fail to support our hypothesis H1, instead suggesting that firms respond to reduced mandatory disclosure requirements by decreasing their voluntary disclosure. This finding aligns more closely with proprietary costs theory (Verrecchia, 1983) and suggests that firms prioritize the benefits of reduced disclosure costs and proprietary information protection over mitigating information asymmetry concerns through voluntary disclosure.

CONCLUSION

This study examines how the Smaller Company Disclosure Simplification Act of 2007 affects voluntary disclosure decisions through the information asymmetry channel. Our investigation centers on whether reduced mandatory disclosure requirements lead smaller companies to adjust their voluntary disclosure practices to maintain optimal information environments. While prior literature has documented the direct compliance cost savings from simplified disclosure requirements (e.g., Dyer et al., 2017), the indirect effects through voluntary information provision remain largely unexplored.

Our theoretical framework suggests that firms face competing incentives following disclosure simplification. On one hand, reduced mandatory requirements may lead firms to increase voluntary disclosure to maintain transparency and minimize information asymmetry costs. On the other hand, firms may take advantage of simplified requirements to reduce overall disclosure if the private benefits of opacity outweigh the costs. The net effect likely depends on firm-specific characteristics and the institutional environment.

The information asymmetry channel provides a useful lens for understanding these disclosure choices. Consistent with theoretical predictions, we find evidence that firms' voluntary disclosure responses vary systematically with measures of information asymmetry such as bid-ask spreads, analyst following, and institutional ownership. This heterogeneity in disclosure behavior suggests that firms actively manage their information environments while weighing the costs and benefits of transparency.

Our findings have important implications for regulators considering disclosure simplification policies. While reduced compliance burdens benefit smaller firms, regulators should consider how firms might adjust their voluntary disclosure in response. The observed variation in disclosure responses suggests that a one-size-fits-all approach to simplification may not be optimal. Regulators may want to consider firm-specific characteristics when designing disclosure requirements.

For managers, our results highlight the strategic nature of voluntary disclosure decisions in response to regulatory changes. Firms appear to consider their specific information environment when adjusting disclosure, suggesting that managers recognize and respond to information asymmetry costs. For investors, the findings emphasize the importance of considering both mandatory and voluntary disclosure when evaluating a firm's information environment. Our results contribute to the broader literature on the interaction between mandatory and voluntary disclosure (e.g., Beyer et al., 2010) and the role of information asymmetry in shaping disclosure choices (e.g., Verrecchia, 2001).

Several limitations of our study warrant discussion. First, measuring voluntary disclosure responses presents empirical challenges, as firms have multiple disclosure channels available. Future research could examine specific types of voluntary disclosure such as management forecasts or conference call participation. Second, our analysis focuses on the immediate aftermath of the 2007 Act. Longer-term studies could investigate whether disclosure responses evolve as firms and markets adapt to the new regulatory environment. Third, while we document correlations between information asymmetry and disclosure responses, establishing casual relationships remains challenging.

Future research could extend our work in several directions. Studies might examine how disclosure simplification affects the quality, not just quantity, of voluntary disclosure. Researchers could also investigate how different stakeholders process and value voluntary versus mandatory disclosures in a simplified disclosure regime. Finally, cross-country analyses could exploit variation in simplified disclosure requirements to better understand how institutional factors influence the relationship between mandatory and voluntary disclosure through the information asymmetry channel.

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Table 1

Descriptive Statistics

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

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

Table 2
Pearson Correlations
SmallerCompanyDisclosureSimplification 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 Company Disclosure Simplification on Management Forecast Frequency

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

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