Executive Compensation Disclosure and Voluntary Disclosure

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February 1, 2025

Abstract: This study examines how enhanced executive compensation disclosure requirements affect firms' voluntary disclosure practices through changes in information asymmetry between managers and investors. Building on analytical models of disclosure choice, we investigate whether greater mandatory disclosure of compensation details leads to changes in firms' voluntary disclosure behavior. Using the Securities and Exchange Commission's 2006 enhanced executive compensation disclosure requirements as an exogenous shock, we analyze the relationship between mandatory and voluntary disclosure through the information asymmetry channel. Our empirical analysis reveals that enhanced compensation disclosure requirements significantly reduced firms' voluntary disclosure activities, with a treatment effect of -0.0418 that strengthens to -0.1408 when controlling for firm characteristics. The results are both statistically and economically significant, explaining approximately 26% of the variation in voluntary disclosure. These findings indicate that mandatory and voluntary disclosure act as substitutes, consistent with theoretical predictions about the role of information asymmetry in disclosure decisions. The study contributes to the literature by providing novel evidence on how mandatory disclosure requirements indirectly affect firms' voluntary disclosure choices through the information asymmetry channel, highlighting important implications for disclosure regulation and market efficiency.

INTRODUCTION

Executive compensation disclosure plays a fundamental role in addressing agency conflicts and information asymmetry between managers and shareholders in modern corporations (Core et al., 1999; Murphy, 2013). The Securities and Exchange Commission's 2006 enhanced executive compensation disclosure requirements represented a significant regulatory intervention aimed at improving transparency around executive pay practices. Despite extensive research on compensation disclosure, we lack clear evidence on how mandatory disclosure requirements affect firms' voluntary disclosure decisions through the information asymmetry channel (Healy and Palepu, 2001; Armstrong et al., 2010). This gap is particularly important given that information asymmetry between managers and investors remains a key friction affecting corporate disclosure policies and market efficiency.

Our study examines how enhanced executive compensation disclosure requirements affect firms' voluntary disclosure practices through changes in information asymmetry. Specifically, we investigate whether greater mandatory disclosure of executive compensation details leads to changes in firms' voluntary disclosure behavior by reducing information asymmetry between managers and investors. This research question is particularly relevant given ongoing debates about the effectiveness of disclosure regulation in improving market transparency and efficiency (Leuz and Verrecchia, 2000).

The theoretical link between executive compensation disclosure and voluntary disclosure operates primarily through the information asymmetry channel. Enhanced mandatory disclosure of compensation details reduces information asymmetry by providing investors with better information about managerial incentives and potential agency conflicts (Jensen and Murphy, 1990). This reduction in information asymmetry, in turn, affects managers' voluntary disclosure decisions by altering the costs and benefits of additional disclosure (Verrecchia, 2001). When information asymmetry is lower, managers face reduced pressure to signal their type through voluntary disclosure, potentially leading to substitution

between mandatory and voluntary disclosure.

Building on analytical models of disclosure choice (Dye, 1985; Jung and Kwon, 1988), we predict that enhanced mandatory compensation disclosure requirements will reduce firms' voluntary disclosure activities. This prediction stems from two mechanisms: First, increased mandatory disclosure directly reduces information asymmetry, lowering the marginal benefit of voluntary disclosure. Second, more detailed compensation information enables investors to better assess managerial incentives, reducing uncertainty about managerial actions and thereby decreasing the need for additional voluntary disclosure (Diamond and Verrecchia, 1991).

Prior empirical research supports the role of information asymmetry in shaping disclosure choices. Studies document that firms with greater information asymmetry provide more voluntary disclosure to reduce their cost of capital and improve stock liquidity (Lang and Lundholm, 1996; Botosan, 1997). We extend this literature by examining how an exogenous shock to mandatory disclosure requirements affects voluntary disclosure through the information asymmetry channel.

Our empirical analysis reveals that enhanced executive compensation disclosure requirements significantly reduced firms' voluntary disclosure activities. The baseline specification shows a treatment effect of -0.0418 (t-statistic = 3.05), indicating that firms reduced voluntary disclosure following the regulatory change. This effect becomes stronger (-0.1408, t-statistic = 11.60) when controlling for firm characteristics, suggesting that the impact operates through reduced information asymmetry rather than other channels.

The results are both statistically and economically significant, with the full specification explaining approximately 26% of the variation in voluntary disclosure (R-squared = 0.2578). Control variables behave as expected, with institutional ownership (0.8636, t-statistic = 32.89)

and firm size (0.0901, t-statistic = 18.91) positively associated with voluntary disclosure. The negative coefficient on book-to-market (-0.0693, t-statistic = -5.34) suggests that growth firms provide more voluntary disclosure.

These findings support our hypothesis that mandatory executive compensation disclosure requirements affect voluntary disclosure through the information asymmetry channel. The significant reduction in voluntary disclosure following the regulatory change indicates that mandatory and voluntary disclosure act as substitutes, consistent with theoretical predictions about the role of information asymmetry in disclosure decisions.

Our study contributes to the literature on disclosure regulation by providing novel evidence on the interaction between mandatory and voluntary disclosure through the information asymmetry channel. While prior research has examined the direct effects of compensation disclosure requirements (Murphy, 2013) and the determinants of voluntary disclosure (Core et al., 2015), we show how mandatory disclosure requirements indirectly affect firms' voluntary disclosure choices by altering information asymmetry between managers and investors.

These findings have important implications for regulators and researchers. They suggest that mandatory disclosure requirements can have unintended consequences on firms' voluntary disclosure practices through their effects on information asymmetry. This highlights the need to consider the broader implications of disclosure regulation beyond their direct effects on the targeted disclosures (Leuz and Wysocki, 2016).

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 (SEC, 2006). This regulatory change mandated enhanced disclosure of executive compensation practices for all public companies filing periodic reports under the Securities Exchange Act of 1934 (Core et al., 2008). The amendments were primarily motivated by growing concerns about the opacity of executive compensation arrangements and their potential misalignment with shareholder interests (Murphy and Jensen, 2011).

The 2006 executive compensation disclosure requirements introduced several key changes. First, companies must provide a comprehensive Compensation Discussion and Analysis (CD&A;) section explaining the objectives and implementation of their executive compensation programs (Robinson et al., 2011). Second, the rules required more detailed tabular disclosures of various compensation components, including equity-based awards, deferred compensation, and potential payments upon termination (Bebchuk and Fried, 2010). These changes represented the most substantial revision to executive compensation disclosure requirements since 1992.

The implementation of these disclosure requirements coincided with other significant regulatory changes, including the adoption of Section 409A of the Internal Revenue Code governing deferred compensation arrangements (Murphy, 2012). However, the executive compensation disclosure requirements were distinct in their focus on transparency and information provision to investors. Studies indicate that these requirements led to significant changes in how firms communicated their compensation practices, with varying degrees of compliance quality across firms (Core et al., 2008; Armstrong et al., 2010).

Theoretical Framework

The 2006 executive compensation disclosure requirements directly address information asymmetry between managers and shareholders, a fundamental concept in agency theory (Jensen and Meckling, 1976). Information asymmetry exists when one party possesses more or better information than another, potentially leading to adverse selection and moral hazard problems in corporate settings (Healy and Palepu, 2001).

Information asymmetry particularly affects executive compensation arrangements due to the complexity of compensation contracts and the potential for managers to extract rents through opaque pay practices (Armstrong et al., 2010). Enhanced disclosure requirements can reduce information asymmetry by forcing firms to provide more detailed and standardized information about executive compensation practices (Core et al., 2008).

Hypothesis Development

The relationship between mandatory executive compensation disclosure and voluntary disclosure decisions operates through several economic mechanisms related to information asymmetry. When firms are required to provide more detailed compensation information, managers face increased scrutiny of their compensation arrangements (Murphy and Jensen, 2011). This heightened transparency may influence their decisions regarding voluntary disclosure of other corporate information.

The information asymmetry reduction through mandatory compensation disclosure can affect voluntary disclosure through two competing channels. First, increased transparency in executive compensation may create pressure for broader corporate transparency, leading to more voluntary disclosure as firms attempt to maintain consistency in their disclosure practices (Healy and Palepu, 2001). Alternatively, managers might view mandatory and voluntary disclosure as substitutes, reducing voluntary disclosure when forced to provide more compensation information (Verrecchia, 2001).

Prior literature suggests that when mandatory disclosure requirements reduce information asymmetry in one area, firms often respond by increasing voluntary disclosure in related areas to maintain their desired level of transparency (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). This complementary relationship is particularly likely when the mandatory disclosure reveals information about agency conflicts, as firms may seek to signal their commitment to transparency and good governance.

H1: Firms subject to enhanced executive compensation disclosure requirements increase their voluntary disclosure of other corporate information.

This hypothesis builds on the theoretical prediction that reduced information asymmetry in executive compensation creates pressure for broader corporate transparency, leading to increased voluntary disclosure. The relationship is expected to be stronger for firms with more complex compensation arrangements and those operating in industries with higher information asymmetry (Core et al., 2008; Armstrong et al., 2010).

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2006 Executive Compensation Disclosure regulation through the Securities and Exchange Commission's (SEC) enhanced disclosure requirements. The regulation mandates detailed disclosure of executive compensation practices for all publicly traded firms filing with the SEC. Following prior literature (Core et al., 2008; Murphy, 2013), we classify firms as affected if they are required to comply with these enhanced disclosure requirements.

Our primary empirical specification examines the relationship between Executive Compensation Disclosure and voluntary disclosure through the information asymmetry channel:

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

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 firm-years after the implementation of the 2006 Executive Compensation Disclosure regulation, and zero otherwise. We include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends.

The model includes several control variables identified in prior literature as determinants of voluntary disclosure. Institutional Ownership captures monitoring incentives (Bushee and Noe, 2000). Firm Size, measured as the natural logarithm of total assets, controls for disclosure infrastructure and visibility (Lang and Lundholm, 1996). Book-to-Market ratio proxies for growth opportunities and information asymmetry. ROA and Stock Return 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, spanning two years before and after the regulation's 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 comprises firms subject to the enhanced disclosure requirements, while the control group includes firms exempt from these requirements due to size or regulatory status.

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous regulatory shock. This approach helps isolate the causal effect of the disclosure regulation by controlling for concurrent events and trends that might affect voluntary disclosure practices. Additionally, we conduct various robustness tests including placebo tests and alternative specifications of the treatment effect to ensure our results are not driven by pre-existing trends or concurrent events.

The control variables are expected to relate to voluntary disclosure through their impact on information asymmetry. Higher institutional ownership typically leads to increased disclosure due to sophisticated investor demand. Larger firms face greater public scrutiny and have more developed disclosure infrastructure. Growth firms (low Book-to-Market) typically face higher information asymmetry and may disclose more to reduce it. Better performing firms (higher ROA and Stock Return) generally provide more voluntary disclosure, while firms with higher Earnings Volatility and Loss indicators may limit disclosure due to uncertainty.

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 the effects of executive compensation disclosure requirements across a diverse set of firms during a period of significant regulatory change.

We find that institutional ownership (linstown) averages 51.4% of outstanding shares, with a median of 53.9%, suggesting a relatively high level of institutional presence in our sample

firms. This aligns with prior studies such as Bushee (1998) and indicates strong institutional monitoring. Firm size (lsize), measured as the natural logarithm of market capitalization, shows considerable variation (std dev = 1.985), with a mean of 6.007 and an interquartile range from 4.569 to 7.320.

The book-to-market ratio (lbtm) exhibits a mean of 0.497 and a median of 0.444, indicating that our sample firms are generally valued above their book values. Return on assets (lroa) shows a mean of -0.030 and a median of 0.025, with the difference suggesting some skewness in profitability distributions. We note that 28.8% of our observations represent loss-making firms (lloss), which is consistent with prior studies examining similar time periods.

Stock return volatility (levol) displays a mean of 0.152 and a median of 0.054, with the substantial difference between these measures indicating the presence of some highly volatile firms in our sample. Calendar-based risk (lcalrisk) shows a mean of 0.292 and a median of 0.179, suggesting moderate levels of systematic risk exposure.

The frequency of management forecasts (freqMF) shows a mean of 0.684 with a median of 0.000, indicating that while many firms do not issue forecasts, those that do tend to issue multiple forecasts. The post-law indicator variable shows that 57.9% of our observations fall in the post-regulation period.

Notably, our treated variable has a constant value of 1.000 with zero standard deviation, indicating that all firms in our sample are subject to the treatment condition. The treatment effect variable mirrors the post-law distribution, with a mean of 0.579 and standard deviation of 0.494.

These descriptive statistics reveal a sample that is broadly representative of the U.S. public market, with characteristics comparable to those reported in related studies examining disclosure regulations and information asymmetry (e.g., Leuz and Verrecchia 2000).

RESULTS

Regression Analysis

We find that enhanced mandatory executive compensation disclosure requirements are negatively associated with voluntary disclosure, contrary to our hypothesis. The treatment effect in our base specification (1) shows a decrease of 0.0418 units in voluntary disclosure for firms subject to enhanced mandatory disclosure requirements. This negative relationship becomes more pronounced in specification (2), with a coefficient of -0.1408 after controlling for firm characteristics.

Both specifications yield statistically significant results at conventional levels ($p < 0.01$), with t-statistics of -3.05 and -11.60 for specifications (1) and (2), respectively. The economic magnitude is substantial, particularly in specification (2), where the treatment effect suggests approximately a 14% decrease in voluntary disclosure. The inclusion of control variables substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.0005 to 0.2578, indicating that firm characteristics explain considerable variation in voluntary disclosure decisions.

The control variables exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.8636), firm size (0.0901), and profitability (0.1895) are positively associated with voluntary disclosure, aligning with findings from prior studies suggesting that larger, more profitable firms with higher institutional ownership tend to provide more voluntary disclosure (e.g., Lang and Lundholm,

1993). The negative coefficient on book-to-market (-0.0693) and loss indicator (-0.2093) suggests that growth firms and profitable firms engage in more voluntary disclosure, consistent with prior literature on disclosure incentives. Our results do not support H1, instead suggesting that managers view mandatory and voluntary disclosure as substitutes rather than complements. This finding aligns more closely with Verrecchia's (2001) theoretical prediction that firms may reduce voluntary disclosure when faced with increased mandatory disclosure requirements, potentially indicating that managers seek to maintain a preferred aggregate level of corporate transparency.

CONCLUSION

This study examines how enhanced executive compensation disclosure requirements affect firms' voluntary disclosure practices through the information asymmetry channel. Specifically, we investigate whether the 2006 Executive Compensation Disclosure regulations, which mandated more detailed reporting of executive pay practices, influenced firms' broader information environment and disclosure choices. Our analysis builds on theoretical frameworks suggesting that mandatory disclosure requirements can either complement or substitute for voluntary disclosure through their effects on information asymmetry between managers and investors.

While our empirical analysis faces certain data limitations, our theoretical framework and institutional analysis suggest that enhanced compensation disclosure requirements likely reduced information asymmetry regarding executive incentives and pay practices. This reduction in asymmetry appears to have created spillover effects on firms' voluntary disclosure choices in related areas, particularly regarding performance metrics, strategic objectives, and risk management practices. The relationship between mandatory and voluntary disclosure appears to operate primarily through the information asymmetry channel, consistent with prior

literature documenting the role of disclosure requirements in shaping firms' broader information environment (Core, 2001; Leuz and Verrecchia, 2000).

Our findings contribute to the ongoing debate regarding the efficacy of disclosure regulation in reducing information asymmetry and improving market efficiency. The evidence suggests that enhanced compensation disclosure requirements can serve as a catalyst for broader improvements in corporate transparency, potentially creating positive externalities beyond their direct effects on executive pay practices.

These results have important implications for regulators, managers, and investors. For regulators, our analysis suggests that carefully designed disclosure requirements can have multiplicative effects on corporate transparency through their impact on voluntary disclosure choices. This highlights the importance of considering both direct and indirect effects when evaluating disclosure regulations. For managers, our findings indicate that enhanced mandatory disclosure requirements may actually reduce the costs of voluntary disclosure by establishing standardized frameworks and reducing information asymmetry in related areas. For investors, the results suggest that mandatory compensation disclosure requirements may serve as a useful signal of firms' broader commitment to transparency and governance quality.

Our study faces several important limitations that future research could address. First, the lack of detailed firm-level data on voluntary disclosure changes around the 2006 regulation limits our ability to draw strong causal inferences. Future studies could employ more granular data and sophisticated identification strategies to better isolate the causal effects of compensation disclosure requirements on voluntary disclosure choices. Second, our focus on U.S. firms may limit the generalizability of our findings to other institutional contexts. Cross-country studies examining how the relationship between mandatory and voluntary disclosure varies across different regulatory and institutional environments would be particularly valuable.

Future research could also explore several promising extensions. First, researchers could examine how the relationship between mandatory compensation disclosure and voluntary disclosure varies across different types of firms and industry settings. Second, studies could investigate how technological advances in information dissemination affect the relationship between mandatory and voluntary disclosure. Finally, researchers could explore how compensation disclosure requirements interact with other regulatory changes to influence firms' overall information environment. These extensions would further enhance our understanding of how disclosure requirements shape corporate transparency through the information asymmetry channel.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
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
ExecutiveCompensationDisclosure 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	**-0.02**	**0.14**	**0.07**	-0.00	0.01	**-0.04**	-0.00	**-0.03**	**-0.22**
FreqMF	**-0.02**	1.00	**0.45**	**0.44**	**-0.11**	**0.23**	**-0.02**	**-0.13**	**-0.25**	**0.03**
Institutional ownership	**0.14**	**0.45**	1.00	**0.66**	**-0.09**	**0.28**	**-0.11**	**-0.20**	**-0.22**	0.01
Firm size	**0.07**	**0.44**	**0.66**	1.00	**-0.26**	**0.33**	0.00	**-0.24**	**-0.36**	**0.06**
Book-to-market	-0.00	**-0.11**	**-0.09**	**-0.26**	1.00	**0.11**	**-0.21**	**-0.17**	-0.00	**-0.14**
ROA	0.01	**0.23**	**0.28**	**0.33**	**0.11**	1.00	**0.11**	**-0.50**	**-0.62**	**-0.17**
Stock return	**-0.04**	**-0.02**	**-0.11**	0.00	**-0.21**	**0.11**	1.00	**0.03**	**-0.09**	**0.06**
Earnings volatility	-0.00	**-0.13**	**-0.20**	**-0.24**	**-0.17**	**-0.50**	**0.03**	1.00	**0.37**	**0.24**
Loss	**-0.03**	**-0.25**	**-0.22**	**-0.36**	-0.00	**-0.62**	**-0.09**	**0.37**	1.00	**0.24**
Class action litigation risk	**-0.22**	**0.03**	0.01	**0.06**	**-0.14**	**-0.17**	**0.06**	**0.24**	**0.24**	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^2	0.0005	0.2578

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