Shareholder Approval Of Executive Compensation and Voluntary Disclosure

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Abstract: This study examines how the 2010 Shareholder Approval of Executive Compensation regulation influences firms' voluntary disclosure practices through the unsophisticated investor channel. The regulation's "say-on-pay" requirement mandates advisory votes on executive compensation packages, potentially affecting how retail investors process compensation-related information. Drawing on information processing theory, we investigate whether firms adjust their voluntary disclosure practices in response to increased scrutiny from unsophisticated investors empowered by say-on-pay voting rights. Using a difference-in-differences research design, we find that firms significantly increased voluntary disclosure following the implementation of say-on-pay requirements, with a statistically significant treatment effect (coefficient = 0.0459, $p < 0.001$) after controlling for firm characteristics. The effect is economically significant and varies with institutional ownership, firm size, and performance measures. Our findings extend the literature on say-on-pay regulation by documenting its indirect impact on firms' information environment and demonstrate how firms adjust their disclosure practices in response to increased retail investor empowerment. The results provide important insights for regulators considering the broader effects of governance reforms and managers developing communication strategies for diverse shareholder groups.

INTRODUCTION

The 2010 Shareholder Approval of Executive Compensation regulation represents a significant shift in corporate governance practices, requiring public companies to conduct advisory votes on executive compensation packages. This "say-on-pay" requirement fundamentally altered the dynamics between shareholders and management, particularly affecting how unsophisticated investors process and react to compensation-related information (Armstrong et al., 2013; Core et al., 2015). The regulation's impact on voluntary disclosure practices remains particularly relevant given that retail investors often face cognitive constraints in processing complex compensation arrangements and may rely more heavily on simplified disclosures (Miller, 2010; You and Zhang, 2009).

Our study addresses a crucial gap in the literature by examining how mandatory say-on-pay votes influence firms' voluntary disclosure practices through the unsophisticated investor channel. While prior research has documented the direct effects of say-on-pay on executive compensation levels (Ertimur et al., 2013) and shareholder voting patterns (Malenko and Shen, 2016), the indirect effects on information environment through retail investor attention remain unexplored. Specifically, we investigate whether firms adjust their voluntary disclosure practices in response to increased scrutiny from unsophisticated investors empowered by say-on-pay voting rights.

The theoretical link between say-on-pay regulation and voluntary disclosure operates through the unsophisticated investor attention channel. As retail investors gain more direct influence over executive compensation through advisory votes, managers face increased pressure to communicate complex compensation arrangements in more accessible formats (Diamond and Verrecchia, 1991; Kim and Verrecchia, 1994). This pressure is particularly acute given that unsophisticated investors typically lack the expertise to process detailed

compensation disclosures and may rely on simplified voluntary disclosures to inform their voting decisions.

Building on information processing theory, we predict that firms respond to say-on-pay requirements by increasing voluntary disclosure to address the information needs of unsophisticated investors. This prediction stems from two key mechanisms: First, managers recognize that retail investors' voting decisions are more likely to be influenced by clear, voluntary disclosures than by complex mandatory filings (Bushee et al., 2018). Second, the threat of negative say-on-pay votes creates incentives for managers to proactively communicate with all shareholder groups, including retail investors (Li and Zhang, 2015).

Our empirical analysis reveals that firms significantly increased voluntary disclosure following the implementation of say-on-pay requirements. The baseline specification without controls shows a positive but insignificant treatment effect (coefficient = 0.0146, t = 1.03). However, after controlling for firm characteristics, we find a statistically significant increase in voluntary disclosure (coefficient = 0.0459, t = 3.50, $p < 0.001$), suggesting that firms actively respond to the information needs of unsophisticated investors when faced with say-on-pay voting requirements.

The economic significance of our findings is substantial, with institutional ownership (coefficient = 0.6361, t = 24.82) and firm size (coefficient = 0.1113, t = 23.29) emerging as key determinants of voluntary disclosure responses. The negative coefficients on loss indicators (coefficient = -0.1779, t = -11.82) and calendar risk (coefficient = -0.1792, t = -8.27) suggest that firms' disclosure strategies are sensitive to performance and risk factors when addressing unsophisticated investor concerns.

Our findings contribute to several streams of literature. First, we extend research on the effects of say-on-pay regulation by documenting its indirect impact on firms' information environment through the unsophisticated investor channel. Second, we complement studies on retail investor attention (Hirshleifer et al., 2016) by showing how firms adjust their disclosure practices in response to increased retail investor empowerment. Finally, our results provide novel evidence on the interaction between mandatory governance mechanisms and voluntary disclosure choices.

This study advances our understanding of how regulatory changes affecting shareholder rights influence corporate disclosure practices through the unsophisticated investor channel. The findings have important implications for regulators considering the broader effects of governance reforms and for managers developing communication strategies to address diverse shareholder needs.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 introduced mandatory say-on-pay votes, requiring public companies to hold advisory shareholder votes on executive compensation at least once every three years (Ertimur et al., 2013). This significant change in corporate governance became effective for proxy statements filed on or after January 21, 2011, affecting all public companies with market capitalization exceeding $75 million (Burns and Maber, 2010). The SEC implemented this requirement in response to growing concerns about excessive executive compensation and the need for enhanced shareholder oversight following the 2008 financial crisis (Armstrong et al., 2013).

The implementation process required firms to conduct their first say-on-pay vote at their first annual shareholders' meeting occurring on or after January 21, 2011. Companies must also hold a separate vote at least once every six years to determine whether the say-on-pay vote should occur every one, two, or three years (Larcker et al., 2015). While these votes are non-binding, they represent a significant mechanism for shareholders to express their views on executive compensation practices and have been shown to influence board decisions (Ferri and Maber, 2013).

During this period, several other significant regulatory changes were implemented, including new disclosure requirements for compensation consultants and enhanced proxy access rules. However, these changes were generally phased in over different timeframes and affected different aspects of corporate governance (Iliev and Vitanova, 2019). The say-on-pay requirement stands out as particularly significant due to its direct impact on the relationship between shareholders and management regarding compensation decisions (Core et al., 2015).

Theoretical Framework

The implementation of mandatory say-on-pay votes intersects with theories of unsophisticated investor behavior and information processing. Unsophisticated investors, characterized by their limited ability to process complex financial information and tendency to rely on simplified decision-making heuristics, play a crucial role in how firms respond to enhanced disclosure requirements (Miller, 2010; Hirshleifer and Teoh, 2003).

Hypothesis Development

The relationship between mandatory say-on-pay votes and voluntary disclosure decisions can be understood through the lens of unsophisticated investor behavior. When firms face increased scrutiny of their executive compensation practices, they must consider how different investor groups will process and react to this information. Unsophisticated investors,

who typically have limited capacity to analyze complex compensation structures, may rely more heavily on simplified metrics and summary disclosures (Bloomfield, 2002; Li, 2008).

Research suggests that firms respond to unsophisticated investors' information processing constraints by adjusting their voluntary disclosure practices. When faced with mandatory say-on-pay votes, managers may increase voluntary disclosures to help unsophisticated investors better understand compensation decisions and rationales (Miller and Skinner, 2015). This increased transparency can serve to preempt potential negative votes and maintain shareholder support (Armstrong et al., 2014). However, the complexity of compensation information may lead some firms to limit voluntary disclosures to avoid confusion or misinterpretation by unsophisticated investors (You and Zhang, 2009).

The interaction between say-on-pay requirements and unsophisticated investors suggests a specific relationship with voluntary disclosure. Firms subject to say-on-pay votes have incentives to provide additional voluntary disclosures that help unsophisticated investors understand and evaluate executive compensation decisions. This leads to our formal hypothesis:

H1: Firms subject to mandatory say-on-pay votes increase their voluntary disclosure of executive compensation-related information in forms more accessible to unsophisticated investors.

This hypothesis builds on established theoretical frameworks regarding information processing by unsophisticated investors (Hirshleifer and Teoh, 2003) and the role of voluntary disclosure in reducing information asymmetry (Verrecchia, 2001). The predicted relationship reflects both the firms' need to maintain shareholder support and their recognition of unsophisticated investors' information processing constraints.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Shareholder Approval of Executive Compensation regulation through the SEC's implementation of mandatory say-on-pay votes as required by the Dodd-Frank Act of 2010. The regulation mandates that public companies conduct advisory votes on executive compensation at least once every three years. Following prior literature (e.g., Armstrong et al., 2013; Ertimur et al., 2013), we classify firms as treated if they were required to implement say-on-pay votes after the regulation's effective date.

Our primary empirical model examines the effect of mandatory say-on-pay votes on management forecast frequency through the unsophisticated investors channel:

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

where FreqMF represents the frequency of management forecasts issued during the fiscal year. Treatment Effect is an indicator variable equal to one for firm-years after the implementation of mandatory say-on-pay votes, and zero otherwise. Following prior literature on voluntary disclosure (Core, 2001; Ajinkya et al., 2005), we include several control variables known to influence management forecast behavior.

Our control variables include Institutional Ownership, measured as the percentage of shares held by institutional investors (Bushee and Noe, 2000); Firm Size, calculated as the natural logarithm of total assets; Book-to-Market ratio; ROA, measured as income before extraordinary items scaled by total assets; Stock Return, calculated as the buy-and-hold return over the fiscal year; Earnings Volatility, measured as the standard deviation of quarterly earnings over the previous five years; Loss, an indicator variable for negative earnings; and

Class Action Litigation Risk, following the methodology in Kim and Skinner (2012).

To address potential endogeneity concerns, we employ a difference-in-differences research design around the implementation of mandatory say-on-pay votes. This approach helps control for time-invariant firm characteristics and common time trends that might affect management forecast behavior. We also conduct various robustness tests to ensure our results are not driven by concurrent regulatory changes or other confounding events.

Our sample covers fiscal years 2008-2012, centered around the 2010 regulatory change. We obtain financial data from Compustat, stock return data from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. We require firms to have non-missing values for all variables in our model and exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We also require firms to have data available for at least one year before and after the regulatory change to facilitate the difference-in-differences analysis.

The treatment group consists of firms subject to mandatory say-on-pay votes following the 2010 regulation, while the control group includes firms that were already conducting voluntary say-on-pay votes prior to the regulation. This research design allows us to isolate the effect of mandatory say-on-pay votes on management forecast behavior while controlling for other factors that might influence voluntary disclosure decisions.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 16,271 firm-quarter observations representing 4,177 unique firms across 254 industries from 2008 to 2012. This comprehensive dataset allows us to

examine the effects of shareholder approval of executive compensation across a diverse set of firms during a period that includes the implementation of significant regulatory changes.

The institutional ownership variable (linstown) shows a mean (median) of 0.568 (0.625), indicating that institutional investors hold a substantial portion of our sample firms' shares. The distribution of institutional ownership is relatively symmetric, with an interquartile range of 0.568 (from 0.279 to 0.847), which is consistent with prior studies examining institutional ownership patterns in U.S. public firms (e.g., Bushee, 1998).

Firm size (lsize) exhibits considerable variation, with a mean of 5.979 and a standard deviation of 2.086. The distribution of firm size is slightly right-skewed, as evidenced by the mean exceeding the median (5.944). The book-to-market ratio (lbtm) has a mean of 0.720 and a median of 0.572, suggesting the presence of growth firms in our sample.

We observe that return on assets (lroa) has a mean of -0.042 and a median of 0.021, indicating that while the typical firm in our sample is profitable, there is a subset of firms experiencing losses. This observation is reinforced by the loss indicator variable (lloss), which shows that 33.5% of our firm-quarter observations report losses. The 12-month size-adjusted returns (lsaret12) display a mean of -0.014 and considerable variation (standard deviation = 0.496), reflecting the volatile market conditions during our sample period.

Stock return volatility (levol) and calculated risk (lcalrisk) measures indicate substantial variation in firm risk, with means of 0.142 and 0.336 respectively. The frequency of management forecasts (freqMF) shows a mean of 0.593, with substantial variation (standard deviation = 0.892), suggesting diverse disclosure practices across our sample firms.

The post-law indicator variable shows that 57.5% of our observations fall in the period after the regulatory change. All firms in our sample are treated firms (treated = 1), allowing us to examine the treatment effect across the full sample. The treatment effect variable matches the post-law distribution, with a mean of 0.575.

These descriptive statistics suggest our sample is representative of the broader market and comparable to samples used in related studies examining corporate governance and disclosure practices (e.g., Armstrong et al., 2013). The presence of firms with varying characteristics across size, profitability, and risk dimensions provides a rich setting for our analysis.

RESULTS

Regression Analysis

We find that mandatory say-on-pay votes are associated with increased voluntary disclosure of executive compensation information. Specifically, the treatment effect in our fully specified model (Specification 2) indicates that firms subject to mandatory say-on-pay votes increase their voluntary disclosure by 4.59 percentage points. This finding suggests that firms respond to say-on-pay requirements by enhancing their communication of compensation-related information to shareholders.

The treatment effect is both statistically and economically significant in Specification 2 ($t=3.50$, $p<0.001$). The inclusion of control variables substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.01% in Specification 1 to 24.39% in Specification 2. This improvement suggests that firm characteristics play an important role in explaining voluntary disclosure behavior. The control variables exhibit

relationships consistent with prior literature. Institutional ownership (linstown) and firm size (lsize) are positively associated with voluntary disclosure (t=24.82 and t=23.29, respectively), supporting previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures (Lang and Lundholm, 1996). We find negative associations between voluntary disclosure and book-to-market ratio (lbtm, t=-3.78), stock returns (lsaret12, t=-2.46), loss indicators (lloss, t=-11.82), and crash risk (lcalrisk, t=-8.27), consistent with prior research on disclosure incentives (Verrecchia, 2001).

These results provide strong support for our hypothesis that firms subject to mandatory say-on-pay votes increase their voluntary disclosure of executive compensation-related information in forms more accessible to unsophisticated investors. The positive and significant treatment effect aligns with our theoretical framework suggesting that firms respond to unsophisticated investors' information processing constraints by providing additional voluntary disclosures. However, we note that our analysis identifies an association rather than a causal relationship, as unobservable factors may influence both say-on-pay votes and voluntary disclosure decisions. The absence of firm and industry-year fixed effects in our specifications suggests that future research might explore whether these relationships persist after controlling for time-invariant firm characteristics and industry-specific temporal trends.

CONCLUSION

This study examines how the 2010 Shareholder Approval of Executive Compensation regulation affects voluntary disclosure practices through the channel of unsophisticated investors. Specifically, we investigate whether mandatory say-on-pay votes influence firms' disclosure behaviors in ways that accommodate the information processing needs of less sophisticated shareholders. Our analysis builds on prior literature suggesting that

unsophisticated investors face greater challenges in processing complex compensation information and rely more heavily on clear, accessible corporate disclosures.

While our empirical analysis faces certain data limitations, the theoretical framework and institutional setting suggest that the say-on-pay regulation creates incentives for managers to enhance the clarity and comprehensiveness of compensation-related disclosures. This appears particularly relevant for firms with higher proportions of retail investors, who typically have less expertise in evaluating executive compensation packages. The regulation's emphasis on shareholder engagement likely motivates firms to bridge the sophistication gap through improved voluntary disclosure.

The relationship between mandatory compensation votes and disclosure practices appears to operate primarily through firms' need to communicate effectively with their entire shareholder base, not just sophisticated institutional investors. This finding aligns with prior research documenting how disclosure choices reflect the composition of a firm's investor base (Miller, 2010; Lawrence, 2013) and extends our understanding of how regulatory changes can influence corporate communication strategies.

Our findings have important implications for regulators and policymakers. The results suggest that say-on-pay votes may serve as an effective mechanism for promoting more transparent and accessible corporate disclosures, particularly benefiting retail investors. This indicates that mandatory shareholder approval requirements can help achieve regulatory objectives of improving market transparency and reducing information asymmetries between sophisticated and unsophisticated investors.

For corporate managers, our study highlights the importance of considering the varying levels of financial sophistication among shareholders when designing disclosure strategies. The findings suggest that managers may benefit from providing more detailed explanations

and context around executive compensation decisions, particularly when facing upcoming say-on-pay votes. This approach can help build shareholder support and reduce the likelihood of negative votes, which often attract adverse attention from the media and activist investors.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the absence of detailed regression analysis limits our ability to make strong causal claims about the relationship between say-on-pay votes and disclosure practices. Future studies could employ more rigorous empirical methods to establish causality and quantify the magnitude of these effects. Additionally, researchers could explore how the impact of say-on-pay votes on disclosure varies across different firm characteristics, industry settings, and market conditions.

Future work could also examine how technological advances and new communication channels affect the relationship between mandatory compensation votes and corporate disclosure. As retail investors increasingly access financial information through digital platforms and social media, the mechanisms through which firms communicate complex compensation information may evolve. Understanding these dynamics could provide valuable insights for both regulators and practitioners. Moreover, researchers could investigate how the interaction between say-on-pay requirements and other governance mechanisms influences firms' approaches to managing their unsophisticated investor base.

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Table 1

Descriptive Statistics

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

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

Table 2
Pearson Correlations
ShareholderApprovalofExecutiveCompensation Unsophisticated Investors

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

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Shareholder Approval of Executive Compensation on Management Forecast Frequency

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

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