Executive Compensation Disclosure and Voluntary Disclosure

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Abstract: Executive compensation disclosure requirements aim to address agency conflicts and information asymmetry, yet their broader effects on corporate disclosure behavior remain understudied. This study examines how enhanced executive compensation disclosure requirements influence voluntary disclosure practices through the reputation risk channel. Drawing on economic theories of disclosure and reputation management, we investigate whether increased scrutiny of executive compensation leads firms to adjust their voluntary disclosure strategies. Using difference-in-differences analysis following the SEC's 2006 enhanced disclosure requirements, we find that affected firms significantly reduce their voluntary disclosure levels. The treatment effect represents a 14% reduction from the sample mean level of voluntary disclosure, with stronger effects observed among firms with higher institutional ownership and larger market capitalization. These findings suggest that firms manage reputation risk by limiting voluntary disclosure when faced with increased compensation scrutiny. The study contributes to the literature by documenting an important indirect channel through which mandatory compensation disclosure requirements influence corporate disclosure behavior and by highlighting how reputation risk considerations shape firms' disclosure strategies. Our results demonstrate the broader implications of disclosure regulations beyond their primary objectives and advance understanding of reputation risk management in corporate disclosure practices.

INTRODUCTION

Executive compensation disclosure represents a critical mechanism for addressing agency conflicts and information asymmetry in corporate governance. The Securities and Exchange Commission's 2006 enhanced disclosure requirements marked a significant shift in compensation transparency, requiring detailed reporting of executive pay practices and related performance metrics (Murphy 2013; Core et al. 2008). This regulatory change heightened public scrutiny of executive compensation packages and created potential reputation risks for firms and their executives. The intersection of mandatory compensation disclosure and voluntary corporate disclosure presents an important yet understudied channel through which reputation concerns influence firm behavior and information environment.

The reputation risk channel becomes particularly salient as enhanced compensation disclosure requirements expose executives to increased public scrutiny and potential criticism. While prior research documents the direct effects of compensation disclosure on executive pay practices (Bebchuk and Fried 2004), we know relatively little about how reputation concerns stemming from compensation disclosure affect firms' broader information environment. This study addresses this gap by examining how enhanced executive compensation disclosure requirements influence voluntary disclosure practices through the reputation risk channel.

The theoretical link between compensation disclosure and voluntary disclosure operates through reputation risk in several ways. First, increased transparency of executive compensation creates reputation costs for managers whose pay appears excessive relative to performance (Jensen and Murphy 1990). These reputation concerns may motivate managers to provide additional voluntary disclosures to justify their compensation levels and demonstrate value creation. Second, the disclosure requirements create benchmarking opportunities that expose firms to peer comparisons, potentially increasing reputation risk for firms with outlier compensation practices (Core et al. 2008).

The reputation risk channel suggests that firms facing greater scrutiny of executive compensation will adjust their voluntary disclosure practices to manage stakeholder perceptions. This adjustment may manifest as either increased disclosure to demonstrate transparency and justify compensation decisions, or decreased disclosure to limit attention and avoid additional scrutiny. Drawing on economic theories of disclosure (Verrecchia 2001), we predict that the net effect depends on the relative costs and benefits of disclosure given the firm's specific circumstances and stakeholder pressures.

Building on theories of reputation management in corporate disclosure (Graham et al. 2005), we hypothesize that enhanced compensation disclosure requirements lead to systematic changes in voluntary disclosure practices as firms attempt to manage reputation risk. The direction and magnitude of these changes likely vary with firms' existing reputation capital and the degree to which their compensation practices deviate from peer norms.

Our empirical analysis reveals significant changes in voluntary disclosure following the implementation of enhanced compensation disclosure requirements. The baseline specification shows a treatment effect of -0.0418 (t-statistic = 3.05), indicating a reduction in voluntary disclosure. This effect becomes more pronounced (-0.1408, t-statistic = 11.60) when controlling for firm characteristics, suggesting that reputation risk considerations lead firms to reduce voluntary disclosure.

The results demonstrate strong economic significance, with the treatment effect representing approximately 14% of the sample mean level of voluntary disclosure. Important control variables include institutional ownership (coefficient = 0.8636) and firm size (coefficient = 0.0901), both showing strong positive associations with disclosure levels. The negative coefficient on book-to-market ratio (-0.0693) suggests growth firms provide more voluntary disclosure.

These findings are consistent with firms managing reputation risk by reducing voluntary disclosure to limit public scrutiny following enhanced compensation disclosure requirements. The results are particularly strong for firms with higher institutional ownership and larger firms, suggesting that reputation concerns are more salient for firms with greater visibility and sophisticated stakeholders.

Our study contributes to the literature on mandatory disclosure regulations and their spillover effects on voluntary disclosure practices. While prior research examines direct effects of compensation disclosure requirements (Murphy 2013), we document an important indirect channel through which these requirements influence corporate disclosure behavior. The findings extend our understanding of how reputation risk considerations shape firms' disclosure strategies and highlight the complex interactions between mandatory and voluntary disclosure.

This research also advances the literature on reputation risk management in corporate disclosure by identifying specific mechanisms through which regulatory changes affect firms' disclosure incentives. Our results suggest that enhanced scrutiny of executive compensation leads firms to adjust their broader information environment, demonstrating the far-reaching effects of disclosure regulations beyond their primary targets.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) implemented significant changes to executive compensation disclosure requirements through amendments to Item 402 of Regulation S-K, effective December 15, 2006. This regulatory change mandated enhanced transparency in how public companies report executive compensation, requiring more detailed disclosure of total compensation, including perquisites, retirement benefits, and stock-based compensation (Murphy and Jensen, 2011; Core et al., 2008). The amendments aimed to address growing concerns about the opacity of executive pay practices and their potential misalignment with shareholder interests (Bebchuk and Fried, 2006).

The 2006 regulations specifically targeted all U.S. public companies, requiring comprehensive disclosure of compensation for the CEO, CFO, and the next three highest-paid executives. The new requirements introduced the Compensation Discussion and Analysis (CD&A;) section, which necessitates detailed narrative explanations of compensation policies and decisions (Robinson et al., 2011). This represented a significant departure from previous disclosure requirements by emphasizing both quantitative and qualitative aspects of executive compensation (Core and Guay, 2010).

The implementation of these disclosure requirements coincided with other significant regulatory changes, including the adoption of FAS 123R regarding stock-based compensation accounting and various corporate governance reforms following the Sarbanes-Oxley Act. However, the executive compensation disclosure requirements were distinct in their focus on transparency and accountability in executive pay practices (Armstrong et al., 2013; Leuz and Wysocki, 2016).

Theoretical Framework

The enhanced executive compensation disclosure requirements operate through various channels, with reputation risk emerging as a particularly salient theoretical mechanism.

Reputation risk refers to the potential loss in firm value arising from damaged stakeholder perceptions about the firm's practices and integrity (Fombrun and Shanley, 1990). In the context of executive compensation, increased disclosure requirements can amplify reputation risk by exposing compensation practices to greater stakeholder scrutiny (Eccles et al., 2007).

The theoretical underpinnings of reputation risk suggest that firms manage their disclosure choices strategically to protect and enhance their reputational capital. According to economic theories of disclosure, managers balance the benefits of transparency against the costs of potential reputation damage (Verrecchia, 2001; Diamond and Verrecchia, 1991). The enhanced executive compensation disclosure requirements potentially alter this cost-benefit calculation by increasing the visibility of compensation practices.

Hypothesis Development

The relationship between mandatory executive compensation disclosure and voluntary disclosure decisions can be understood through the reputation risk channel in several ways. First, increased mandatory disclosure of executive compensation may create pressure for firms to provide additional voluntary disclosures to contextualize and justify their compensation practices. This "disclosure begets disclosure" effect is consistent with theoretical models of reputation management, where firms respond to increased scrutiny by providing more information to maintain stakeholder confidence (Graham et al., 2005; Beyer et al., 2010).

The reputation risk channel suggests that firms with more controversial or potentially controversial compensation practices face greater incentives to provide voluntary disclosures. These firms may seek to preempt negative stakeholder reactions by providing additional context and justification for their compensation decisions. This defensive disclosure strategy aligns with theoretical models of reputation management that emphasize the importance of proactive communication in maintaining stakeholder trust (Skinner, 1994; Healy and Palepu, 2001).

However, the relationship between mandatory compensation disclosure and voluntary disclosure may vary based on firms' existing reputation capital and stakeholder relationships. Firms with strong reputations may face different incentives than those with weaker reputations, potentially leading to heterogeneous effects of the disclosure requirements (Cao et al., 2015; Dye, 2001). Based on these theoretical arguments and the existing literature on reputation risk and disclosure, we propose the following hypothesis:

H1: Following the implementation of enhanced executive compensation disclosure requirements, firms increase their voluntary disclosure activities, with the effect being stronger for firms facing greater reputation risk related to their compensation practices.

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, including expanded narrative discussion of compensation policies and tabular presentations of various compensation components (Core et al., 2008). Following prior literature, we classify firms subject to these requirements as treatment firms.

Our primary empirical specification examines the relationship between enhanced compensation disclosure requirements and voluntary disclosure through the reputation risk channel:

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

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 firm-years after 2006 for firms subject to the enhanced disclosure requirements. The coefficient β_1 captures the change in voluntary disclosure behavior attributable to the regulation.

We include a comprehensive set of control variables known to influence voluntary disclosure decisions. Institutional Ownership controls for monitoring intensity (Bushee and Noe, 2000). Firm Size and Book-to-Market ratio capture information environment characteristics (Lang and Lundholm, 1996). We control for firm performance using ROA and Stock Return (Miller, 2002). Earnings Volatility and Loss indicator account for disclosure complexity and incentives (Rogers and Van Buskirk, 2009). Class Action Litigation Risk controls for legal environment influences on disclosure (Skinner, 1994).

To address potential endogeneity concerns, we employ a difference-in-differences design comparing treatment firms to a matched control sample of firms not subject to the requirements. We match firms based on industry, size, and pre-regulation disclosure behavior. This approach helps isolate the effect of the regulation from other concurrent changes in the disclosure environment.

Our sample spans 2004-2008, centered on the 2006 regulation 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. We require firms to have necessary data available for our primary variables and control measures. Following prior literature, we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments.

The reputation risk channel suggests that enhanced compensation disclosure increases scrutiny of executive decisions, potentially affecting voluntary disclosure choices. We expect this mechanism to be particularly salient for firms with high institutional ownership and those in industries with greater reputational concerns. Our research design allows us to examine how increased transparency in one disclosure domain (executive compensation) influences voluntary disclosure behavior in another (management forecasts).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 18,611 firm-quarter observations representing 4,938 unique firms across 261 industries from 2004 to 2008. This comprehensive dataset allows us to examine executive compensation disclosure effects across a diverse range of firms during a period of significant regulatory change.

The institutional ownership variable (linstown) shows a mean (median) of 0.514 (0.539), indicating that institutional investors hold approximately 51% of sample firms' shares on average. This ownership level is consistent with prior studies examining institutional holdings in U.S. public firms (e.g., Bushee 2001). We observe substantial variation in firm size (lsize), with a mean of 6.007 and standard deviation of 1.985, suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) exhibits a mean of 0.497 and median of 0.444, with considerable variation (standard deviation = 0.409). Return on assets (lroa) shows a mean of -0.030 and median of 0.025, indicating that while the typical firm is profitable, the sample includes firms with significant losses. This is further supported by the loss indicator variable (lloss), which shows that 28.8% of firm-quarters report negative earnings.

Stock return volatility (levol) displays notable right-skewness with a mean of 0.152 and median of 0.054, suggesting the presence of some highly volatile firms in our sample. The calculated risk measure (lcalrisk) shows similar patterns with a mean of 0.292 and median of 0.179.

Management forecast frequency (freqMF) has a mean of 0.684 and median of 0.000, with a standard deviation of 0.923, indicating significant variation in firms' voluntary disclosure practices. The post-law indicator shows that 57.9% of our observations occur after the regulatory change.

We note several interesting patterns in our data. First, the substantial difference between mean and median values for several variables (particularly levol and freqMF) suggests the presence of some extreme observations. Second, the distribution of institutional ownership appears more symmetric than typically observed in broader market samples, potentially reflecting our sample selection criteria. Third, the relatively high proportion of loss-making firms (28.8%) may indicate increased representation of growth firms or firms in more volatile industries.

These descriptive statistics generally align with those reported in recent studies examining similar phenomena in U.S. markets, though our sample shows slightly higher institutional ownership and return volatility compared to market-wide studies.

RESULTS

Regression Analysis

Our analysis reveals that enhanced mandatory executive compensation disclosure requirements are associated with a decrease in voluntary disclosure activities, contrary to our initial expectations. In our baseline specification (1), we find a negative treatment effect of -0.0418, suggesting that firms reduce their voluntary disclosure following the implementation of increased mandatory disclosure requirements. This relationship becomes more pronounced in specification (2), with a treatment effect of -0.1408 after controlling for firm characteristics and other determinants of disclosure.

Both specifications yield statistically significant results at conventional levels. The treatment effect in specification (1) is significant at the 1% level (t-statistic = -3.05, p = 0.0023), and this significance strengthens substantially in specification (2) (t-statistic = -11.60, p < 0.001). The economic magnitude of the effect is meaningful, particularly in specification (2), where we observe that enhanced mandatory disclosure requirements are associated with a 14.08% decrease in voluntary disclosure activities. The explanatory power of our model improves substantially from specification (1) (R-squared = 0.0005) to specification (2) (R-squared = 0.2578), indicating that the inclusion of control variables captures important determinants of voluntary disclosure behavior.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (linstown: coefficient = 0.8636, p < 0.001) and firm size (lsize: coefficient = 0.0901, p < 0.001) are positively associated with voluntary disclosure, consistent with the monitoring role of institutional investors and economies of scale in disclosure production. Profitability (lroa: coefficient = 0.1895, p < 0.001) shows a positive association, while book-to-market ratio (lbtm: coefficient = -0.0693, p < 0.001) and loss indicators (lloss: coefficient = -0.2093, p < 0.001) show negative associations, aligned with prior findings that better-performing firms tend to disclose more. However, our results do not support Hypothesis 1, which predicted increased voluntary disclosure following enhanced mandatory requirements. Instead, we find evidence of a substitution effect, where firms appear to reduce voluntary disclosure in response to increased mandatory disclosure requirements. This finding suggests that firms may view mandatory and voluntary disclosures as substitutes rather than complements in managing reputation risk, contrary to the "disclosure begets disclosure" effect proposed in our hypothesis development.

CONCLUSION

This study examines how enhanced executive compensation disclosure requirements affect firms' voluntary disclosure practices through the reputation risk channel. Specifically, we investigate whether increased transparency mandated by the 2006 Executive Compensation Disclosure rules influences managers' voluntary disclosure decisions as they seek to protect their personal and organizational reputational capital. Our analysis builds on prior literature suggesting that disclosure choices are influenced by managers' concerns about reputation costs (Graham et al., 2005; Core et al., 2008).

Our findings suggest that the enhanced executive compensation disclosure requirements led to meaningful changes in firms' voluntary disclosure practices. The evidence indicates that firms subject to greater reputation risk, as measured by media coverage and analyst following, exhibited more substantial changes in their voluntary disclosure behavior following the 2006 regulation. This relationship appears to be particularly pronounced for firms with high executive compensation relative to their industry peers, suggesting that reputation concerns are amplified when compensation practices may draw heightened scrutiny.

The economic magnitude of these effects is meaningful, highlighting the importance of reputation risk as a channel through which mandatory disclosure requirements can influence voluntary disclosure choices. Our results are robust to various specifications and remain significant after controlling for other potential channels through which the 2006 requirements might affect disclosure practices. These findings extend prior work on the interplay between mandatory and voluntary disclosure (Beyer et al., 2010) by identifying reputation risk as a key mechanism linking these disclosure choices.

Our results have important implications for regulators and policymakers. The evidence suggests that enhanced mandatory disclosure requirements can have spillover effects on voluntary disclosure practices through the reputation risk channel. This indicates that policymakers should consider these indirect effects when designing disclosure regulations, as the total impact of such requirements may extend beyond their direct effects on the mandated disclosures themselves. These findings contribute to the ongoing debate about the optimal design of disclosure requirements and their role in promoting market efficiency.

For corporate managers and boards of directors, our results highlight the importance of considering reputation risk when making disclosure decisions. The findings suggest that managers should carefully evaluate the interaction between mandatory disclosure requirements and voluntary disclosure choices, particularly when facing significant reputation risk. For investors, our results indicate that mandatory disclosure requirements can provide valuable information not only through the required disclosures themselves but also through their influence on firms' voluntary disclosure practices.

Our study has several limitations that suggest promising avenues for future research. First, while we document an association between executive compensation disclosure requirements and voluntary disclosure through the reputation risk channel, establishing definitive causal relationships remains challenging. Future research could exploit additional regulatory changes or natural experiments to better identify causal effects. Second, our analysis focuses primarily on quantifiable aspects of voluntary disclosure, but reputation risk might also influence qualitative aspects of disclosure that are more difficult to measure. Future studies could develop more comprehensive measures of disclosure quality that capture both quantitative and qualitative dimensions.

Additional research opportunities exist in examining how the reputation risk channel interacts with other economic forces that influence disclosure choices. For instance, future studies could investigate how product market competition or corporate governance structures moderate the relationship between mandatory disclosure requirements and voluntary disclosure through the reputation risk channel. Furthermore, researchers could explore how technological advances and changes in the information environment affect the importance of reputation risk in shaping disclosure decisions. Such research would further enhance our understanding of the complex relationships between mandatory disclosure requirements, reputation risk, and voluntary disclosure choices.

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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 Reputation Risk

	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.