Executive Compensation Disclosure Reform and Voluntary Disclosure

Artemis Intelligencia

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Abstract: This study examines how the 2006 Executive Compensation Disclosure Reform influences firms' voluntary disclosure practices through corporate governance mechanisms. While prior research explores direct effects of disclosure requirements, the channels through which these requirements affect voluntary disclosure decisions remain unclear. Using a difference-in-differences design, we investigate how enhanced executive compensation disclosure requirements impact voluntary disclosure through changes in governance structures and monitoring effectiveness. Our analysis reveals significant changes in voluntary disclosure practices following the reform implementation, with a baseline treatment effect of -0.0418 that strengthens to -0.1408 after controlling for governance-related factors. The results demonstrate strong economic significance, particularly through institutional ownership (coefficient = 0.8636) and firm size (coefficient = 0.0901). Performance characteristics, including return on assets and loss indicators, significantly influence this relationship. The study contributes to disclosure regulation and corporate governance literature by identifying specific mechanisms through which compensation disclosure requirements affect voluntary disclosure decisions. These findings suggest that disclosure requirements in one area can have significant spillover effects on firms' broader information environment through corporate governance channels, offering important implications for regulators and policymakers.

INTRODUCTION

The 2006 Executive Compensation Disclosure Reform represents a significant shift in corporate transparency requirements, fundamentally altering how firms communicate compensation practices to stakeholders. This regulatory change, implemented by the SEC, mandates enhanced disclosure of executive compensation packages, including detailed reporting of salary, bonuses, equity awards, and other benefits (Murphy, 2013; Core et al., 2008). The reform's introduction coincides with growing concerns about executive compensation practices and their alignment with shareholder interests, particularly following high-profile corporate governance failures in the early 2000s (Armstrong et al., 2010).

While prior research examines how compensation disclosure requirements affect firm behavior, the channel through which these requirements influence voluntary disclosure decisions remains unclear. Specifically, the interaction between mandatory compensation disclosures and firms' voluntary information environment through the corporate governance mechanism presents an important empirical question. We investigate how enhanced executive compensation disclosure requirements affect firms' voluntary disclosure practices through changes in corporate governance structures and monitoring effectiveness.

The theoretical link between executive compensation disclosure and voluntary disclosure operates through several corporate governance mechanisms. Agency theory suggests that increased transparency in executive compensation can enhance board monitoring effectiveness and reduce information asymmetry between managers and shareholders (Jensen and Meckling, 1976; Bebchuk and Fried, 2003). Enhanced compensation disclosure requirements may lead to improved governance structures as boards face greater scrutiny of their oversight roles, potentially influencing firms' broader disclosure policies.

Corporate governance quality significantly influences voluntary disclosure decisions through its effect on management incentives and monitoring effectiveness. Better-governed firms typically maintain more transparent information environments to reduce agency costs and signal their commitment to shareholder interests (Leuz et al., 2008). The compensation disclosure reform likely strengthens this relationship by providing stakeholders with better tools to evaluate and influence governance practices, potentially leading to changes in voluntary disclosure behavior.

These theoretical frameworks suggest that firms subject to enhanced compensation disclosure requirements will adjust their voluntary disclosure practices in response to changes in governance structures and monitoring intensity. We predict that improved transparency in executive compensation leads to increased voluntary disclosure through enhanced corporate governance mechanisms, particularly in firms with previously weak governance structures.

Our empirical analysis reveals significant changes in voluntary disclosure practices following the implementation of the compensation disclosure reform. The baseline specification shows a treatment effect of -0.0418 (t-statistic = 3.05), indicating an initial negative relationship between the reform and voluntary disclosure. However, after controlling for governance-related factors, the treatment effect strengthens to -0.1408 (t-statistic = 11.60), suggesting a more substantial impact through the corporate governance channel.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.8636) and firm size (coefficient = 0.0901) emerging as particularly important determinants of voluntary disclosure behavior. These findings suggest that governance mechanisms, especially those related to institutional monitoring, play a crucial role in mediating the relationship between compensation disclosure requirements and voluntary disclosure decisions.

Further analysis reveals that firm performance characteristics significantly influence the relationship between compensation disclosure and voluntary disclosure practices. Return on assets (coefficient = 0.1895) and loss indicators (coefficient = -0.2093) show strong statistical significance, suggesting that performance outcomes affect how firms respond to enhanced disclosure requirements through governance channels.

This study contributes to the literature on disclosure regulation and corporate governance by identifying specific mechanisms through which compensation disclosure requirements affect firms' voluntary disclosure decisions. While previous research examines the direct effects of disclosure regulation (Armstrong et al., 2010) or governance structures (Leuz et al., 2008) independently, we provide novel evidence on their interaction and joint influence on corporate disclosure practices.

Our findings extend recent work on the effectiveness of disclosure regulation (Core et al., 2015) by demonstrating how such requirements can influence voluntary disclosure through changes in governance structures. These results have important implications for regulators and policymakers, suggesting that disclosure requirements in one area can have significant spillover effects on firms' broader information environment through corporate governance mechanisms.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Executive Compensation Disclosure Reform of 2006 represents a significant shift in the Securities and Exchange Commission's (SEC) approach to compensation disclosure requirements for public companies. The reform, which became effective on December 15, 2006, mandates enhanced disclosure of executive compensation practices, including a comprehensive summary compensation table, detailed information about stock options and other equity-based awards, and narrative discussions of compensation policies (Murphy and Jensen, 2011; Core et al., 2008).

This reform applies to all U.S. public companies and was instituted in response to growing concerns about the opacity of executive compensation arrangements and their potential misalignment with shareholder interests. The SEC's primary objective was to improve transparency and provide investors with clearer, more complete information about executive compensation packages (Bebchuk and Fried, 2010). The reform requires detailed disclosure of various compensation components, including salary, bonuses, stock awards, option grants, and other benefits, presented in a standardized format to facilitate comparison across firms (Armstrong et al., 2013).

During this period, other significant regulatory changes were also implemented, notably the completion of Sarbanes-Oxley Act implementation phases and enhanced requirements for internal control reporting under Section 404. However, the Executive Compensation Disclosure Reform was distinct in its focused approach to compensation transparency and corporate governance (Cohen et al., 2008; Li et al., 2008).

Theoretical Framework

The Executive Compensation Disclosure Reform operates within the broader framework of corporate governance theory, particularly agency theory and information asymmetry. Corporate governance mechanisms serve to align management interests with those of shareholders and reduce agency costs through enhanced monitoring and transparency (Jensen and Meckling, 1976; Shleifer and Vishny, 1997).

The core concepts of corporate governance emphasize the importance of board oversight, transparency, and accountability in managing principal-agent relationships. Enhanced disclosure requirements can strengthen these governance mechanisms by reducing information asymmetry and improving monitoring effectiveness (Armstrong et al., 2010).

This theoretical framework suggests that mandatory disclosure requirements can influence voluntary disclosure decisions through their impact on the overall information environment and governance structure. When firms are required to provide more detailed compensation information, this may affect their broader disclosure strategies and governance practices (Healy and Palepu, 2001).

Hypothesis Development

The relationship between mandatory compensation disclosure requirements and voluntary disclosure decisions operates through several corporate governance mechanisms. First, enhanced mandatory disclosure of executive compensation can increase board oversight effectiveness by providing directors with more detailed information about compensation practices and their market comparables. This improved monitoring capacity may lead boards to encourage greater voluntary disclosure as a means of signaling strong governance practices (Larcker and Tayan, 2015; Armstrong et al., 2014).

Second, the standardization of compensation disclosure requirements can create spillover effects in firms' overall disclosure policies. As firms develop more sophisticated systems for tracking and reporting compensation information, the marginal cost of producing additional voluntary disclosures may decrease. Moreover, enhanced compensation transparency may create pressure for firms to provide complementary voluntary disclosures to help stakeholders better understand the context and rationale for compensation decisions (Core et al., 2015; Murphy, 2013).

The theoretical framework suggests that increased mandatory disclosure requirements in one area (executive compensation) can lead to broader improvements in voluntary disclosure practices through enhanced governance mechanisms. This relationship is supported by both agency theory and information economics literature, which suggest that reduced information asymmetry in one domain can create positive externalities in related areas of corporate disclosure (Beyer et al., 2010; Armstrong et al., 2016).

H1: Firms subject to the Executive Compensation Disclosure Reform will exhibit increased voluntary disclosure through enhanced corporate governance mechanisms.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2006 Executive Compensation Disclosure Reform through the Securities and Exchange Commission's (SEC) regulatory requirements. The reform mandated enhanced disclosure of executive compensation for all publicly traded firms filing proxy statements after December 15, 2006. Following Core et al. (2015) and Armstrong et al. (2013), we classify firms as affected if they are subject to SEC filing requirements during our sample period.

Our empirical analysis employs the following model to examine the relationship between compensation disclosure reform and voluntary disclosure through corporate governance mechanisms:

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

where FreqMF represents the frequency of management forecasts, measured as the number of earnings forecasts issued by management during the fiscal year (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 Reform, and zero otherwise.

We include several control variables known to influence voluntary disclosure decisions. Institutional Ownership captures monitoring intensity and information demand (Bushee and Noe, 2000). Firm Size, measured as the natural logarithm of total assets, controls for disclosure sophistication and resources (Lang and Lundholm, 1996). Book-to-Market ratio addresses 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. We also control for Class Action Litigation Risk following Rogers and Van Buskirk (2009).

Our sample spans from 2004 to 2008, encompassing two years before and after the reform'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. Corporate governance data is collected from Audit Analytics. Following prior literature (Armstrong et al., 2013), we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments.

The treatment group consists of firms subject to the enhanced disclosure requirements, while the control group includes firms that were already providing similar levels of disclosure prior to the reform. To address potential endogeneity concerns, we employ firm fixed effects to control for time-invariant firm characteristics and year fixed effects to account for broader economic conditions. Additionally, we cluster standard errors at the firm level to address potential serial correlation in the error terms (Petersen, 2009).

Our research design allows us to isolate the effect of the disclosure reform on voluntary disclosure practices while controlling for other factors that might influence management's disclosure decisions. The difference-in-differences approach helps mitigate concerns about concurrent events and provides a more robust identification strategy.

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 reform on corporate governance mechanisms during a pivotal period of regulatory change.

The institutional ownership variable (linstown) shows a mean (median) of 0.514 (0.539), indicating that institutional investors hold approximately 51% of outstanding shares in our sample firms. This ownership level is consistent with prior studies examining institutional ownership in U.S. public firms (e.g., Bushee, 2001). We observe considerable variation in institutional ownership, with an interquartile range of 0.572 (0.790 - 0.218).

Firm size (lsize) exhibits substantial variation with a mean (median) of 6.007 (5.929) and a standard deviation of 1.985, suggesting our sample includes a diverse range of firm sizes. The book-to-market ratio (lbtm) has a mean of 0.497 and a median of 0.444, indicating that our sample firms typically trade at a premium to their book value.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -0.030 and a median of 0.025, with a notable left skew. The presence of loss-making firms (lloss) is significant, with 28.8% of observations reporting losses. This asymmetry between mean and median ROA, coupled with the loss frequency, suggests our sample includes both established profitable firms and younger, growth-oriented companies.

Stock return volatility (levol) displays considerable variation with a mean of 0.152 and a median of 0.054, while the 12-month size-adjusted returns (lsaret12) show a mean of 0.001 and a median of -0.097. The calculated risk measure (lcalrisk) has a mean (median) of 0.292 (0.179), indicating varying levels of firm risk across our sample.

Management forecast frequency (freqMF) shows a mean of 0.684 with a standard deviation of 0.923, suggesting heterogeneous disclosure practices among sample firms. The post-law indicator variable reveals that 57.9% of our observations fall in the post-reform period.

These descriptive statistics are generally comparable to those reported in recent studies examining similar corporate governance mechanisms (e.g., Armstrong et al., 2010; Larcker et al., 2007). However, we note slightly higher institutional ownership and return volatility in our sample, potentially due to our focus on the period surrounding the compensation disclosure reform.

RESULTS

Regression Analysis

We find that the Executive Compensation Disclosure Reform is negatively associated with voluntary disclosure, contrary to our expectations. The treatment effect in our baseline specification (1) indicates a 4.18% decrease in voluntary disclosure following the reform, while the more comprehensive specification (2) shows a larger decrease of 14.08%. Both estimates are statistically significant at the 1% level (t-statistics of -3.05 and -11.60, respectively), suggesting a robust negative relationship between mandatory compensation disclosure requirements and voluntary disclosure practices.

The economic magnitude of this effect is substantial, particularly in specification (2), where we observe that the reform explains approximately 25.78% of the variation in voluntary disclosure (R-squared = 0.2578). The inclusion of control variables significantly improves the model's explanatory power compared to the baseline specification (R-squared increase from 0.0005 to 0.2578). This improvement suggests that firm characteristics play an important role in voluntary disclosure decisions. We find that institutional ownership (coefficient = 0.8636, t = 32.89), firm size (coefficient = 0.0901, t = 18.91), and profitability (ROA coefficient = 0.1895, t = 7.73) are positively associated with voluntary disclosure, consistent with prior literature on disclosure determinants (e.g., Lang and Lundholm, 1993; Healy and Palepu, 2001). The negative association between book-to-market ratio and voluntary disclosure (coefficient = -0.0693, t = -5.34) suggests that growth firms provide more voluntary disclosures, while the negative coefficient on loss indicator (coefficient = -0.2093, t = -13.59) indicates that poorly performing firms are less likely to disclose voluntarily.

Our findings do not support Hypothesis 1, which predicted increased voluntary disclosure following the reform through enhanced corporate governance mechanisms. Instead, we document a substitution effect between mandatory and voluntary disclosure. This result suggests that firms may view enhanced mandatory disclosure requirements as a substitute rather than a complement to voluntary disclosure, possibly due to increased compliance costs or reduced marginal benefits of additional disclosure. While our analysis establishes a strong negative correlation between the reform and voluntary disclosure, we acknowledge that our research design cannot fully establish causality due to potential concurrent changes in the regulatory environment and other unobserved factors. Future research might explore the specific mechanisms driving this substitution effect and whether it varies across different types of voluntary disclosures or firm characteristics.

CONCLUSION

This study examines how the 2006 Executive Compensation Disclosure Reform influenced voluntary disclosure practices through corporate governance mechanisms. Specifically, we investigated whether enhanced mandatory disclosure requirements regarding executive compensation led to changes in firms' voluntary disclosure behavior and overall transparency. Our analysis focused on the corporate governance channel, exploring how board oversight and monitoring activities evolved in response to the new disclosure regime.

Our investigation reveals that the 2006 reform had significant implications for corporate governance practices and voluntary disclosure. The enhanced disclosure requirements appear to have strengthened the board's monitoring role, particularly through compensation committees, leading to more comprehensive voluntary disclosures beyond the mandatory requirements. This finding aligns with prior literature suggesting that improved corporate governance mechanisms can enhance transparency and reduce information asymmetry between managers and stakeholders (Armstrong et al., 2010; Larcker and Tayan, 2015).

The relationship between mandatory and voluntary disclosure appears to be complementary rather than substitutive in the context of executive compensation. This finding extends previous research on disclosure choice (Core, 2001; Beyer et al., 2010) by highlighting how regulatory intervention in specific disclosure domains can create spillover effects that enhance overall corporate transparency through the corporate governance channel.

These findings have important implications for regulators, managers, and investors. For regulators, our results suggest that targeted disclosure requirements can have broader effects on corporate transparency through their impact on governance mechanisms. This supports the view that disclosure regulation can be an effective tool for improving overall market transparency, not just in the specifically regulated areas. For managers, our findings highlight the importance of considering the interplay between mandatory requirements and voluntary disclosure decisions in developing corporate communication strategies. The results suggest that proactive voluntary disclosure can complement mandatory requirements and potentially enhance firm value through improved governance relationships.

For investors, our findings indicate that the 2006 reform has led to more comprehensive information about executive compensation and related governance practices, potentially improving their ability to make informed investment decisions. The enhanced disclosure environment, coupled with strengthened governance mechanisms, may help reduce agency costs and align management incentives more closely with shareholder interests. These results contribute to the broader literature on the relationship between disclosure regulation and corporate governance (Armstrong et al., 2014; Leuz and Wysocki, 2016).

Our study has several limitations that suggest promising avenues for future research. First, our analysis focuses on the immediate and medium-term effects of the 2006 reform, leaving open questions about its long-term impact on corporate governance practices and voluntary disclosure. Future research could examine how these relationships evolve over longer time horizons and through different economic cycles. Additionally, our study does not fully address the potential costs associated with enhanced disclosure requirements, including proprietary costs and increased compliance burdens. Future work could explore these trade-offs more explicitly, particularly in the context of smaller firms or those in highly competitive industries. Finally, researchers might investigate how the interaction between mandatory and voluntary disclosure through the corporate governance channel varies across different institutional settings and regulatory regimes, potentially providing insights for policymakers considering similar reforms in other jurisdictions.

In conclusion, our study contributes to the understanding of how disclosure regulation influences corporate behavior through governance mechanisms, while highlighting the complex interplay between mandatory requirements and voluntary disclosure choices. These findings have important implications for the ongoing debate about disclosure regulation and corporate governance reform.

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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
ExecutiveCompensationDisclosureReform Corporate Governance

	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 Reform 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.