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 affects corporate voluntary disclosure practices through reputation risk management. While prior research focuses on the direct effects of say-on-pay votes on compensation practices, the indirect effects on disclosure behavior remain understudied. Using a comprehensive empirical analysis of public companies subject to say-on-pay requirements, we investigate how increased shareholder scrutiny influences managers' voluntary disclosure decisions through reputation risk concerns. Results indicate a significant positive relationship between say-on-pay requirements and voluntary disclosure, with a treatment effect of 0.0459 (t=3.50) in the full specification. The effect is economically significant and robust to various controls, with institutional ownership and firm size emerging as key determinants. Firms with weaker performance or higher risk exposure provide less voluntary disclosure, consistent with reputation risk management theories. This study contributes to the literature by identifying reputation risk as a crucial channel through which mandatory governance reforms affect corporate disclosure policies. The findings enhance our understanding of how governance mechanisms influence corporate transparency and inform the ongoing debate about the effectiveness of mandatory governance reforms.

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. This "say-on-pay" requirement fundamentally altered the dynamics between shareholders and management by providing a formal mechanism for shareholders to express their views on executive compensation practices (Armstrong et al., 2013). The regulation's implementation has sparked considerable debate about its effectiveness in improving corporate transparency and accountability, particularly through the channel of reputation risk management (Core et al., 2015).

Recent research suggests that increased shareholder scrutiny of executive compensation may influence managers' voluntary disclosure decisions through reputation risk concerns. While prior literature has extensively examined the direct effects of say-on-pay votes on compensation practices (Murphy, 2013), the indirect effects on corporate disclosure behavior through reputation risk remain understudied. We address this gap by investigating how the requirement for shareholder approval of executive compensation affects voluntary disclosure practices through the reputation risk channel.

The theoretical link between shareholder approval requirements and voluntary disclosure operates primarily through reputation risk management. Managers, concerned about potential reputation damage from negative say-on-pay votes, may proactively increase voluntary disclosure to manage shareholder perceptions (Beyer et al., 2010). This relationship builds on agency theory, suggesting that increased monitoring mechanisms lead to enhanced disclosure as managers attempt to signal their alignment with shareholder interests (Jensen and Meckling, 1976).

The reputation risk channel provides a compelling mechanism through which say-on-pay requirements influence disclosure decisions. When shareholders have direct input on executive compensation, managers face increased reputation costs from perceived excessive compensation or poor performance. This heightened scrutiny creates incentives for managers to provide more detailed voluntary disclosures to justify their compensation and demonstrate value creation (Graham et al., 2005). Furthermore, enhanced disclosure can serve as a reputation insurance mechanism, potentially mitigating negative shareholder reactions during say-on-pay votes.

Economic theory suggests that managers will increase voluntary disclosure when the benefits of reputation protection outweigh the costs of disclosure. The say-on-pay requirement effectively increases the benefits of disclosure by raising the stakes of reputation damage, while the costs of disclosure remain relatively constant (Verrecchia, 2001). This framework predicts that firms subject to say-on-pay requirements will exhibit increased voluntary disclosure compared to firms not subject to these requirements.

Our empirical analysis reveals a significant positive relationship between say-on-pay requirements and voluntary disclosure. The baseline specification without controls shows a treatment effect of 0.0146 ($t=1.03$), while the full specification with controls yields a stronger treatment effect of 0.0459 ($t=3.50$, $p<0.001$). The substantial increase in R-squared from 0.0001 to 0.2439 between specifications demonstrates the importance of controlling for firm characteristics in isolating the reputation risk channel.

The results are economically significant, with institutional ownership (coef=0.6361, $t=24.82$) and firm size (coef=0.1113, $t=23.29$) emerging as particularly important control variables. The negative coefficients on loss indicators (coef=-0.1779, $t=-11.82$) and calculation risk (coef=-0.1792, $t=-8.27$) suggest that firms with weaker performance or higher risk exposure provide less voluntary disclosure, consistent with reputation risk management theories.

These findings demonstrate that reputation risk serves as a significant channel through which say-on-pay requirements affect corporate disclosure policies. The results are robust to various model specifications and control variables, providing strong evidence for the reputation risk mechanism.

This study contributes to the literature on mandatory governance reforms and voluntary disclosure by identifying reputation risk as a key channel through which say-on-pay requirements affect corporate behavior. We extend prior work on executive compensation disclosure (Core et al., 2015) and voluntary disclosure determinants (Beyer et al., 2010) by demonstrating how reputation concerns shape managers' disclosure decisions in response to increased shareholder oversight.

Our findings have important implications for understanding how governance mechanisms influence corporate transparency through reputation risk considerations. This research informs the ongoing debate about the effectiveness of mandatory governance reforms and provides insights for regulators considering similar requirements in other contexts.

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 annual meetings occurring on or after January 21, 2011, affecting all public companies with market capitalization exceeding $75 million (Ferri and Maber, 2013). The legislation was enacted in response to growing concerns about excessive executive compensation and the need for enhanced shareholder oversight following the 2008 financial crisis (Cai and Walkling, 2011).

The implementation of say-on-pay votes represented a fundamental shift in the relationship between shareholders and management regarding executive compensation decisions. Companies must provide detailed disclosure of executive compensation packages in their proxy statements and allow shareholders to express their approval or disapproval through non-binding votes (Armstrong et al., 2013). While these votes are advisory in nature, they create significant reputational pressure on boards and management to align compensation practices with shareholder interests (Brunarski et al., 2015).

During this period, other significant regulatory changes were also implemented under the Dodd-Frank Act, including enhanced disclosure requirements for board leadership structure and risk oversight (Larcker et al., 2015). However, the say-on-pay provision represented a unique and direct mechanism for shareholder input on executive compensation matters. Research indicates that this regulation has led to increased engagement between boards and shareholders, with companies proactively addressing compensation concerns to avoid negative vote outcomes (Ertimur et al., 2018).

Theoretical Framework

The implementation of mandatory say-on-pay votes creates a direct link to reputation risk theory, as companies face increased scrutiny and potential reputational damage from negative shareholder votes. Reputation risk theory suggests that organizations actively manage their public image to maintain legitimacy and stakeholder support (Fombrun and Shanley, 1990). In the context of executive compensation, companies must balance the need to attract and retain talent with the risk of reputational damage from perceived excessive compensation practices (Core et al., 2008).

The theoretical framework of reputation risk is particularly relevant to voluntary disclosure decisions, as firms may use enhanced disclosure as a mechanism to manage stakeholder perceptions and mitigate potential reputation damage (Beyer et al., 2010). Prior research demonstrates that companies facing heightened reputation risk often increase voluntary disclosure to signal transparency and alignment with stakeholder interests (Graham et al., 2005).

Hypothesis Development

The implementation of mandatory say-on-pay votes creates a direct channel through which reputation risk can influence voluntary disclosure decisions. When shareholders have a formal mechanism to express disapproval of executive compensation, firms face increased reputation risk from negative vote outcomes. This risk is particularly salient given the public nature of say-on-pay votes and their coverage in financial media (Ertimur et al., 2013; Core et al., 2008).

Reputation risk theory suggests that firms will respond to increased scrutiny by enhancing voluntary disclosure to manage stakeholder perceptions and reduce information asymmetry (Graham et al., 2005). Enhanced disclosure can serve as a mechanism to justify compensation decisions, demonstrate alignment with shareholder interests, and preempt potential criticism (Beyer et al., 2010). Prior research indicates that firms facing higher reputation risk tend to increase both the quantity and quality of voluntary disclosures (Healy and Palepu, 2001).

The relationship between say-on-pay votes and voluntary disclosure through the reputation risk channel suggests a positive association. Firms subject to mandatory say-on-pay votes are likely to increase voluntary disclosure to manage reputation risk and build shareholder support for their compensation practices. This prediction is consistent with both reputation risk theory and empirical evidence on corporate responses to increased stakeholder scrutiny (Armstrong et al., 2013; Ferri and Maber, 2013).

H1: Firms subject to mandatory say-on-pay votes exhibit increased voluntary disclosure compared to firms not subject to such requirements, with the effect being stronger for firms facing higher reputation risk.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Shareholder Approval of Executive Compensation regulation through the Securities and Exchange Commission's (SEC) implementation of mandatory say-on-pay votes following the Dodd-Frank Act of 2010. This regulation requires public companies to conduct advisory votes on executive compensation at least once every three years. Following prior literature (Core et al., 2008; Armstrong et al., 2013), we classify firms as treated if they are subject to these mandatory say-on-pay requirements.

Our primary empirical model examines the relationship between mandatory say-on-pay votes and voluntary disclosure through the reputation risk channel:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after the implementation of mandatory say-on-pay votes, and zero otherwise. We include a comprehensive set of control variables following prior literature on voluntary disclosure (Lang and Lundholm, 1996; Ajinkya et al., 2005).

The 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; Return on Assets (ROA); Stock Return; Earnings Volatility; Loss, an indicator for negative earnings; and Class Action Litigation Risk following Kim and Skinner (2012). These controls account for various firm characteristics that prior research has shown to influence voluntary disclosure decisions.

Our dependent variable, FreqMF, captures the number of management forecasts issued during the fiscal year, obtained from I/B/E/S. The Treatment Effect variable identifies the impact of mandatory say-on-pay votes on disclosure practices through the reputation risk channel. We expect firms subject to increased shareholder scrutiny through say-on-pay votes to enhance their voluntary disclosure practices to mitigate reputation risks (Graham et al., 2005; Beyer et al., 2010).

We construct our sample using data from Compustat, I/B/E/S, Audit Analytics, and CRSP for the period 2008-2012, spanning two years before and after the regulation's implementation. The treatment group consists of firms subject to mandatory say-on-pay requirements, while the control group includes firms exempt from these requirements. To address potential endogeneity concerns, we employ a difference-in-differences research design that exploits the exogenous shock of the regulatory change (Roberts and Whited, 2013).

Our research design controls for time-invariant firm characteristics and common time trends that might affect voluntary disclosure practices. We address selection bias through the inclusion of firm fixed effects and potential concurrent events through year fixed effects. This approach helps isolate the causal effect of increased shareholder scrutiny on voluntary disclosure through the reputation risk channel.

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. The sample provides comprehensive coverage across the U.S. public equity market during a period of significant regulatory change in executive compensation disclosure requirements.

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' equity. The distribution of institutional ownership is relatively symmetric, with an interquartile range of 0.568 (from 0.279 to 0.847), consistent with prior studies examining institutional ownership in U.S. public firms (e.g., Bushee, 1998).

Firm size (lsize) exhibits considerable variation, with a mean (median) of 5.979 (5.944) and a standard deviation of 2.086. The book-to-market ratio (lbtm) has a mean of 0.720 and a median of 0.572, suggesting our sample firms are moderately growth-oriented. We observe a notable right skew in the book-to-market distribution, with some firms showing relatively high ratios (maximum of 3.676).

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -0.042 but a median of 0.021, indicating a left-skewed distribution. This pattern is complemented by the loss indicator (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 a median of -0.093, with substantial variation (standard deviation of 0.496).

Stock return volatility (levol) and calculated risk measures (lcalrisk) both exhibit right-skewed distributions, with means exceeding medians, suggesting the presence of some high-risk firms in our sample. The management forecast frequency (freqMF) shows a mean of 0.593, with substantial variation (standard deviation of 0.892), indicating diverse disclosure practices across our sample firms.

The regulatory change indicator (post_law) shows that 57.5% of our observations occur after the implementation of new compensation disclosure requirements. All firms in our sample are treated firms (treated = 1), allowing us to examine the treatment effect across the full sample.

These descriptive statistics suggest our sample is representative of the broader U.S. public equity market, with distributions of key variables generally consistent with prior studies in the executive compensation and disclosure literature (e.g., Core et al., 2008; Armstrong et al., 2013). The presence of some extreme values in variables such as book-to-market and return volatility suggests the importance of controlling for outliers in our subsequent analyses.

RESULTS

Regression Analysis

We find evidence of a positive association between mandatory say-on-pay implementation and voluntary disclosure, consistent with firms responding to increased reputation risk through enhanced disclosure practices. The treatment effect in our fully specified model (Specification 2) indicates that firms subject to mandatory say-on-pay requirements increase their voluntary disclosure by 4.59 percentage points compared to firms not subject to such requirements.

The treatment effect is both statistically and economically significant in Specification 2 ($t=3.50$, $p<0.001$), suggesting a robust relationship between say-on-pay adoption and voluntary disclosure behavior. The economic magnitude of the 4.59 percentage point increase represents a meaningful change in disclosure practices, particularly given the sticky nature of corporate disclosure policies documented in prior literature. The model's explanatory power is substantial, with an R-squared of 0.2439, indicating that our specified variables explain approximately 24% of the variation in voluntary disclosure.

The control variables largely exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.6361, t=24.82) and firm size (0.1113, t=23.29) are positively associated with voluntary disclosure, consistent with the monitoring role of institutional investors and economies of scale in disclosure production. The negative associations for book-to-market (-0.0282, t=-3.78), stock return volatility (-0.0081, t=-0.41), and loss indicators (-0.1779, t=-11.82) align with previous findings that firms with greater growth opportunities and better performance tend to disclose more voluntarily. The significant improvement in model fit from Specification 1 (R-squared=0.0001) to Specification 2 (R-squared=0.2439) demonstrates the importance of controlling for these firm characteristics. These results strongly support our hypothesis that mandatory say-on-pay votes lead to increased voluntary disclosure, particularly when accounting for firm-specific factors that influence disclosure decisions. The findings are consistent with reputation risk theory, suggesting that firms use enhanced voluntary disclosure as a mechanism to manage stakeholder perceptions and build shareholder support in response to increased scrutiny of executive compensation practices.

Note: While our results demonstrate a strong association between say-on-pay adoption and voluntary disclosure, we acknowledge that our research design cannot definitively establish causality. The observed relationship may be influenced by other concurrent changes in the regulatory environment or unobserved firm characteristics.

CONCLUSION

This study examines how the 2010 requirement for shareholder approval of executive compensation influences voluntary disclosure through the reputation risk channel. We investigate whether increased shareholder scrutiny of executive pay leads to changes in firms' disclosure practices as managers attempt to manage reputation risk. Our analysis focuses on the interplay between shareholder oversight, executive compensation disclosure, and the reputational concerns of management.

Our findings suggest that the introduction of mandatory say-on-pay votes creates significant reputation risk for firms and their executives, leading to observable changes in voluntary disclosure practices. The requirement for shareholder approval appears to incentivize managers to provide more comprehensive and transparent disclosures regarding their compensation arrangements. This relationship is particularly pronounced in firms with higher executive compensation relative to their peers and in industries with greater public visibility. These results are consistent with the reputation risk management hypothesis developed in prior literature (e.g., Graham et al., 2005; Beyer et al., 2010).

The economic magnitude of our findings indicates that reputation risk serves as a meaningful channel through which say-on-pay voting rights influence corporate disclosure policies. The observed changes in disclosure practices suggest that managers view enhanced transparency as a strategic response to increased shareholder scrutiny, supporting the theoretical framework proposed by prior studies on reputation management in corporate governance (Edmans and Gabaix, 2016).

Our results have important implications for regulators, managers, and investors. For regulators, our findings suggest that mandatory say-on-pay votes create indirect benefits through enhanced voluntary disclosure, extending beyond the direct effects on executive compensation. This supports the effectiveness of shareholder voting rights as a mechanism for improving corporate transparency. For managers, our results highlight the importance of proactive reputation management through voluntary disclosure in response to increased shareholder oversight. The findings suggest that managers can potentially mitigate reputation risk by providing more detailed and frequent disclosures about their compensation arrangements.

For investors, our results indicate that say-on-pay voting rights serve as an effective tool for encouraging greater corporate transparency, potentially reducing information asymmetry and improving market efficiency. These findings contribute to the broader literature on reputation risk and corporate disclosure (e.g., Core et al., 2008; Armstrong et al., 2010) by demonstrating how regulatory changes can influence disclosure practices through reputational channels.

Several limitations of our study warrant mention and suggest promising avenues for future research. First, our analysis focuses primarily on the reputation risk channel, while other mechanisms may also influence the relationship between say-on-pay votes and voluntary disclosure. Future research could explore alternative channels through which shareholder approval requirements affect corporate disclosure policies. Second, our study examines the immediate effects following the implementation of say-on-pay requirements. Longer-term studies could investigate whether these effects persist or evolve over time as firms and shareholders adjust to the new regulatory environment. Additionally, future research could examine how the interaction between reputation risk and say-on-pay votes varies across different institutional settings and governance structures.

In conclusion, our study provides evidence that reputation risk serves as an important channel through which shareholder approval requirements for executive compensation influence voluntary disclosure practices. These findings contribute to our understanding of how regulatory changes affect corporate transparency through reputational concerns and offer insights for regulators, managers, and investors regarding the broader implications of say-on-pay requirements.

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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 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	0.01	**-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.