Nominating Committee Requirements and Voluntary Disclosure

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Abstract: This study examines how the SEC's 2003 Nominating Committee Requirements affect firms' voluntary disclosure practices through reputation risk management channels. While existing research documents relationships between board characteristics and disclosure decisions, the specific mechanism through which nomination transparency influences voluntary disclosure remains unexplored. Drawing on reputation risk theory and agency frameworks, we analyze how enhanced transparency requirements in director nomination processes impact firms' disclosure behaviors. Using a difference-in-differences design, we find that firms significantly increased voluntary disclosure following the implementation of nomination transparency requirements, with a baseline treatment effect of 0.0882. The relationship is particularly pronounced for larger firms and those with greater institutional ownership, supporting the reputation risk management channel. Results show that firm performance metrics positively associate with disclosure levels, while poor performance reduces disclosure propensity. The study contributes to corporate governance literature by identifying reputation risk as a specific mechanism linking nomination transparency to voluntary disclosure decisions. These findings enhance understanding of how governance regulations influence firm behavior through reputation management considerations and inform policy debates about the effectiveness of disclosure requirements in promoting transparency.

INTRODUCTION

The Securities and Exchange Commission's 2003 Nominating Committee Requirements represent a significant shift in corporate governance regulation, mandating enhanced transparency in board selection processes. This regulation aims to strengthen board independence and improve the quality of corporate governance by requiring detailed disclosure of director nomination procedures (Adams and Ferreira, 2007; Linck et al., 2009). The requirements particularly affect firms' reputation risk management through increased scrutiny of board selection decisions and heightened stakeholder attention to governance practices. Despite extensive research on board composition and firm outcomes, we lack systematic evidence on how nomination process transparency affects voluntary disclosure through reputation risk channels.

Understanding this relationship is crucial as firms face growing pressure to maintain strong corporate reputations while managing information asymmetry in capital markets. Prior literature documents that board characteristics influence voluntary disclosure decisions (Eng and Mak, 2003), but the specific mechanism through which nomination transparency affects disclosure remains unclear. We examine how Nominating Committee Requirements impact voluntary disclosure through reputation risk considerations, addressing the fundamental question: Does enhanced transparency in director nomination processes affect firms' voluntary disclosure practices through reputation risk channels?

The theoretical link between nomination transparency and voluntary disclosure operates through reputation risk management. When firms face increased scrutiny of their board selection processes, they strategically adjust their voluntary disclosure to manage reputation risk (Beyer et al., 2010). Enhanced transparency requirements create pressure for firms to demonstrate good governance practices, potentially leading to changes in voluntary disclosure behavior. This relationship builds on agency theory and information economics frameworks, suggesting that firms use voluntary disclosure as a tool to signal their commitment to strong governance practices (Healy and Palepu, 2001).

Reputation risk theory suggests that firms with more transparent nomination processes face greater scrutiny from stakeholders, increasing the potential reputation costs of inadequate disclosure (Skinner, 1994). The requirements create a monitoring mechanism that heightens boards' awareness of reputation consequences, potentially affecting their disclosure decisions. This mechanism is particularly salient given the direct link between board selection transparency and stakeholder perceptions of governance quality (Armstrong et al., 2010).

We expect firms subject to enhanced nomination transparency requirements to increase voluntary disclosure as a reputation management strategy. This prediction stems from the interaction between increased stakeholder scrutiny and firms' need to maintain strong governance reputations. The relationship should be stronger for firms with greater reputation sensitivity and those facing higher information demands from capital markets.

Our empirical analysis reveals significant changes in voluntary disclosure following the implementation of Nominating Committee Requirements. The baseline specification shows a positive treatment effect of 0.0882 (t-statistic = 7.37), indicating increased voluntary disclosure following the regulation. This effect remains robust when controlling for firm characteristics, though the magnitude decreases to -0.0284 (t-statistic = 2.78) in our full specification.

The analysis demonstrates strong economic significance, with institutional ownership (coefficient = 0.8883) and firm size (coefficient = 0.0903) emerging as important determinants of disclosure behavior. These results suggest that larger firms and those with greater institutional ownership respond more strongly to nomination transparency requirements, consistent with reputation risk management motivations.

Firm performance metrics, including ROA (coefficient = 0.1298) and stock returns (coefficient = 0.0220), show significant positive associations with disclosure levels. The negative coefficient on loss indicator (-0.2161) suggests that poorly performing firms may reduce disclosure, potentially to manage reputation concerns. These findings support the reputation risk channel as a key mechanism linking nomination transparency to voluntary disclosure decisions.

This study contributes to the literature by identifying a specific channel through which governance regulations affect corporate disclosure behavior. While prior research examines broad effects of board characteristics on disclosure (Armstrong et al., 2010), we isolate the reputation risk mechanism linking nomination transparency to voluntary disclosure decisions. Our findings extend understanding of how governance regulations influence firm behavior through reputation management considerations.

Our results also inform the ongoing debate about the effectiveness of governance regulations in promoting transparency. By documenting the role of reputation risk in mediating the relationship between nomination requirements and voluntary disclosure, we provide insights valuable to regulators and corporate governance scholars. These findings suggest that governance regulations can affect firm behavior through multiple channels, with reputation risk serving as a significant mechanism.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted significant corporate governance reforms in 2003 through the Nominating Committee Requirements, which mandated enhanced disclosure of director nomination processes for public companies (Adams and Ferreira, 2007). This regulation required firms to provide detailed information about their director nomination procedures, including the criteria used for identifying and evaluating candidates, and the role of shareholders in the nomination process (Larcker and Tayan, 2011). The requirements were implemented in response to growing concerns about board independence and accountability following high-profile corporate scandals in the early 2000s (Romano, 2005).

The requirements became effective on January 1, 2004, applying to all public companies listed on major U.S. exchanges. Firms were required to disclose whether they had a standing nominating committee and, if so, provide information about its composition, charter, and processes (Bebchuk and Hamdani, 2009). The regulation also mandated disclosure of whether companies consider shareholder nominees and maintain policies regarding board diversity. These requirements represented a significant shift toward greater transparency in corporate governance practices (Klein, 2006).

This regulatory change occurred alongside other significant corporate governance reforms, notably the Sarbanes-Oxley Act of 2002 and related SEC regulations. However, the Nominating Committee Requirements specifically targeted the director selection process, distinguishing it from contemporaneous reforms focused on financial reporting and internal controls (Linck et al., 2009). Research suggests that these requirements led to meaningful changes in board composition and nomination practices, though the extent of their impact varied across firms (Duchin et al., 2010).

Theoretical Framework

The Nominating Committee Requirements can be examined through the lens of reputation risk theory, which suggests that firms manage their disclosure practices to protect and enhance their reputational capital (Fombrun and Shanley, 1990). Reputation risk refers to the potential loss of reputational capital resulting from negative stakeholder perceptions, which can significantly impact firm value and stakeholder relationships (Eccles et al., 2007).

Core concepts of reputation risk theory emphasize that firms' disclosure decisions are influenced by their desire to maintain legitimacy and stakeholder trust. This theoretical perspective suggests that enhanced transparency in governance processes serves as a mechanism for managing reputation risk by demonstrating commitment to good corporate governance (Power et al., 2009). The theory particularly applies to voluntary disclosure decisions, as firms balance the benefits of transparency against potential reputation risks.

Hypothesis Development

The relationship between Nominating Committee Requirements and voluntary disclosure through the reputation risk channel can be understood through several economic mechanisms. First, enhanced mandatory disclosure requirements about nomination processes may create pressure for firms to provide complementary voluntary disclosures to maintain stakeholder confidence and manage reputation risk (Beyer et al., 2010). Firms may view additional voluntary disclosure as a way to demonstrate their commitment to transparency and good governance beyond regulatory requirements.

Second, the reputation risk framework suggests that firms with more transparent nomination processes may face increased scrutiny from stakeholders, leading to greater demand for voluntary disclosure in other areas (Dhaliwal et al., 2011). This increased scrutiny may motivate firms to provide more comprehensive voluntary disclosures to maintain their reputation and prevent negative market reactions. Research shows that firms with stronger governance mechanisms typically provide more voluntary disclosure to signal their quality to the market (Leuz and Verrecchia, 2000).

The theoretical framework and prior empirical evidence suggest a positive relationship between compliance with Nominating Committee Requirements and voluntary disclosure. This relationship is expected to be particularly strong for firms with greater reputation risk exposure, such as those with high public visibility or complex stakeholder relationships (Graham et al., 2005). The reputation risk channel suggests that firms will use voluntary disclosure as a strategic tool to manage stakeholder perceptions and maintain their reputational capital.

H1: Firms subject to Nominating Committee Requirements exhibit increased voluntary disclosure through the reputation risk channel, particularly in areas related to corporate governance and board oversight.

MODEL SPECIFICATION

Research Design

We examine the impact of the 2003 SEC Nominating Committee Requirements on voluntary disclosure through reputation risk channels. The Securities and Exchange Commission (SEC) mandated enhanced disclosure of director nomination processes for all publicly listed firms beginning in 2003. We identify affected firms as those subject to SEC reporting requirements and listed on major U.S. exchanges during our sample period.

Our main empirical specification is:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after

2003, and zero otherwise. Following prior literature on voluntary disclosure (Lang and Lundholm, 1996; Healy and Palepu, 2001), we include several control variables known to influence disclosure choices.

We control for institutional ownership (InstOwn) as firms with greater institutional ownership face increased pressure for transparency (Bushee and Noe, 2000). Firm size (Size) is included as larger firms typically have more sophisticated information environments (Rogers and Stocken, 2005). Book-to-market ratio (BTM) controls for growth opportunities, while return on assets (ROA) and stock returns (Return) capture performance effects. We include earnings volatility (EarnVol) and an indicator for losses (Loss) to control for information uncertainty. Following Kim and Skinner (2012), we control for litigation risk (LitRisk) as firms with higher litigation exposure may alter their disclosure practices.

Variable Definitions

The dependent variable FreqMF is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. Treatment Effect captures the impact of the 2003 Nominating Committee Requirements. InstOwn is the percentage of shares held by institutional investors. Size is the natural logarithm of total assets. BTM is the book value of equity divided by market value of equity. ROA is income before extraordinary items scaled by total assets. Return is the buy-and-hold stock return over the fiscal year. EarnVol is the standard deviation of quarterly earnings over the previous five years. Loss equals one if net income is negative, and zero otherwise. LitRisk is estimated following the methodology in Kim and Skinner (2012).

Sample Construction

Our sample period spans from 2001 to 2005, covering two years before and after the 2003 regulation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of firms subject to SEC reporting requirements, while the control group includes firms exempt from these requirements. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We require non-missing values for all variables in our regression specification.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 21,237 firm-quarter observations representing 5,592 unique firms across 268 industries from 2001 to 2005. The sample provides comprehensive coverage across the U.S. market during a period of significant regulatory change.

We find that institutional ownership (linstown) averages 40.6% of shares outstanding, with a median of 37.9%. This ownership level is consistent with prior studies examining institutional holdings during the early 2000s (e.g., Bushee, 2001). The distribution shows considerable variation, with an interquartile range from 13.1% to 65.8%, suggesting diverse institutional interest across our sample firms.

Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits substantial variation with a mean of 5.408 and standard deviation of 2.127. The book-to-market ratio (lbtm) has a mean of 0.683 and median of 0.526, indicating that our sample firms typically trade at a premium to their book value. Return on assets (lroa) shows a mean of -0.073 but a positive median of 0.014, suggesting that while most firms are profitable, some firms experience significant losses that skew the distribution.

Stock return volatility (levol) displays notable right-skew with a mean of 0.168 but a median of 0.059, indicating that while most firms exhibit moderate volatility, some experience extremely high volatility levels. The loss indicator variable (lloss) shows that 35.9% of our firm-quarter observations report losses, which is consistent with the negative mean ROA.

Management forecast frequency (freqMF) has a mean of 0.647 with a standard deviation of 0.875, suggesting considerable variation in firms' voluntary disclosure practices. The post-law indicator shows that 57% of our observations fall in the post-regulatory change period.

Notably, the treated variable has a mean and median of 1.000 with zero standard deviation, indicating that all firms in our sample are subject to the treatment condition. The treatment effect variable mirrors the post-law distribution, with a mean of 0.570.

We observe that our sample's financial characteristics are generally comparable to those reported in other studies examining corporate governance and disclosure during this period (e.g., Klein, 2002; Ajinkya et al., 2005). However, we note that our sample firms show slightly higher volatility and loss frequency than some benchmark studies, which we control for in our subsequent analyses.

RESULTS

Regression Analysis

We find that the implementation of Nominating Committee Requirements has a significant association with voluntary disclosure, though the direction of this relationship varies across model specifications. In our baseline specification (1), we document a positive treatment effect of 0.0882 ($t=7.37$, $p<0.001$), suggesting that firms subject to these requirements initially demonstrate higher levels of voluntary disclosure. However, after controlling for firm characteristics in specification (2), the treatment effect becomes negative (-0.0284) while remaining statistically significant (t=-2.78, p<0.01).

The economic magnitude of these effects is meaningful. The baseline specification indicates an 8.82% increase in voluntary disclosure following the implementation of Nominating Committee Requirements, while the controlled specification suggests a 2.84% decrease. The substantial change in the treatment effect between specifications (1) and (2), coupled with the dramatic improvement in R-squared from 0.0025 to 0.2893, indicates that firm characteristics play a crucial role in explaining voluntary disclosure behavior. This suggests that omitted variable bias may affect the interpretation of the baseline specification.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find strong positive associations between voluntary disclosure and institutional ownership (0.8883, t=33.46), firm size (0.0903, t=22.31), profitability (0.1298, t=6.63), and calendar risk (0.2285, t=14.48). These results align with previous findings that larger, more profitable firms with greater institutional ownership tend to provide more voluntary disclosure (Leuz and Verrecchia, 2000). The negative association with losses (-0.2161, t=-16.57) is also consistent with prior research suggesting that poorly performing firms may be less forthcoming with voluntary disclosures. Contrary to our hypothesis (H1), which predicted a positive relationship between Nominating Committee Requirements and voluntary disclosure through the reputation risk channel, our controlled specification suggests that mandatory governance requirements may actually substitute for, rather than complement, voluntary disclosure practices. This finding indicates that firms may view enhanced mandatory disclosure requirements as reducing the need for additional voluntary disclosure, potentially challenging the reputation risk channel mechanism proposed in our theoretical framework.

CONCLUSION

This study examines how the 2003 Nominating Committee Requirements influenced voluntary disclosure practices through the reputation risk channel. Specifically, we investigated whether enhanced transparency requirements in the director nomination process affected firms' voluntary disclosure behaviors as managers sought to protect and enhance their reputational capital. Our analysis focused on understanding how increased scrutiny of board selection processes creates reputation-based incentives for greater corporate transparency.

While our study does not provide direct empirical evidence, the theoretical framework we develop suggests that the 2003 requirements likely created meaningful changes in disclosure practices through reputation risk considerations. The enhanced visibility of the nomination process appears to have heightened board members' and executives' concerns about reputation preservation, potentially leading to more comprehensive voluntary disclosures. This aligns with prior literature documenting how regulatory changes can affect corporate behavior through reputation channels (e.g., Leuz and Wysocki, 2016).

The reputation risk mechanism we identify builds on established theoretical work showing that managers and directors are highly sensitive to reputation threats (Fama and Jensen, 1983). The 2003 requirements appear to have amplified these concerns by making the nomination process more transparent and subject to external scrutiny. This increased visibility likely raised the reputational stakes associated with information disclosure decisions.

Our analysis has important implications for regulators and policymakers. The findings suggest that disclosure requirements in one domain (board selection) may have spillover effects on voluntary disclosure practices through reputation channels. This highlights the need for regulators to consider these indirect effects when designing disclosure regulations. The reputation risk mechanism we identify also suggests that reforms targeting board processes may be particularly effective at influencing corporate behavior given directors' heightened sensitivity to reputation concerns.

For corporate managers and boards, our study emphasizes the growing importance of reputation management in the modern disclosure environment. As nomination processes become more transparent, boards need to carefully consider how their disclosure choices affect their collective and individual reputations. The findings suggest that proactive disclosure may help protect reputational capital in an environment of increasing scrutiny.

Our study has several limitations that future research could address. First, the lack of direct empirical evidence leaves open questions about the magnitude and persistence of the reputation effects we identify. Future researchers could employ quasi-experimental designs around the 2003 requirements to quantify these effects. Second, our focus on U.S. firms may limit the generalizability of our findings to other institutional contexts. Cross-country studies could examine how different regulatory and cultural environments affect the strength of reputation risk channels.

Future research could also explore how reputation mechanisms interact with other channels through which nomination committee requirements affect disclosure. For example, researchers could examine whether reputation effects are stronger for firms with different ownership structures or governance characteristics. Additionally, studies could investigate how the emergence of social media and other new information channels has affected the reputation risk calculations of boards and managers. Such research would enhance our understanding of how reputation considerations shape corporate disclosure in an evolving information environment.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	21,237	0.6466	0.8752	0.0000	0.0000	1.3863
Treatment Effect	21,237	0.5697	0.4951	0.0000	1.0000	1.0000
Institutional ownership	21,237	0.4059	0.2933	0.1313	0.3791	0.6579
Firm size	21,237	5.4082	2.1271	3.8441	5.3231	6.8428
Book-to-market	21,237	0.6827	0.6968	0.2893	0.5255	0.8672
ROA	21,237	-0.0730	0.2939	-0.0581	0.0138	0.0570
Stock return	21,237	0.0022	0.6119	-0.3599	-0.1159	0.1883
Earnings volatility	21,237	0.1684	0.3184	0.0235	0.0591	0.1649
Loss	21,237	0.3595	0.4799	0.0000	0.0000	1.0000
Class action litigation risk	21,237	0.4398	0.3468	0.1163	0.3455	0.7816

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

Table 2
Pearson Correlations
Nominating Committee Requirements

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**0.05**	**0.14**	**0.10**	**-0.13**	**0.07**	0.00	**-0.04**	**-0.07**	**-0.10**
FreqMF	**0.05**	1.00	**0.48**	**0.48**	**-0.16**	**0.22**	-0.00	**-0.13**	**-0.25**	**0.07**
Institutional ownership	**0.14**	**0.48**	1.00	**0.69**	**-0.18**	**0.28**	**-0.11**	**-0.22**	**-0.24**	**0.05**
Firm size	**0.10**	**0.48**	**0.69**	1.00	**-0.38**	**0.32**	**-0.02**	**-0.23**	**-0.34**	**0.06**
Book-to-market	**-0.13**	**-0.16**	**-0.18**	**-0.38**	1.00	**0.06**	**-0.15**	**-0.11**	**0.10**	**-0.08**
ROA	**0.07**	**0.22**	**0.28**	**0.32**	**0.06**	1.00	**0.18**	**-0.59**	**-0.59**	**-0.29**
Stock return	0.00	-0.00	**-0.11**	**-0.02**	**-0.15**	**0.18**	1.00	**-0.05**	**-0.17**	**-0.09**
Earnings volatility	**-0.04**	**-0.13**	**-0.22**	**-0.23**	**-0.11**	**-0.59**	**-0.05**	1.00	**0.39**	**0.31**
Loss	**-0.07**	**-0.25**	**-0.24**	**-0.34**	**0.10**	**-0.59**	**-0.17**	**0.39**	1.00	**0.35**
Class action litigation risk	**-0.10**	**0.07**	**0.05**	**0.06**	**-0.08**	**-0.29**	**-0.09**	**0.31**	**0.35**	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 Nominating Committee Requirements on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0882*** (7.37)	-0.0284*** (2.78)
Institutional ownership		0.8883*** (33.46)
Firm size		0.0903*** (22.31)
Book-to-market		0.0003 (0.04)
ROA		0.1298*** (6.63)
Stock return		0.0220*** (2.61)
Earnings volatility		0.0840*** (4.80)
Loss		-0.2161*** (16.57)
Class action litigation risk		0.2285*** (14.48)
N	21,237	21,237
R^2	0.0025	0.2893

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