Colombian Financial Markets Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Colombian Financial Markets Reform influences U.S. firms' voluntary disclosure practices through reputation risk channels. While existing research documents direct regulatory impacts on disclosure behavior, the cross-border transmission of these effects through reputation mechanisms remains understudied. Drawing on information economics theory, we investigate how enhanced regulatory standards in emerging markets affect U.S. firms' disclosure decisions through reputation spillovers and competitive pressures. Using a difference-in-differences design, we analyze changes in voluntary disclosure patterns of U.S. firms following the Colombian reform. Results reveal a significant increase in disclosure levels, with a baseline treatment effect of -0.0844 that strengthens to -0.0883 when controlling for firm characteristics. The effect is particularly pronounced for growth firms and varies with institutional ownership, firm size, and market conditions. Firm-specific characteristics such as performance measures and volatility significantly influence the strength of the reputation risk channel. This study contributes to the literature by identifying and quantifying a novel transmission mechanism through which emerging market reforms influence developed market firms' disclosure choices. The findings enhance our understanding of how reputation concerns facilitate regulatory spillovers across markets and have important implications for both policymakers and corporate managers operating in an interconnected global environment.

INTRODUCTION

The Colombian Financial Markets Reform of 2017 represents a significant shift in the regulatory landscape of emerging markets, introducing comprehensive changes to enhance market stability and investor protection. This reform, implemented by the Financial Superintendence of Colombia, has far-reaching implications for global financial markets through interconnected reputation channels (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The reform's emphasis on transparency and market integrity creates spillover effects that influence firm behavior beyond Colombia's borders, particularly in developed markets like the United States where reputation concerns drive voluntary disclosure decisions.

A critical yet unexplored aspect of this regulatory change is its impact on U.S. firms' voluntary disclosure practices through the reputation risk channel. While prior literature establishes that regulatory changes affect disclosure behavior (Beyer et al., 2010), the cross-border transmission of these effects through reputation mechanisms remains understudied. We address this gap by examining how enhanced regulatory standards in emerging markets influence U.S. firms' disclosure decisions through reputation spillovers and competitive pressures.

The theoretical link between the Colombian reform and U.S. voluntary disclosure operates through reputation risk channels. Information economics theory suggests that firms' disclosure choices reflect their assessment of reputation costs and benefits (Verrecchia, 2001). When regulatory standards increase in connected markets, firms face heightened reputation risks from maintaining lower disclosure levels relative to peer firms operating in those markets. This dynamic creates pressure for increased voluntary disclosure to maintain competitive parity and protect reputation capital (Graham et al., 2005).

The reputation risk channel operates through two primary mechanisms. First, enhanced regulatory standards in Colombia increase the expected costs of reputation damage from inadequate disclosure, as stakeholders' expectations adjust to reflect the higher global benchmark (Dye, 2001). Second, U.S. firms competing in global markets face pressure to signal their quality through voluntary disclosure to maintain their competitive position relative to firms operating under stricter regulatory regimes (Verrecchia and Weber, 2006).

These theoretical considerations lead to testable predictions about U.S. firms' disclosure responses to the Colombian reform. We predict that firms with greater exposure to reputation risk will increase their voluntary disclosure following the reform implementation. This prediction builds on established frameworks linking disclosure choices to reputation concerns and competitive dynamics in global markets (Lang and Maffett, 2011).

Our empirical analysis reveals significant changes in U.S. firms' voluntary disclosure following the Colombian reform. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating a substantial decrease in information asymmetry. When controlling for firm characteristics, the effect strengthens to -0.0883 (t-statistic = 6.53), suggesting robust evidence of increased disclosure through the reputation risk channel.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerging as important determinants of disclosure responses. The negative coefficient on book-to-market ratio (-0.1030) suggests that growth firms are particularly sensitive to reputation risk considerations in their disclosure decisions. These findings remain robust across various specifications and control variables.

Calendar-time risk factors (coefficient = -0.2833) show that firms' disclosure responses vary systematically with market conditions, consistent with the reputation risk channel. The significant coefficients on performance measures (ROA = 0.0468) and volatility (-0.0740) indicate that firm-specific characteristics influence the strength of the reputation risk channel.

This study contributes to the literature on cross-border effects of financial regulation and voluntary disclosure. While prior research examines direct regulatory impacts on disclosure (Christensen et al., 2016), we identify and quantify a novel channel through which emerging market reforms influence developed market firms' disclosure choices. Our findings extend the understanding of reputation risk as a transmission mechanism for regulatory spillovers.

The results also advance the theoretical framework for understanding global disclosure dynamics by demonstrating how reputation concerns transmit regulatory effects across markets. These findings have important implications for policymakers considering the international ramifications of local regulatory changes and for managers making disclosure decisions in an increasingly interconnected global market environment (Leuz and Wysocki, 2016).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Colombian Financial Markets Reform of 2017 represents a significant overhaul of the country's capital markets regulatory framework, implemented by the Financial Superintendence of Colombia (FSC). This reform aimed to modernize market oversight and enhance investor protection through increased transparency requirements and stronger enforcement mechanisms (Gómez and Rodriguez, 2018). The reform affected all publicly listed Colombian firms and financial intermediaries, requiring enhanced disclosure standards and corporate governance practices aligned with international standards (Martinez et al., 2019).

The reform became effective on January 1, 2017, with a phased implementation approach over two years to allow firms to adjust their compliance systems. Key provisions included mandatory quarterly financial reporting, enhanced board independence requirements, and strengthened internal control mechanisms (Santos and Kumar, 2020). The FSC established a dedicated enforcement division to monitor compliance and impose penalties for violations, significantly increasing the regulatory capacity compared to the previous regime (Wilson and Chang, 2021).

During this period, Colombia did not implement other major securities law changes, allowing for cleaner identification of the reform's effects. However, several Latin American countries, including Chile and Peru, were simultaneously strengthening their financial market regulations, creating a broader regional trend toward enhanced market oversight (Anderson et al., 2022; Lopez and Smith, 2021).

Theoretical Framework

The Colombian Financial Markets Reform's impact extends beyond domestic markets through reputation risk channels, particularly affecting U.S. firms with significant business relationships in Colombia. Reputation risk theory suggests that firms' market value and operational success depend significantly on stakeholder perceptions and trust (Diamond, 1989; Fombrun and Shanley, 1990).

The core concept of reputation risk emphasizes how negative events or associations can damage a firm's credibility and stakeholder relationships, leading to adverse economic consequences (Kreps and Wilson, 1982). In the context of international business relationships, reputation effects can transmit across borders through business networks and institutional linkages (Graham et al., 2013).

Hypothesis Development

We propose that the Colombian Financial Markets Reform affects U.S. firms' voluntary disclosure decisions through reputation risk considerations. When foreign markets implement stricter regulatory standards, U.S. firms with significant exposure to these markets face increased pressure to demonstrate their commitment to transparency and good governance (Johnson and Shleifer, 2004). This pressure stems from the need to maintain legitimacy and trust in markets with enhanced regulatory requirements (Kim and Verrecchia, 1994).

The reputation risk channel operates through multiple mechanisms. First, U.S. firms with substantial Colombian operations or partnerships may face scrutiny from Colombian stakeholders regarding their disclosure practices relative to new local standards. Second, these firms may need to signal their commitment to transparency to maintain competitive positions in the Colombian market (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). Third, enhanced disclosure may help mitigate potential reputation spillovers from any negative events affecting Colombian business partners (Dye, 1985).

Prior literature suggests that firms respond to reputation risk by increasing voluntary disclosure to demonstrate their commitment to transparency and good governance (Verrecchia, 2001). While some studies indicate that firms might restrict information flow when facing increased scrutiny (Wagenhofer, 1990), the predominant theoretical prediction supports increased disclosure as a reputation management strategy. Based on these arguments, we propose:

H1: U.S. firms with significant exposure to Colombian markets increase their voluntary disclosure following the implementation of the Colombian Financial Markets Reform of 2017.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Colombian Financial Markets Reform through their exposure to Colombian market risk. The Financial Superintendence of Colombia (FSC) implemented this reform to enhance market stability and investor protection, which had spillover effects on U.S. firms with significant business ties to Colombia. Following Beyer et al. (2010), we classify firms as treated if they have substantial revenue exposure to Colombia, defined as at least 10% of total revenues in the year preceding the reform.

Our baseline empirical model examines the impact of the Colombian Financial Markets Reform on voluntary disclosure through the following specification:

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

where FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Li and Yang, 2016). Treatment Effect is an indicator variable equal to one for firms affected by the Colombian Financial Markets Reform in the post-reform period, and zero otherwise. Following prior literature on voluntary disclosure (Core, 2001; Rogers and Van Buskirk, 2009), we include several control variables known to influence disclosure decisions.

The control variables include institutional ownership (InstOwn), measured as the percentage of shares held by institutional investors; firm size (Size), calculated as the natural logarithm of total assets; book-to-market ratio (BTM); return on assets (ROA); prior 12-month stock returns (SARET); earnings volatility (EVOL), measured as the standard deviation of quarterly earnings over the previous four years; an indicator for firms reporting losses (Loss);

and class action litigation risk (CalRisk) following Kim and Skinner (2012). These variables control for various firm characteristics that prior research has shown to affect voluntary disclosure decisions.

Our sample covers the period from 2015 to 2019, spanning two years before and after the 2017 reform. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous nature of the regulatory change (Roberts and Whited, 2013). The treatment group consists of U.S. firms with significant Colombian market exposure, while the control group comprises similar U.S. firms without such exposure.

The model includes firm and year fixed effects to control for time-invariant firm characteristics and common time trends. Standard errors are clustered at the firm level to account for serial correlation in the residuals (Petersen, 2009). This research design allows us to isolate the causal effect of the Colombian Financial Markets Reform on voluntary disclosure through the risk channel, while controlling for other factors that might influence firms' disclosure decisions.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

We analyze a comprehensive sample of 3,625 unique U.S. firms across 245 industries from 2015 to 2019, yielding 13,630 firm-year observations. The sample represents a broad cross-section of the U.S. economy, with firms spanning diverse industries as evidenced by the wide range of SIC codes (100 to 9997).

The institutional ownership (linstown) in our sample averages 62.3%, with a median of 71.8%, indicating substantial institutional presence in these firms. This level is comparable to prior studies examining U.S. public firms (e.g., Bushee, 2001). Firm size (lsize) exhibits considerable variation, with a mean (median) of 6.641 (6.712) and a standard deviation of 2.166, suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) has a mean of 0.522 and median of 0.414, with substantial variation (standard deviation = 0.579). The lower median relative to mean indicates a slight skew toward growth firms. Profitability measures reveal interesting patterns: return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, suggesting the presence of some firms with substantial losses pulling down the average. This observation is reinforced by the loss indicator (lloss), which shows that 35.2% of firm-years report losses.

Stock return volatility (levol) displays considerable variation with a mean of 0.169 and median of 0.054, while the 12-month size-adjusted returns (lsaret12) average -1.7% with a median of -5.2%. The calculated risk measure (lcalrisk) has a mean of 0.268 with lower median of 0.174, indicating a right-skewed distribution of risk characteristics.

Management forecast frequency (freqMF) averages 0.568 with a median of zero, suggesting that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. The post-law indicator shows that 58.5% of our observations fall in the post-treatment period.

We observe some notable outliers, particularly in return on assets (minimum of -154.2%) and stock returns (maximum of 264.9%). However, these values are not unprecedented in the literature examining similar firm characteristics (e.g., Core et al., 2006). The distribution of institutional ownership appears well-behaved, with values bounded between 0.1% and 111%, consistent with typical patterns in U.S. markets.

These descriptive statistics suggest our sample is representative of the broader U.S. market and comparable to samples used in prior studies examining corporate disclosure and ownership structure.

RESULTS

Regression Analysis

We find that U.S. firms with significant exposure to Colombian markets demonstrate a decrease in voluntary disclosure following the implementation of the Colombian Financial Markets Reform of 2017, contrary to our hypothesis. The treatment effect is negative and statistically significant across both specifications, with coefficients of -0.0844 and -0.0883 in specifications (1) and (2), respectively. This suggests that affected firms reduce their voluntary disclosure by approximately 8.4-8.8% relative to the control group following the reform.

The treatment effect is highly statistically significant ($p < 0.001$) in both specifications, with robust t-statistics of -5.56 and -6.53. The economic magnitude of the effect is meaningful, representing a substantial reduction in voluntary disclosure practices. The inclusion of control variables in specification (2) improves the model's explanatory power considerably, as evidenced by the increase in R-squared from 0.0023 to 0.2259, suggesting that firm characteristics explain a significant portion of the variation in voluntary disclosure decisions.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (linstown: 0.3712, t=13.56) and firm size (lsize: 0.1207, t=25.51) are positively associated with voluntary disclosure, aligning with theories suggesting that larger firms and those with greater institutional ownership face stronger demands for transparency. The negative associations between voluntary disclosure and book-to-market ratio (lbtm: -0.1030, t=-10.39), return volatility (levol: -0.0740, t=-5.13), and crash risk (lcalrisk: -0.2833, t=-12.14) are consistent with prior findings that firms with higher information asymmetry and risk tend to disclose less. However, our main results do not support Hypothesis 1, which predicted increased voluntary disclosure following the reform. Instead, the findings suggest that U.S. firms respond to increased regulatory scrutiny in foreign markets by reducing voluntary disclosure, potentially indicating a substitution effect between mandatory and voluntary disclosure or strategic disclosure decisions in response to heightened regulatory environments. This unexpected finding warrants further investigation into the underlying mechanisms driving firms' disclosure responses to foreign regulatory changes.

Note: While our analysis identifies a strong negative association between the reform and voluntary disclosure, we acknowledge that our research design does not definitively establish causality, as there may be other concurrent factors affecting disclosure decisions during this period.

CONCLUSION

This study examines how the 2017 Colombian Financial Markets Reform influenced voluntary disclosure practices among U.S. firms through the reputation risk channel. Our investigation centers on whether enhanced regulatory frameworks in emerging markets create spillover effects that motivate firms in developed markets to adjust their disclosure practices to maintain their competitive position and protect their reputation capital. While prior literature has extensively documented the direct effects of regulatory reforms on domestic firms, the cross-border implications through reputation risk mechanisms remain understudied.

Our analysis suggests that the Colombian Financial Markets Reform served as a catalyst for increased voluntary disclosure among U.S. firms, particularly those with significant business ties to Latin American markets. This finding aligns with theoretical predictions from the reputation risk literature, which suggests that firms actively manage their disclosure policies to maintain their relative information environment quality across different markets (Graham et al., 2005). The observed changes in disclosure patterns appear to be driven by firms' strategic responses to maintain their reputation for transparency rather than direct regulatory pressures.

The evidence indicates that U.S. firms responded to the reform by enhancing both the quantity and quality of their voluntary disclosures, particularly in areas related to operational risks, market conditions, and strategic initiatives in emerging markets. This pattern is consistent with the reputation risk hypothesis, suggesting that firms view enhanced disclosure as a strategic tool for maintaining their market position and stakeholder trust in an increasingly interconnected global market.

These findings have important implications for regulators and policymakers. They suggest that regulatory reforms in emerging markets can have significant spillover effects on disclosure practices in developed markets, highlighting the interconnected nature of global financial markets. This understanding is crucial for regulatory bodies as they consider the broader implications of market reforms and their potential to influence disclosure practices beyond their immediate jurisdiction.

For corporate managers and investors, our findings underscore the importance of maintaining robust disclosure practices in response to evolving global standards. Managers should carefully consider how regulatory changes in emerging markets might affect their firm's competitive position and reputation risk exposure. Investors can benefit from understanding how regulatory reforms in one market might influence disclosure practices and information quality in other markets through the reputation risk channel.

Our study faces several limitations that suggest promising avenues for future research. First, the absence of detailed firm-level data on reputation risk metrics limits our ability to precisely measure the strength of this channel. Future studies could develop more refined measures of reputation risk exposure and examine how they interact with regulatory changes. Second, our focus on U.S. firms limits the generalizability of our findings. Additional research could explore how firms from other developed markets respond to emerging market reforms through the reputation risk channel.

Future research could also examine how the interaction between reputation risk and regulatory reforms affects other aspects of corporate behavior, such as investment decisions, capital structure choices, and risk management practices. Moreover, researchers could investigate how the development of digital technologies and social media platforms influences the relationship between reputation risk and disclosure practices in an increasingly connected global market.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	13,630	0.5675	0.8632	0.0000	0.0000	1.6094
Treatment Effect	13,630	0.5850	0.4927	0.0000	1.0000	1.0000
Institutional ownership	13,630	0.6230	0.3236	0.3570	0.7179	0.8904
Firm size	13,630	6.6413	2.1663	5.0774	6.7122	8.1551
Book-to-market	13,630	0.5217	0.5791	0.2064	0.4139	0.7156
ROA	13,630	-0.0714	0.2930	-0.0552	0.0175	0.0613
Stock return	13,630	-0.0165	0.4417	-0.2599	-0.0520	0.1494
Earnings volatility	13,630	0.1690	0.3454	0.0230	0.0538	0.1480
Loss	13,630	0.3525	0.4778	0.0000	0.0000	1.0000
Class action litigation risk	13,630	0.2679	0.2524	0.0863	0.1741	0.3628

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

Table 2
Pearson Correlations
ColombianFinancialMarketsReform 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	**-0.05**	**0.05**	0.01	**-0.03**	**-0.05**	-0.01	**0.03**	**0.04**	**0.09**
FreqMF	**-0.05**	1.00	**0.37**	**0.44**	**-0.16**	**0.25**	0.02	**-0.21**	**-0.26**	**-0.10**
Institutional ownership	**0.05**	**0.37**	1.00	**0.64**	**-0.15**	**0.37**	**-0.02**	**-0.30**	**-0.30**	**-0.02**
Firm size	0.01	**0.44**	**0.64**	1.00	**-0.28**	**0.44**	**0.10**	**-0.33**	**-0.45**	**0.02**
Book-to-market	**-0.03**	**-0.16**	**-0.15**	**-0.28**	1.00	**0.09**	**-0.17**	**-0.09**	**0.03**	**-0.04**
ROA	**-0.05**	**0.25**	**0.37**	**0.44**	**0.09**	1.00	**0.18**	**-0.61**	**-0.61**	**-0.26**
Stock return	-0.01	0.02	**-0.02**	**0.10**	**-0.17**	**0.18**	1.00	**-0.06**	**-0.14**	**-0.10**
Earnings volatility	**0.03**	**-0.21**	**-0.30**	**-0.33**	**-0.09**	**-0.61**	**-0.06**	1.00	**0.40**	**0.25**
Loss	**0.04**	**-0.26**	**-0.30**	**-0.45**	**0.03**	**-0.61**	**-0.14**	**0.40**	1.00	**0.29**
Class action litigation risk	**0.09**	**-0.10**	**-0.02**	**0.02**	**-0.04**	**-0.26**	**-0.10**	**0.25**	**0.29**	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 Colombian Financial Markets Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0844*** (5.56)	-0.0883*** (6.53)
Institutional ownership		0.3712*** (13.56)
Firm size		0.1207*** (25.51)
Book-to-market		-0.1030*** (10.39)
ROA		0.0468** (2.23)
Stock return		-0.0846*** (6.77)
Earnings volatility		-0.0740*** (5.13)
Loss		-0.0700*** (4.02)
Class action litigation risk		-0.2833*** (12.14)
N	13,630	13,630
R^2	0.0023	0.2259

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