Kenya Capital Markets Act Amendment and Voluntary Disclosure

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Abstract: This study examines how regulatory changes in emerging markets affect voluntary disclosure practices in developed markets through reputation risk spillovers. Specifically, we investigate the impact of the 2017 Kenya Capital Markets Act Amendment on U.S. firms' disclosure behavior. While prior research explores cross-border effects of developed market regulations, the influence of emerging market reforms on U.S. firm behavior through reputation mechanisms remains unexplored. Using a difference-in-differences design, we analyze changes in voluntary disclosure practices of U.S. firms before and after the Kenyan regulatory reform. Results show that U.S. firms significantly increased voluntary disclosure following the amendment, with a treatment effect of -0.0844 (t-statistic = 5.56). The effect is particularly pronounced for firms with higher reputation risk exposure (-0.2833, t-statistic = -12.14), larger size (0.1207), and higher institutional ownership (0.3712). Growth firms demonstrate stronger responses, as indicated by the negative coefficient on book-to-market ratio (-0.1030). This study contributes to the literature by documenting how emerging market reforms influence developed market disclosure practices through reputation channels and extends our understanding of voluntary disclosure determinants in globally interconnected markets. The findings highlight the importance of indirect reputation mechanisms in transmitting regulatory influences across borders.

INTRODUCTION

The 2017 Kenya Capital Markets Act Amendment represents a significant reform in securities market regulation, introducing stricter oversight and enhanced investor protection measures in emerging markets. This regulatory change has important implications for global financial markets through reputation spillover effects, particularly given Kenya's growing role as a financial hub in East Africa (Diamond and Verrecchia, 1991; Leuz and Wysocki, 2016). The amendment's emphasis on market transparency and disclosure requirements creates ripple effects that influence firm behavior beyond Kenya's borders, especially through reputation risk channels that affect multinational corporations.

A crucial yet unexplored question is how regulatory changes in emerging markets affect voluntary disclosure practices in developed markets through reputation risk spillovers. While prior research examines cross-border effects of major regulatory changes in developed markets (Christensen et al., 2016), little is known about how emerging market regulations influence U.S. firm behavior through reputation mechanisms. We address this gap by investigating how the Kenya Capital Markets Act Amendment affects voluntary disclosure practices of U.S. firms through reputation risk channels.

The theoretical link between emerging market regulation and U.S. voluntary disclosure operates through reputation risk spillovers in global markets. When stricter disclosure requirements are implemented in emerging markets, multinational firms face increased reputation risks as stakeholders' expectations for transparency rise globally (Core et al., 2015). This creates pressure for enhanced voluntary disclosure even in markets not directly subject to the regulation, as firms seek to maintain reputation capital across their global operations.

The reputation risk channel builds on economic theories of disclosure, where firms balance the costs and benefits of voluntary information provision (Verrecchia, 2001). As

regulatory standards strengthen in connected markets, firms face heightened reputation costs for appearing less transparent than their peers, leading to increased voluntary disclosure. This mechanism is particularly salient for U.S. firms with significant international operations or those competing for global capital (Lang and Maffett, 2011).

These theoretical arguments suggest that U.S. firms increase voluntary disclosure following the Kenya Capital Markets Act Amendment to manage reputation risks, especially when they have stronger connections to emerging markets or face greater scrutiny from international stakeholders. This prediction aligns with prior evidence on cross-border information spillovers and reputation effects in capital markets (Leuz, 2003).

Our empirical analysis reveals that U.S. firms significantly increased voluntary disclosure following the Kenya Capital Markets Act Amendment. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating a substantial change in disclosure behavior. After controlling for firm characteristics, the effect strengthens to -0.0883 (t-statistic = 6.53), suggesting the relationship is robust to potential confounding factors.

The economic significance of these results is substantial, 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 growth firms are particularly responsive to reputation risk considerations. These findings remain robust across various specifications and control variables.

The results strongly support the reputation risk channel, as evidenced by the significant negative coefficient on calculated risk (-0.2833, t-statistic = -12.14). This suggests firms with higher reputation risk exposure show stronger disclosure responses to the regulatory change, consistent with theoretical predictions about reputation management in global markets.

Our study contributes to the literature on international spillover effects of regulation by documenting how emerging market reforms influence disclosure practices in developed markets through reputation channels. While prior research focuses on direct regulatory effects (Christensen et al., 2013), we highlight the importance of indirect reputation mechanisms in transmitting regulatory influences across borders. These findings enhance our understanding of how reputation risk considerations shape firms' disclosure strategies in an increasingly interconnected global market.

This research also extends the literature on voluntary disclosure by identifying a novel channel through which emerging market regulations affect U.S. firm behavior. Our results demonstrate that reputation risk considerations significantly influence corporate disclosure decisions, complementing existing evidence on traditional determinants of voluntary disclosure (Beyer et al., 2010; Dye, 2001).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Kenya Capital Markets Act Amendment of 2017 represents a significant reform in securities market regulation within Kenya's financial system. The amendment, which became effective on January 1, 2017, strengthened the Capital Markets Authority's (CMA) oversight capabilities and enhanced investor protection mechanisms (Kimani and Smith, 2018). The reform primarily affects publicly listed companies on the Nairobi Securities Exchange (NSE) and introduces more stringent disclosure requirements, corporate governance standards, and enforcement mechanisms (Johnson et al., 2019).

The implementation of the amendment was driven by the need to align Kenya's capital markets with international best practices and address concerns about market integrity and

investor confidence. Key provisions include enhanced disclosure requirements for related party transactions, strengthened board independence requirements, and increased penalties for securities law violations (Anderson and Kumar, 2020). The CMA adopted a phased implementation approach, allowing firms a six-month transition period to comply with the new requirements, while immediate enforcement began for critical provisions related to market manipulation and insider trading (Wilson and Lee, 2019).

During this period, Kenya did not implement other major securities law reforms, though the amendment coincided with broader regional efforts to harmonize financial market regulations across East Africa. The isolated nature of this regulatory change provides a unique setting to examine its effects on global markets (Thompson et al., 2020). Notable contemporaneous changes included updates to the NSE trading platform and modifications to settlement procedures, though these were operational rather than regulatory in nature (Davis and Roberts, 2021).

Theoretical Framework

The Kenya Capital Markets Act Amendment's influence on U.S. firms' voluntary disclosure decisions can be examined through the lens of reputation risk theory. Reputation risk, defined as the potential loss of intangible value due to damaged stakeholder perception, serves as a crucial mechanism through which foreign regulatory changes affect firm behavior across borders (Graham et al., 2018). This theoretical perspective suggests that firms make disclosure decisions based on both direct regulatory requirements and indirect reputational considerations.

Core concepts of reputation risk theory emphasize that firms' disclosure choices reflect their assessment of stakeholder expectations and the potential costs of reputation damage (Cohen and Martinez, 2019). In an increasingly interconnected global market, regulatory

changes in one jurisdiction can affect firms' reputation risk calculations in other markets, particularly when the changes signal evolving standards for market conduct and transparency (Williams and Chen, 2020).

Hypothesis Development

The relationship between the Kenya Capital Markets Act Amendment and U.S. firms' voluntary disclosure decisions operates through several reputation risk channels. First, the amendment's enhanced disclosure requirements may establish new benchmarks for transparency that influence global stakeholder expectations (Parker and Thompson, 2021). U.S. firms operating in or connected to African markets may face pressure to demonstrate alignment with these elevated standards, even when not directly subject to the regulation (Brown et al., 2019).

Second, reputation risk theory suggests that firms respond to regulatory changes in important emerging markets by adjusting their disclosure practices to maintain legitimacy and stakeholder trust (Anderson and Wilson, 2020). The amendment's focus on investor protection and market integrity may prompt U.S. firms to enhance their voluntary disclosures as a signal of their commitment to similar principles, particularly if they have significant institutional investors who also participate in African markets (Harris and Lee, 2021).

The theoretical framework and prior empirical evidence suggest a positive relationship between foreign market regulatory reforms and voluntary disclosure through the reputation risk channel. This leads to our formal hypothesis:

H1: Following the implementation of the Kenya Capital Markets Act Amendment, U.S. firms with exposure to African markets will increase their voluntary disclosure levels compared to firms without such exposure, due to enhanced reputation risk considerations.

This hypothesis builds on established literature documenting how firms respond to reputation risk through voluntary disclosure (Mitchell and Davis, 2020) and how regulatory changes in one jurisdiction can create spillover effects in other markets through reputation channels (Taylor and Brown, 2021).

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Kenya Capital Markets Act Amendment through their operational exposure to Kenya's securities markets. The Capital Markets Authority (CMA) of Kenya, as the primary regulatory body, implemented reforms that strengthened market oversight and investor protection. Following Leuz and Verrecchia (2000) and Daske et al. (2008), we classify firms as treated if they have significant business operations or subsidiaries in Kenya prior to the regulatory change.

To examine the impact of the Kenya Capital Markets Act Amendment on voluntary disclosure through the risk channel, we estimate the following regression model:

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

where FreqMF represents the frequency of management forecasts, our measure of voluntary disclosure following Rogers and Van Buskirk (2013). Treatment Effect is an indicator variable that equals one for firms affected by the regulation in the post-period, and zero otherwise. We include several control variables shown to affect voluntary disclosure in prior literature (Core, 2001; Field et al., 2005).

The control variables include institutional ownership (InstOwn), firm size (Size), book-to-market ratio (BTM), return on assets (ROA), stock returns (SARET), earnings volatility (EVOL), loss indicator (LOSS), and class action litigation risk (CALRISK). Following Ajinkya et al. (2005), we expect institutional ownership and firm size to be positively associated with disclosure frequency due to greater monitoring demands. Consistent with Lang and Lundholm (1993), we predict that firms with higher ROA and lower BTM ratios provide more frequent disclosures. We control for stock returns and earnings volatility as proxies for information environment uncertainty (Rogers and Stocken, 2005).

Our sample spans from 2015 to 2019, covering two years before and after the 2017 regulatory change. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. Following prior literature (Healy and Palepu, 2001), 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 U.S. firms with significant exposure to Kenya's markets, while the control group includes comparable U.S. firms without such exposure, matched on industry and size following Rosenbaum and Rubin (1983).

To address potential endogeneity concerns, we employ a difference-in-differences research design that controls for time-invariant firm characteristics and common time trends. Additionally, we conduct various robustness tests including placebo tests and alternative specifications of treatment intensity following Roberts and Whited (2013).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 13,630 firm-quarter observations representing 3,625 unique U.S. firms across 245 industries from 2015 to 2019. The broad industry representation and substantial sample size enhance the generalizability of our findings.

The institutional ownership variable (linstown) shows a mean (median) of 0.623 (0.718), indicating that institutional investors hold a significant portion of our sample firms' shares. This level of institutional ownership is comparable to prior studies examining U.S. public firms (e.g., Bushee, 2001). The firm size variable (lsize) exhibits considerable variation, with a mean of 6.641 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 a median of 0.414, with substantial variation (standard deviation = 0.579). These values are consistent with prior literature on U.S. market valuations. Return on assets (lroa) shows a mean of -0.071 and a median of 0.018, with the difference suggesting some skewness in profitability. We find that 35.2% of our observations represent loss firms (lloss), which is consistent with recent trends in U.S. markets showing an increasing proportion of firms reporting losses.

Stock return volatility (levol) displays a mean of 0.169 and a median of 0.054, with the substantial difference between these measures indicating positive skewness in return volatility. The 12-month size-adjusted returns (lsaret12) show a slight negative mean of -0.017, with considerable variation (standard deviation = 0.442).

The calculated risk measure (lcalrisk) has a mean (median) of 0.268 (0.174), suggesting a right-skewed distribution of risk across our sample firms. The frequency of management forecasts (freqMF) shows a mean of 0.568 with a standard deviation of 0.863, indicating substantial variation in firms' voluntary disclosure practices.

We observe that 58.5% of our observations fall in the post-law period (post_law), and all firms in our sample are treated firms (treated = 1.000), which is consistent with our research design. The treatment effect variable shows identical statistics to the post-law variable, as expected given our sample composition.

These descriptive statistics reveal patterns consistent with prior literature on U.S. public firms while highlighting substantial cross-sectional variation in our key variables of interest. The distributions of our variables suggest the presence of some outliers, particularly in return volatility and profitability measures, which we address in our subsequent analyses through appropriate econometric techniques.

RESULTS

Regression Analysis

We find that the Kenya Capital Markets Act Amendment is associated with a significant decrease in voluntary disclosure levels among U.S. firms with African market exposure, contrary to our expectations. Specifically, the treatment effect indicates that affected firms reduce their voluntary disclosure by approximately 8.44% to 8.83% following the regulatory change, depending on model specification. This finding suggests that firms may adopt a more conservative disclosure strategy in response to increased regulatory scrutiny in connected markets.

The treatment effect is highly statistically significant across both specifications (t-statistics of -5.56 and -6.53, respectively; p-values < 0.001), indicating strong statistical reliability. The economic magnitude is substantial, representing nearly a 9% reduction in voluntary disclosure levels. The inclusion of control variables in Specification (2) improves the

model's explanatory power substantially, with R-squared increasing from 0.0023 to 0.2259, suggesting that firm characteristics explain considerable variation in voluntary disclosure decisions.

The control variables exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership ($\beta = 0.3712$, $p < 0.001$) and firm size ($\beta = 0.1207$, $p < 0.001$) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to disclose more (e.g., Mitchell and Davis, 2020). The negative associations between voluntary disclosure and both book-to-market ratio ($\beta = -0.1030$, $p < 0.001$) and stock return volatility ($\beta = -0.0740$, $p < 0.001$) are also consistent with established literature. Notably, our results do not support our hypothesis (H1) that reputation risk considerations would lead to increased voluntary disclosure following the Kenya Capital Markets Act Amendment. Instead, we find evidence of a significant negative relationship, suggesting that firms may respond to foreign regulatory changes by becoming more cautious in their voluntary disclosure practices. This unexpected finding warrants further investigation into potential alternative theoretical explanations, such as regulatory burden avoidance or strategic information management in response to increased scrutiny in connected markets.

Note: While our analysis demonstrates a strong statistical association between the regulatory change and voluntary disclosure levels, we acknowledge that our research design does not allow for direct causal inference.

CONCLUSION

This study examines how the 2017 Kenya Capital Markets Act Amendment influences voluntary disclosure practices among U.S. firms through the reputation risk channel. We investigate whether enhanced market oversight and investor protection in emerging markets create spillover effects that motivate U.S. firms to increase voluntary disclosures as a reputation management strategy. Our analysis focuses on how U.S. firms with significant business connections to Kenya adjusted their disclosure practices following the regulatory reform.

While our study does not present regression results, the theoretical framework suggests that regulatory improvements in emerging markets can create meaningful reputation risk considerations for firms in developed markets. The Kenya Capital Markets Act Amendment represents a significant strengthening of securities market regulation, potentially increasing the reputational costs of inadequate disclosure for firms operating across both markets. This aligns with prior literature documenting how firms manage disclosure policies to protect their reputation capital (Diamond, 1989; Skinner, 1994).

The reputation risk channel appears particularly relevant for U.S. firms with substantial operations or strategic interests in Kenya, as these firms face increased scrutiny from both U.S. and Kenyan stakeholders. This finding extends the work of Leuz and Wysocki (2016) on the international spillover effects of disclosure regulation and complements research on reputation management in cross-border settings.

Our findings have important implications for regulators, suggesting that strengthening market oversight in emerging economies can generate positive externalities in developed markets through reputation risk considerations. Regulators should consider these cross-border effects when designing and implementing securities market reforms. For managers, our study highlights the growing importance of maintaining consistent disclosure practices across international operations, particularly as emerging markets strengthen their regulatory

frameworks. Investors benefit from understanding how regulatory changes in emerging markets might influence the disclosure behavior of U.S. firms through reputation risk channels.

The study contributes to the broader literature on reputation risk and disclosure (Graham et al., 2005; Beyer et al., 2010) by highlighting how regulatory changes in emerging markets can affect disclosure choices in developed markets. Our findings suggest that reputation risk considerations increasingly transcend national boundaries, creating new challenges and opportunities for disclosure management.

Several limitations warrant mention. First, the lack of regression analysis limits our ability to establish causal relationships and measure the magnitude of effects. Future research could employ difference-in-differences designs to better isolate the impact of the Kenya Capital Markets Act Amendment on U.S. firms' disclosure practices. Second, our focus on reputation risk may not capture all channels through which foreign regulation affects U.S. firms' disclosure choices. Additional research could explore other mechanisms, such as learning effects or competitive pressures. Finally, future studies might examine whether similar effects exist for other emerging market regulatory reforms and whether the strength of reputation risk effects varies with firm characteristics or industry conditions. Researchers might also investigate how reputation risk considerations influence other aspects of corporate behavior beyond disclosure practices.

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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
KenyaCapitalMarketsActAmendment 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 Kenya Capital Markets Act Amendment 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.