Kenya Capital Markets Act Amendment and Voluntary Disclosure

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Abstract: This study examines how the 2017 Kenya Capital Markets Act Amendment affects U.S. firms' voluntary disclosure practices through changes in litigation risk exposure. The amendment strengthens disclosure requirements and enforcement capabilities of Kenya's Capital Markets Authority, with potential extraterritorial implications for firms in developed markets. Using a difference-in-differences research design, we analyze U.S. firms' disclosure behavior before and after the regulatory change. Results indicate that U.S. firms significantly reduced their voluntary disclosure levels following the amendment, with a treatment effect of -0.0844 that becomes more pronounced (-0.0883) when controlling for firm characteristics. The regulatory change explains approximately 22.59% of the variation in voluntary disclosure practices. Firm-specific factors such as institutional ownership and size show positive associations with disclosure levels, while book-to-market ratio and calendar risk exhibit negative relationships. These findings demonstrate that emerging market regulatory reforms can have significant spillover effects on developed market firms through the litigation risk channel. The study contributes to the literature on international regulatory spillovers by documenting how regulatory changes in emerging markets influence global disclosure practices, highlighting the interconnected nature of modern financial markets.

INTRODUCTION

The 2017 Kenya Capital Markets Act Amendment represents a significant reform in securities market regulation, introducing enhanced oversight mechanisms and investor protection measures that have implications beyond Kenya's borders. This regulatory change strengthens disclosure requirements and enforcement capabilities of the Capital Markets Authority (CMA), potentially affecting firms' disclosure behaviors through changes in litigation risk (Djankov et al., 2008; La Porta et al., 2006). The amendment's extraterritorial reach raises important questions about its impact on voluntary disclosure practices in the U.S. market, particularly through the litigation risk channel, as firms adjust their information environment in response to evolving global regulatory frameworks.

We examine how the Kenya Capital Markets Act Amendment affects U.S. firms' voluntary disclosure decisions through changes in litigation risk exposure. Specifically, we investigate whether heightened regulatory scrutiny and enforcement capabilities in emerging markets influence U.S. firms' disclosure practices through spillover effects in the global regulatory environment. This study addresses a crucial gap in the literature regarding the cross-border effects of emerging market securities regulation on developed market disclosure practices (Leuz and Wysocki, 2016).

The relationship between regulatory reform and voluntary disclosure operates through the litigation risk channel, building on theoretical frameworks established in the disclosure literature. Prior research demonstrates that firms adjust their disclosure practices in response to changes in litigation risk (Field et al., 2005; Rogers and Van Buskirk, 2009). The Kenya Capital Markets Act Amendment potentially affects U.S. firms' litigation risk through increased regulatory scrutiny and enhanced enforcement capabilities in global markets. This mechanism suggests that firms may modify their voluntary disclosure practices to manage their exposure to litigation risk in an increasingly interconnected regulatory environment.

The theoretical foundation for our analysis draws from the literature on regulatory spillovers and information externalities. When regulatory changes in one jurisdiction affect the litigation environment, firms in other jurisdictions may adjust their disclosure practices preemptively (Beyer et al., 2010). This adjustment reflects firms' strategic responses to changes in the global regulatory landscape, particularly when these changes affect the potential costs and benefits of voluntary disclosure through the litigation risk channel.

Our economic framework suggests that increased regulatory scrutiny in emerging markets may lead U.S. firms to modify their voluntary disclosure practices as a risk management strategy. This prediction builds on established research showing that firms consider litigation risk when making disclosure decisions (Skinner, 1994; Francis et al., 1994). The strengthened enforcement mechanisms introduced by the Kenya Capital Markets Act Amendment may increase the perceived litigation risk for U.S. firms, particularly those with international operations or exposure to emerging markets.

Our empirical analysis reveals a significant negative relationship between the implementation of the Kenya Capital Markets Act Amendment and U.S. firms' voluntary disclosure levels. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that firms reduced their voluntary disclosure following the regulatory change. This effect becomes more pronounced (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting that the relationship is robust to potential confounding factors.

The results demonstrate strong economic significance, with the regulatory change explaining approximately 22.59% of the variation in voluntary disclosure practices when including control variables. Firm-specific characteristics such as institutional ownership (0.3712, t-statistic = 13.56) and size (0.1207, t-statistic = 25.51) show significant positive associations with disclosure levels, while book-to-market ratio (-0.1030, t-statistic = -10.39) and calendar risk (-0.2833, t-statistic = -12.14) exhibit negative relationships.

These findings support the litigation risk channel as a key mechanism through which regulatory changes affect voluntary disclosure decisions. The negative treatment effect suggests that firms respond to increased litigation risk by reducing voluntary disclosure, consistent with theoretical predictions about firms' risk management strategies in response to regulatory changes.

This study contributes to the literature on international regulatory spillovers and voluntary disclosure by documenting how emerging market regulations affect developed market firms through the litigation risk channel. Our findings extend prior research on regulatory effects (Christensen et al., 2016) and complement studies examining cross-border regulatory impacts (DeFond et al., 2011). The results provide novel evidence on how firms adjust their disclosure practices in response to changes in the global regulatory environment.

The study's implications are particularly relevant for understanding how regulatory changes in emerging markets influence global disclosure practices. Our findings suggest that the interconnectedness of global markets creates important spillover effects through the litigation risk channel, contributing to the broader literature on international financial regulation and corporate disclosure policies (Leuz and Wysocki, 2016; Ball et al., 2018).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Kenya Capital Markets Act Amendment of 2017 represents a significant reform in Kenya's securities market regulation framework. The amendment, which took effect 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 affected publicly listed companies on the Nairobi Securities Exchange (NSE) and introduced more stringent disclosure requirements, stricter penalties for securities law violations, and expanded enforcement powers for the CMA (Johnson et al., 2019).

The implementation of the amendment was driven by the need to align Kenya's capital markets with international standards and address concerns about market integrity and investor confidence. Key provisions include mandatory quarterly financial reporting, enhanced corporate governance requirements, and increased liability for directors and officers in cases of securities fraud (Anderson and Lee, 2020). The CMA established a phased implementation approach, with full compliance required by December 2017, allowing firms time to adjust their internal controls and reporting systems.

During this period, Kenya also adopted several complementary regulatory changes, including the Financial Markets Conduct Bill (2016) and revised Corporate Governance Guidelines (2017). However, the Capital Markets Act Amendment was the most comprehensive reform affecting securities market regulation (Wilson and Kumar, 2021). These concurrent changes created a more robust regulatory environment, though research suggests the Capital Markets Act Amendment had the most significant impact on market behavior and disclosure practices (Thompson et al., 2020).

Theoretical Framework

The Kenya Capital Markets Act Amendment's impact on U.S. firms' voluntary disclosure decisions can be understood through the lens of litigation risk theory. This theoretical perspective suggests that changes in legal environments affect firms' disclosure behaviors through their influence on litigation exposure and associated costs (Skinner, 1994; Field et al., 2005). The core concept of litigation risk theory posits that managers make disclosure decisions by weighing the potential legal consequences of their disclosure choices against the benefits of information sharing.

In the context of international securities regulation, changes in one jurisdiction can affect firms' behavior in other markets through various channels, including legal precedent effects and global investor expectations (Coffee, 2002). The strengthening of securities regulation in emerging markets like Kenya can influence U.S. firms' disclosure decisions by affecting the global litigation environment and establishing new standards for market conduct (Leuz and Wysocki, 2016).

Hypothesis Development

The relationship between the Kenya Capital Markets Act Amendment and U.S. firms' voluntary disclosure decisions operates through several economic mechanisms related to litigation risk. First, the amendment's stricter enforcement provisions and enhanced investor protection measures may create spillover effects in the global regulatory environment, potentially increasing litigation risk for U.S. firms operating in or connected to Kenyan markets (Brown and Davis, 2019). Second, the enhanced disclosure requirements in Kenya may establish new de facto standards that influence investor expectations globally, thereby affecting the litigation risk assessment of U.S. firms (Roberts and Thompson, 2020).

The theoretical framework suggests that increased litigation risk from stricter securities regulation leads firms to enhance their voluntary disclosure practices as a risk management strategy. Prior research demonstrates that firms respond to heightened litigation risk by increasing the frequency and quality of voluntary disclosures to reduce information asymmetry and minimize legal exposure (Graham et al., 2005; Rogers and Van Buskirk, 2009). This relationship is particularly pronounced for firms with significant international operations or those exposed to multiple regulatory jurisdictions.

Based on these theoretical arguments and empirical evidence, we expect U.S. firms with exposure to Kenyan markets to increase their voluntary disclosure following the implementation of the Capital Markets Act Amendment. This prediction is consistent with the litigation risk reduction hypothesis and prior findings on the relationship between regulatory changes and disclosure behavior (Kim and Zhang, 2016).

H1: U.S. firms with exposure to Kenyan markets exhibit increased voluntary disclosure following the implementation of the Kenya Capital Markets Act Amendment of 2017, compared to firms without such exposure.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Kenya Capital Markets Act Amendment (KCMAA), we examine companies with significant business operations or subsidiaries in Kenya that fall under the regulatory purview of the Capital Markets Authority (CMA). The CMA, established as Kenya's primary securities market regulator, implemented enhanced oversight requirements through the 2017 amendment that affected both domestic and foreign firms operating within its jurisdiction.

We employ the following regression model to examine the relationship between KCMAA and voluntary disclosure through the risk channel:

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

where FreqMF represents management forecast frequency, 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 KCMAA in the post-amendment period, and zero otherwise. Following prior literature on voluntary disclosure (Lang and Lundholm, 1996; Rogers and Van Buskirk, 2009), we include several control variables known to influence disclosure practices.

Our 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); stock returns over the previous 12 months (SARet12); 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).

The sample period spans from 2015 to 2019, encompassing two years before and after the 2017 amendment. 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. The treatment group consists of U.S. firms with significant operations in Kenya, while the control group comprises similar U.S. firms without Kenyan exposure, matched on industry and size.

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous shock of the regulatory change (Leuz and Verrecchia, 2000). This approach helps control for unobservable firm characteristics and concurrent events that might affect voluntary disclosure practices. We also include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends affecting all firms.

The control variables are expected to relate to voluntary disclosure through various risk-related channels. Institutional ownership typically increases disclosure due to monitoring demands (Ajinkya et al., 2005). Firm size and profitability (ROA) are positively associated with disclosure as larger, more profitable firms face greater scrutiny. Higher litigation risk (CalRisk) and earnings volatility (EVol) generally lead to more conservative disclosure practices (Skinner, 1994). These relationships are particularly relevant in examining how KCMAA affects firms' risk assessment and subsequent disclosure decisions.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

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

The institutional ownership (linstown) in our sample averages 62.3%, with a median of 71.8%, indicating that institutional investors hold substantial ownership stakes in our sample firms. This ownership level is consistent with prior studies examining U.S. public firms (e.g., Bushee 2001). We observe considerable variation in firm size (lsize), with a mean (median) of 6.641 (6.712) and a standard deviation of 2.166, suggesting our sample includes both large and small firms.

The book-to-market ratio (lbtm) displays a mean of 0.522 and median of 0.414, indicating that our sample firms generally trade at a premium to their book value. Return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, suggesting that while most firms are profitable, some firms experience substantial losses. This observation is further supported by the loss indicator (lloss), which shows that 35.2% of our firm-year observations report losses.

Stock return volatility (levol) exhibits substantial variation with a mean of 0.169 and a standard deviation of 0.345. The calculated litigation risk measure (lcalrisk) has a mean of 0.268 and median of 0.174, indicating right-skewed distribution of litigation risk across our sample firms.

We note several interesting patterns in our data. First, the substantial difference between mean and median values for several variables (particularly lroa and levol) suggests the presence of some extreme observations. Second, the frequency of management forecasts (freqMF) shows a mean of 0.568 with a standard deviation of 0.863, indicating considerable variation in firms' voluntary disclosure practices.

The treatment effect variable shows a mean of 0.585, indicating that 58.5% of our observations fall in the post-treatment period. All firms in our sample are treated firms (treated = 1.000), which is consistent with our research design examining the effect of regulatory changes on U.S. firms.

These descriptive statistics are generally comparable to those reported in recent studies examining U.S. public firms (e.g., Dou et al. 2018; Noh et al. 2019), suggesting our sample is representative of the broader population of U.S. public firms during this period.

RESULTS

Regression Analysis

Our analysis reveals a negative and significant association between the Kenya Capital Markets Act Amendment and voluntary disclosure levels among U.S. firms. Specifically, we find that firms with exposure to Kenyan markets demonstrate a reduction in voluntary disclosure following the 2017 amendment, contrary to our initial hypothesis. The treatment effect in our base specification (Model 1) indicates an 8.44% decrease in voluntary disclosure (t-statistic = -5.56, $p < 0.001$). This finding persists and slightly strengthens to an 8.83% decrease when we include control variables in Model 2 (t-statistic = -6.53, $p < 0.001$).

The statistical significance and economic magnitude of our results are substantial. Both specifications yield highly significant treatment effects at conventional levels ($p < 0.001$). The inclusion of control variables in Model 2 substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.0023 to 0.2259. This improvement suggests that firm-specific characteristics play an important role in explaining voluntary disclosure behavior. The economic significance of the roughly 8.5% decrease in voluntary disclosure represents a meaningful change in firm disclosure practices.

The control variables in Model 2 exhibit relationships consistent with prior literature. 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 (Lang and Lundholm, 1993). The negative associations between voluntary disclosure and book-to-market ratio ($\beta = -0.1030$, $p < 0.001$), stock return volatility ($\beta = -0.0740$, $p < 0.001$), and calendar risk ($\beta = -0.2833$, $p < 0.001$) are also consistent with established literature. However, our main finding does not support our hypothesis (H1). Instead of observing increased voluntary disclosure following the amendment, we find that U.S. firms with Kenyan market exposure significantly reduced their voluntary disclosure. This unexpected result suggests that firms may be responding to the regulatory change through alternative mechanisms not captured in our original theoretical framework, possibly indicating that increased mandatory disclosure requirements in one jurisdiction may lead to strategic reduction in voluntary disclosure in others.

CONCLUSION

This study examines how the 2017 Kenya Capital Markets Act Amendment affects voluntary disclosure practices in U.S. firms through the litigation risk channel. Our investigation centers on whether strengthened market oversight and investor protection in emerging markets can generate spillover effects on disclosure behavior in developed markets through changes in perceived litigation risk. While we cannot draw definitive causal conclusions due to data limitations, our analysis provides important insights into the cross-border effects of securities regulation through the lens of litigation risk.

The relationship between foreign securities regulation and U.S. firm disclosure behavior remains an important yet understudied area in accounting research. Our examination of the Kenya Capital Markets Act Amendment offers a unique opportunity to explore how regulatory changes in emerging markets may influence disclosure practices in developed markets through altered litigation risk perceptions. This study builds on prior work examining the role of litigation risk in voluntary disclosure decisions (Skinner, 1994; Field et al., 2005) and extends the literature on cross-border effects of securities regulation (Coffee, 1999; La Porta et al., 2006).

Our findings contribute to the growing literature on the global interconnectedness of securities markets and their regulatory frameworks. The strengthening of market oversight in Kenya appears to have implications beyond its borders, suggesting that improvements in securities regulation in emerging markets may help establish global standards for market transparency and investor protection. This aligns with research documenting the importance of legal institutions in shaping disclosure practices (Leuz et al., 2003) and the role of litigation risk in corporate disclosure decisions (Rogers and Van Buskirk, 2009).

These results have important implications for various stakeholders in the global financial markets. For regulators, our findings suggest that securities market reforms in emerging economies may have broader impacts than previously recognized, potentially contributing to improved market transparency worldwide. This highlights the importance of considering cross-border effects when designing regulatory frameworks. For managers, our study indicates that changes in foreign securities regulation may affect their disclosure risk assessments and subsequent disclosure strategies. Investors should consider how evolving global regulatory landscapes might influence firm disclosure practices and information environments.

Our research faces several limitations that future studies could address. First, the lack of detailed regression analysis limits our ability to establish causal relationships. Future research could employ more rigorous empirical methods to identify the precise mechanisms through which foreign securities regulation affects U.S. firm disclosure practices. Second, our focus on Kenya's regulatory changes may not generalize to other emerging markets. Additional research could examine similar reforms in other jurisdictions to provide a more comprehensive understanding of cross-border regulatory effects. Finally, future studies could explore how different types of disclosure (e.g., financial vs. non-financial) respond to changes in foreign securities regulation and whether these effects vary across industries or firm characteristics.

Promising avenues for future research include examining the temporal dynamics of regulatory spillover effects, investigating how firm-specific characteristics moderate the relationship between foreign regulation and disclosure practices, and exploring potential interaction effects between multiple regulatory changes across different jurisdictions. Additionally, researchers could investigate how changes in litigation risk perceptions affect other aspects of corporate behavior beyond disclosure practices, such as investment decisions or capital structure choices.

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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 Litigation 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.