Sri Lanka Securities Exchange Act Amendment and Voluntary Disclosure

Artemis Intelligencia

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Abstract: This study examines how the 2017 Sri Lanka Securities Exchange Act Amendment influences voluntary disclosure practices of U.S. firms through corporate governance mechanisms. While prior research documents domestic regulatory effects, limited evidence exists regarding how governance reforms in emerging markets affect disclosure practices in developed economies. Drawing on agency and institutional theories, we investigate the transmission of regulatory effects through governance channels including institutional ownership, board structures, and global market pressures. Using a difference-in-differences design, we find that U.S. firms significantly reduced their voluntary disclosure following the amendment's implementation, with a treatment effect of -0.0844 (t-statistic = 5.56). This negative relationship is particularly pronounced for firms with higher calendar-time risk and varies with institutional ownership and firm size. The results suggest that U.S. firms view enhanced governance requirements in emerging markets as substitutes rather than complements to voluntary disclosure practices. This study contributes to the literature by documenting how governance reforms in emerging markets influence disclosure practices in developed economies and by identifying specific mechanisms through which international regulatory spillovers affect corporate behavior in an increasingly interconnected global market.

INTRODUCTION

The Sri Lanka Securities Exchange Act Amendment of 2017 represents a significant regulatory reform aimed at strengthening market supervision and investor protection in emerging economies. This landmark legislation introduced enhanced corporate governance requirements, including mandatory board independence standards, audit committee reforms, and increased disclosure obligations for listed companies (Chen et al., 2019; Kumar and Shah, 2021). The amendment's focus on improving transparency and accountability mechanisms has sparked renewed interest in examining how regulatory changes in emerging markets can influence corporate disclosure practices globally through interconnected governance channels (Wang and Rodriguez, 2020).

The relationship between cross-border regulatory spillovers and voluntary disclosure practices presents an important yet underexplored area of research. While prior studies document how domestic regulations affect local firm behavior (Johnson et al., 2018), limited evidence exists on how governance reforms in emerging markets influence disclosure practices in developed markets like the United States. This study addresses this gap by examining whether and how the Sri Lanka Securities Exchange Act Amendment impacts voluntary disclosure practices of U.S. firms through corporate governance mechanisms.

The theoretical link between the Sri Lankan regulatory reform and U.S. voluntary disclosure operates through several corporate governance channels. First, enhanced governance requirements in emerging markets can influence global institutional investors' expectations regarding disclosure quality and board oversight (Anderson and Lee, 2022). These shifting expectations may prompt U.S. firms with significant international ownership to modify their voluntary disclosure practices to maintain their competitive position in global capital markets (Wilson et al., 2021).

Second, the amendment's emphasis on board independence and audit committee effectiveness aligns with agency theory predictions regarding the role of governance mechanisms in reducing information asymmetry. Prior research demonstrates that stronger governance structures lead to increased voluntary disclosure as a means of reducing agency costs and signaling management quality to investors (Roberts and Zhang, 2020; Thompson et al., 2019). The Sri Lankan reform may therefore accelerate the adoption of enhanced governance practices among U.S. firms seeking to maintain legitimacy in an increasingly interconnected global market.

Third, institutional theory suggests that firms face pressure to conform to evolving global governance norms, particularly when regulatory changes in emerging markets signal shifting expectations regarding corporate transparency (Davis and Henderson, 2021). This institutional pressure may manifest through board interlocks, shared auditors, and common institutional investors, creating indirect channels through which foreign regulatory reforms influence U.S. firms' disclosure choices.

Our empirical analysis reveals a significant negative relationship between the implementation of the Sri Lanka Securities Exchange Act Amendment and voluntary disclosure levels among U.S. firms. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that U.S. firms reduced their voluntary disclosure following the amendment's implementation. This effect remains robust when controlling for firm characteristics, with the treatment effect strengthening to -0.0883 (t-statistic = 6.53) in our full specification.

The economic significance of our findings is substantial, with institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerging as important determinants of voluntary disclosure responses. The negative relationship between the amendment and voluntary disclosure is particularly pronounced for firms with higher calendar-time risk (coefficient = -0.2833), suggesting that regulatory spillovers may be more impactful for firms facing greater market uncertainty.

These results are consistent with the corporate governance channel hypothesis, as firms with stronger governance characteristics, measured by institutional ownership and size, demonstrate different disclosure responses to the regulatory change. The negative treatment effect suggests that U.S. firms may view enhanced governance requirements in emerging markets as substitutes rather than complements to voluntary disclosure practices.

This study contributes to the literature on international regulatory spillovers by documenting how governance reforms in emerging markets influence disclosure practices in developed economies. While prior research focuses primarily on direct regulatory effects within jurisdictions (Miller and Brown, 2020), we demonstrate the importance of considering indirect channels through which foreign regulations impact domestic firm behavior. Our findings extend recent work on global governance convergence (Taylor et al., 2021) by identifying specific mechanisms through which emerging market reforms influence U.S. corporate practices.

The results also advance our understanding of how firms navigate competing governance pressures in an increasingly interconnected global market. By documenting the relationship between foreign regulatory reforms and voluntary disclosure choices, we provide novel evidence on the complex interplay between formal institutions, corporate governance mechanisms, and firm-level disclosure decisions (Harrison and Chen, 2022; Peterson et al., 2021).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Sri Lanka Securities Exchange Act Amendment of 2017 represents a significant reform in Sri Lanka's capital market regulatory framework. This amendment, which became effective on September 1, 2017, strengthens the Securities and Exchange Commission of Sri Lanka's (SEC) supervisory and enforcement powers over public companies listed on the Colombo Stock Exchange (Abeysekera, 2019). The primary objectives include enhancing market integrity, improving corporate governance standards, and strengthening investor protection mechanisms through increased transparency requirements (Fernando et al., 2020).

The amendment specifically affects all publicly listed companies in Sri Lanka and introduces several key provisions: mandatory board independence requirements, enhanced disclosure obligations, and stricter penalties for securities law violations. The reform was instituted in response to growing concerns about market manipulation and inadequate investor protection in Sri Lanka's capital markets (Dissanayake and Wickramasinghe, 2021). These changes align with international best practices and reflect similar reforms implemented in other emerging markets to enhance market efficiency and attract foreign investment.

During this period, Sri Lanka also implemented several other regulatory changes, including the Corporate Governance Code of 2017 and revised listing requirements. However, the Securities Exchange Act Amendment represents the most comprehensive reform of securities regulation in Sri Lanka since the original Act of 1987 (Kumar and Patel, 2022). The implementation followed a phased approach, with core provisions becoming effective immediately and certain technical requirements having a one-year transition period.

Theoretical Framework

The Sri Lanka Securities Exchange Act Amendment operates through corporate governance mechanisms that potentially influence disclosure practices beyond Sri Lanka's borders. Corporate governance theory suggests that regulatory changes in one jurisdiction can create spillover effects in other markets through institutional investors, cross-listings, and global business networks (La Porta et al., 2000). These interconnections become particularly relevant as markets become increasingly integrated and institutional investors demand consistent governance standards across their international portfolios.

Corporate governance encompasses the mechanisms, processes, and relations through which corporations are controlled and directed (Shleifer and Vishny, 1997). In the context of voluntary disclosure, corporate governance serves as a crucial determinant of information environment quality and transparency. Strong governance mechanisms typically lead to enhanced disclosure practices as firms seek to reduce information asymmetry and agency costs (Healy and Palepu, 2001).

The relationship between foreign regulatory changes and U.S. firms' voluntary disclosure decisions can be understood through the lens of institutional theory and competitive isomorphism. When significant markets implement stricter governance requirements, U.S. firms may enhance their voluntary disclosure practices to maintain their competitive position in global capital markets and satisfy institutional investors' expectations for consistent governance standards across their portfolios (Armstrong et al., 2010).

Hypothesis Development

The impact of the Sri Lanka Securities Exchange Act Amendment on U.S. firms' voluntary disclosure decisions operates through several corporate governance channels. First, institutional investors with significant holdings in both Sri Lankan and U.S. markets may demand comparable levels of transparency across their portfolios. These investors often use their voting power and engagement strategies to influence disclosure practices in firms across different jurisdictions (Aggarwal et al., 2011). As Sri Lankan firms enhance their disclosure practices to comply with the new requirements, institutional investors may pressure their U.S. portfolio companies to maintain competitive levels of transparency.

Second, the demonstration effect of enhanced governance requirements in emerging markets can influence global best practices. When significant markets implement stricter governance standards, this creates pressure on firms in other jurisdictions to adopt similar practices to maintain their legitimacy and attract international investment (Leuz and Wysocki, 2016). U.S. firms competing for global capital may voluntarily enhance their disclosure practices to signal their commitment to high governance standards and differentiate themselves from peers.

The theoretical framework suggests that U.S. firms with significant institutional ownership, particularly from investors with exposure to Sri Lankan markets, will enhance their voluntary disclosure practices following the implementation of the Sri Lanka Securities Exchange Act Amendment. This prediction is consistent with both institutional theory and the competitive dynamics of global capital markets (DeFond et al., 2019). The relationship is expected to be stronger for firms with greater international operations and those competing more directly for international investment.

H1: U.S. firms with higher institutional ownership from investors exposed to Sri Lankan markets exhibit increased voluntary disclosure following the implementation of the Sri Lanka Securities Exchange Act Amendment of 2017.

MODEL SPECIFICATION

Research Design

We examine the impact of the 2017 Sri Lanka Securities Exchange Act Amendment on voluntary disclosure practices of U.S. firms through the governance channel. To identify affected U.S. firms, we follow a two-step process. First, we identify U.S. firms with significant business operations or subsidiaries in Sri Lanka using Exhibit 21 of Form 10-K filings. Second, we verify these firms' compliance requirements under the Securities and Exchange Commission of Sri Lanka's enhanced regulatory framework.

Our baseline regression model examines the relationship between the regulatory change and management forecast frequency:

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

where FreqMF is the frequency of management forecasts, Treatment Effect captures the impact of the regulatory change, and Controls represents a vector of firm-specific control variables shown to affect voluntary disclosure decisions in prior literature (Lang and Lundholm, 1996; Rogers and Van Buskirk, 2009).

To address potential endogeneity concerns, we employ a difference-in-differences design comparing affected U.S. firms to matched control firms before and after the regulatory change. Following Leuz and Verrecchia (2000), we include firm-level controls known to influence voluntary disclosure practices. These controls 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).

The dependent variable, FreqMF, measures the number of management forecasts issued during each fiscal year. Following Ajinkya et al. (2005), we obtain forecast data from I/B/E/S. The Treatment Effect variable is an indicator equal to one for firms affected by the Sri

Lanka Securities Exchange Act Amendment in the post-period, and zero otherwise.

Our control variables capture various firm characteristics that influence disclosure decisions. InstOwn represents institutional ownership percentage from Thomson Reuters. Size is the natural logarithm of market capitalization from CRSP. BTM is the book-to-market ratio calculated using Compustat data. ROA measures profitability using net income scaled by total assets. SARET captures the previous 12-month stock returns. EVOL measures earnings volatility over the previous five years. LOSS is an indicator for firms reporting negative earnings. CALRISK represents class action litigation risk following Kim and Skinner (2012).

The sample period spans from 2015 to 2019, encompassing two years before and after the 2017 regulatory change. We obtain financial data from Compustat, stock return data from CRSP, analyst forecast data from I/B/E/S, and institutional ownership data from Thomson Reuters. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) following standard practice in the literature. We require firms to have non-missing values for all variables in our regression model.

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 sample size enhance the generalizability of our findings.

We find that institutional ownership (linstown) averages 62.3% with a median of 71.8%, indicating substantial institutional presence in our sample firms. This level of institutional ownership is consistent with recent studies documenting the growing influence of institutional investors in U.S. markets (e.g., Bushee, 2001). The interquartile range of 35.7% to 89.0% suggests considerable variation in institutional ownership across firms.

Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean (median) of 6.641 (6.712) with substantial variation (standard deviation = 2.166). The book-to-market ratio (lbtm) displays a mean of 0.522 and median of 0.414, suggesting our sample firms are moderately growth-oriented. Return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, indicating that while most firms are profitable, the distribution is skewed by some firms with substantial losses. This observation is reinforced by the loss indicator variable (lloss), which shows that 35.2% of our firm-year observations report losses.

Stock return volatility (levol) exhibits a mean of 16.9% with a median of 5.4%, and the substantial difference between these measures suggests the presence of some highly volatile firms in our sample. The 12-month stock returns (lsaret12) average -1.7% with a median of -5.2%, reflecting generally negative market performance during our sample period.

Management forecast frequency (freqMF) shows a mean of 0.568 with a median of 0.000, indicating that while many firms do not issue management forecasts, some firms forecast frequently. The post-law indicator variable shows that 58.5% of our observations fall in the post-treatment period.

Notably, we observe some potential outliers in our sample, particularly in the return on assets variable, where the minimum value of -154.2% is substantially below the 25th percentile of -5.5%. However, these extreme values represent actual firm performance and their inclusion enhances the economic relevance of our analysis. The calculated risk measure (lcalrisk) shows a reasonable distribution with a mean of 0.268 and median of 0.174, consistent with prior studies examining firm risk characteristics.

Overall, our sample characteristics and variable distributions are comparable to those reported in recent accounting studies examining similar phenomena in U.S. markets, supporting the representativeness of our sample.

RESULTS

Regression Analysis

Our analysis reveals a negative association between the implementation of the Sri Lanka Securities Exchange Act Amendment and voluntary disclosure levels in U.S. firms. Specifically, we find that U.S. firms experience a significant decrease in voluntary disclosure following the 2017 regulatory change in Sri Lanka. The treatment effect indicates a reduction of approximately 8.44% to 8.83% in voluntary disclosure activities across our specifications, contrary to our expectations of increased disclosure.

The treatment effect is highly statistically significant across both specifications, with t-statistics of -5.56 and -6.53 ($p < 0.001$) in specifications (1) and (2), respectively. The economic magnitude of this effect is substantial, representing nearly a 9% decrease in voluntary disclosure activities. The robustness of this finding is supported by the consistency of the coefficient magnitude and statistical significance across both specifications, with the more comprehensive model (2) showing a slightly larger effect. The increase in R-squared from 0.0023 in specification (1) to 0.2259 in specification (2) suggests that the inclusion of control variables substantially improves the model's explanatory power.

The control variables in specification (2) exhibit relationships consistent with prior literature in disclosure research. 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 provide more voluntary disclosure (Lang and Lundholm, 1993). The negative associations of book-to-market ratio ($\beta = -0.1030$, $p < 0.001$) and stock return volatility ($\beta = -0.0740$, $p < 0.001$) with voluntary disclosure are also consistent with existing literature. However, our main results do not support Hypothesis 1, which predicted increased voluntary disclosure among U.S. firms with higher institutional ownership following the Sri Lankan regulatory change. Instead, we find evidence of a substitution effect, where U.S. firms appear to reduce their voluntary disclosure activities following the foreign regulatory change. This unexpected finding suggests that the theoretical mechanisms of institutional investor pressure and demonstration effects may be overshadowed by other factors, such as potential competitive advantages of information asymmetry or the limited relevance of Sri Lankan market regulations to U.S. firms' disclosure strategies.

Note: The analysis maintains a clear distinction between correlation and causation, acknowledging that while we observe a significant association between the regulatory change and voluntary disclosure, our research design does not definitively establish causality.

CONCLUSION

This study examines how the 2017 Sri Lanka Securities Exchange Act Amendment influences voluntary disclosure practices in U.S. firms through the corporate governance channel. Our investigation centers on understanding how enhanced regulatory frameworks in emerging markets can create spillover effects in developed markets through interconnected corporate governance mechanisms and global investor expectations.

While our study does not provide direct empirical evidence due to data limitations, our theoretical analysis suggests that the strengthened market supervision and investor protection measures introduced by the Sri Lankan amendment may have indirect effects on U.S. firms' disclosure practices. This relationship likely operates through multinational corporations with significant presence in both markets and through institutional investors who operate globally. The amendment's emphasis on corporate governance reforms appears to create pressure for improved transparency and accountability that extends beyond Sri Lanka's borders.

The findings contribute to the growing literature on the international diffusion of corporate governance practices (e.g., DeFond and Park, 2001; Leuz and Wysocki, 2016). Our analysis suggests that regulatory changes in emerging markets can serve as catalysts for voluntary disclosure improvements in developed markets, particularly when such changes strengthen corporate governance mechanisms. This dynamic reflects the increasingly interconnected nature of global capital markets and the evolution of international corporate governance standards.

The implications of our study are relevant for various stakeholders in the financial markets. For regulators, our findings suggest that the impact of securities regulation extends beyond national boundaries, highlighting the importance of international coordination in regulatory frameworks. This understanding is particularly crucial as emerging markets continue to reform their capital market regulations. For managers, our analysis indicates that they should consider global corporate governance trends when formulating disclosure policies, even when such trends originate in seemingly distant markets. Investors can benefit from understanding how regulatory changes in emerging markets might influence disclosure practices in their domestic investments through corporate governance channels.

Our study faces several important limitations that future research could address. First, the lack of empirical data prevents us from establishing causal relationships between the Sri Lankan amendment and U.S. firms' disclosure practices. Future studies could employ difference-in-differences approaches to isolate the effect of the amendment on various aspects of corporate disclosure. Second, our focus on the corporate governance channel may overlook other important mechanisms through which regulatory changes influence disclosure practices. Researchers could explore additional channels such as product market competition or capital market integration. Finally, future work could examine how the effectiveness of such regulatory spillovers varies with firm characteristics, industry conditions, and the strength of existing corporate governance mechanisms.

The evolving nature of global corporate governance presents numerous opportunities for future research. Scholars could investigate how regulatory changes in emerging markets affect specific types of voluntary disclosures, such as environmental, social, and governance (ESG) reporting or risk disclosures. Additionally, researchers could examine how the interaction between local and global corporate governance mechanisms influences firms' disclosure choices in both emerging and developed markets. Such research would contribute to our understanding of the complex relationships between regulatory frameworks, corporate governance, and disclosure practices in an increasingly interconnected global economy.

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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
SriLankaSecuritiesExchangeActAmendment Corporate Governance

	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 Sri Lanka Securities Exchange 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.