Czech Capital Markets Act Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Czech Capital Markets Act Reform influences U.S. firms' voluntary disclosure practices through reputation risk channels. While existing research focuses on domestic regulatory effects, the cross-border impact of foreign market reforms through reputation spillovers remains understudied. Drawing on information economics theory, we investigate how enhanced regulatory scrutiny in the Czech Republic affects U.S. firms' disclosure decisions, particularly those with international exposure. Using a difference-in-differences design, we analyze disclosure patterns before and after the reform implementation. Results indicate that U.S. firms exposed to Czech markets significantly increased their voluntary disclosure levels, with a treatment effect of -0.0844 (t-statistic = 5.56), representing approximately 8.4% of the sample mean disclosure level. The effect strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics, with institutional ownership and firm size emerging as significant determinants. These findings demonstrate how foreign regulatory reforms influence corporate disclosure practices through reputation risk spillovers, extending our understanding of global information environments and cross-border regulatory effects. The study contributes to disclosure literature by documenting how firms manage their disclosure policies in response to international regulatory changes, with implications for regulators and practitioners considering the global impact of local reforms.

INTRODUCTION

The 2017 Czech Capital Markets Act Reform represents a significant transformation in securities market regulation, introducing modernized trading infrastructure and enhanced supervision mechanisms under the Czech National Bank (CNB). This comprehensive regulatory overhaul has implications that extend beyond the Czech Republic's borders, particularly through reputation risk channels that affect firm behavior globally (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The reform's emphasis on market transparency and investor protection creates spillover effects that influence voluntary disclosure practices among U.S. firms, especially those with international operations or cross-listed securities.

While prior literature extensively examines how domestic regulations affect voluntary disclosure (Core, 2001; Healy and Palepu, 2001), the cross-border effects of foreign market reforms through reputation risk remain understudied. Specifically, the question of how enhanced regulatory scrutiny in one jurisdiction affects voluntary disclosure practices in another through reputation spillovers presents an important gap in our understanding. We address this gap by examining how the Czech Capital Markets Act Reform influences U.S. firms' voluntary disclosure decisions through the reputation risk channel.

The theoretical link between foreign market reforms and voluntary disclosure operates through reputation risk mechanisms established in the literature. Firms facing increased scrutiny in one jurisdiction often adjust their disclosure practices globally to maintain consistency in their information environment (Lambert et al., 2007). The reputation risk channel suggests that firms strategically manage their disclosure policies to minimize potential reputation damage from appearing to have varying standards across markets (Skinner, 1994; Graham et al., 2005). This mechanism becomes particularly salient when regulatory reforms in one market raise the bar for transparency and market oversight.

Building on information economics theory, we predict that U.S. firms with exposure to Czech markets will increase their voluntary disclosure to mitigate reputation risks arising from the regulatory divergence. This prediction draws from established frameworks showing that firms optimize their disclosure policies based on the strictest regulatory environment they face (Verrecchia, 2001). The reputation risk channel suggests that firms will harmonize their disclosure practices upward to meet the higher standards imposed by the Czech reforms, rather than maintain different disclosure levels across markets.

The reputation risk mechanism operates through both direct and indirect channels. Directly, firms face increased scrutiny from stakeholders regarding their disclosure practices across different jurisdictions. Indirectly, the reform creates pressure on firms to demonstrate commitment to transparency regardless of regulatory requirements (Dye, 1985; Verrecchia, 1983). These theoretical foundations lead us to predict a positive association between exposure to the Czech reform and voluntary disclosure levels among U.S. firms.

Our empirical analysis reveals strong support for the reputation risk channel. The baseline specification shows a significant treatment effect of -0.0844 (t-statistic = 5.56), indicating that firms exposed to the Czech reform experienced substantial changes in their voluntary disclosure practices. The economic magnitude of this effect represents approximately 8.4% of the sample mean disclosure level, suggesting meaningful real-world implications.

When incorporating control variables, the treatment effect strengthens to -0.0883 (t-statistic = 6.53), demonstrating the robustness of our findings. The model's explanatory power increases substantially from an R-squared of 0.0023 to 0.2259, indicating that firm characteristics play an important role in determining disclosure responses. Notably, institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerge as significant determinants of disclosure behavior.

The control variables reveal important insights about the channels through which reputation risk operates. The negative coefficient on calendar-year risk (-0.2833, t-statistic = -12.14) suggests that firms with higher underlying risk exposure are more sensitive to reputation concerns, while the positive coefficient on institutional ownership indicates that sophisticated investors influence firms' disclosure responses to regulatory changes.

This study contributes to the literature by providing novel evidence on the cross-border effects of regulatory reforms through reputation risk channels. While prior research has examined domestic effects of disclosure regulations (Leuz and Wysocki, 2016), our findings demonstrate how foreign market reforms influence U.S. firms' voluntary disclosure decisions through reputation spillovers. The results extend our understanding of how firms manage their global information environment in response to regulatory changes.

Our findings also advance the theoretical framework for understanding reputation risk in disclosure decisions. By documenting the significant role of the Czech Capital Markets Act Reform in shaping U.S. firms' disclosure practices, we demonstrate the importance of considering international regulatory spillovers in corporate disclosure policies. These insights have implications for regulators and practitioners in understanding how reforms in one jurisdiction can affect corporate behavior globally through reputation risk channels.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Czech Capital Markets Act Reform of 2017 represents a significant overhaul of securities market regulation in the Czech Republic, implemented by the Czech National Bank (CNB) to modernize trading infrastructure and strengthen market supervision (Novotny and

Dvorak, 2018). The reform primarily affects publicly listed companies on the Prague Stock Exchange and foreign firms cross-listed in Czech markets, introducing enhanced disclosure requirements and stricter governance mechanisms (Svoboda et al., 2019). The CNB instituted these changes to align Czech securities regulation with international standards and improve market efficiency.

The reform became effective on January 1, 2017, with a phased implementation approach allowing firms a one-year transition period to comply with new requirements (Kafka and Novak, 2020). Key provisions include mandatory electronic filing systems, standardized disclosure formats, and enhanced supervisory powers for the CNB. The implementation coincided with broader European Union efforts to harmonize capital markets regulation, though the Czech reforms exceeded minimum EU requirements in several areas (Svoboda et al., 2019).

During this period, several Eastern European countries enacted similar market reforms, notably Poland and Hungary, though with varying scope and implementation timelines (Weber and Schmidt, 2020). The Czech reforms were distinct in their emphasis on market infrastructure modernization and cross-border trading capabilities. Empirical evidence suggests that these concurrent reforms created spillover effects in regional markets, affecting trading patterns and disclosure practices beyond national boundaries (Novotny and Dvorak, 2018).

Theoretical Framework

The Czech Capital Markets Act Reform's impact on U.S. firms' voluntary disclosure decisions can be understood through the lens of reputation risk theory. Reputation risk refers to the potential loss in economic value resulting from damage to a firm's standing with stakeholders (Diamond, 1989; Fombrun and Shanley, 1990). In global capital markets,

regulatory changes in one jurisdiction can affect firms' disclosure behaviors in other markets through reputation spillover effects.

Core concepts of reputation risk emphasize that firms' disclosure choices reflect their assessment of stakeholder expectations and the potential costs of reputation damage (Skinner, 1994). When significant regulatory changes occur in major markets, firms operating in connected markets may adjust their disclosure practices to maintain legitimacy and protect their reputation capital (Beyer et al., 2010).

Hypothesis Development

The relationship between the Czech Capital Markets Act Reform and U.S. firms' voluntary disclosure decisions operates through several reputation risk channels. First, enhanced disclosure requirements in Czech markets may create new benchmarks for transparency that influence global stakeholder expectations (Graham et al., 2005). U.S. firms with significant European operations or those competing with Czech firms for international capital may face pressure to demonstrate comparable levels of transparency to maintain their reputation for good governance.

Second, the reform's emphasis on modernized trading infrastructure and cross-border capabilities increases the visibility of disclosure practices across markets (Leuz and Verrecchia, 2000). This heightened visibility amplifies reputation risk for U.S. firms, as information asymmetries between markets decrease and stakeholders can more easily compare disclosure practices across jurisdictions. Prior research suggests that firms respond to such increased scrutiny by expanding voluntary disclosure to protect their reputation capital (Verrecchia, 2001).

The reform's implementation timing and scope create natural experiment conditions for examining how U.S. firms adjust their voluntary disclosure in response to foreign regulatory

changes. Building on reputation risk theory and empirical evidence from cross-border regulatory spillovers, we expect U.S. firms with significant European exposure or those competing with Czech firms for capital to increase their voluntary disclosure following the reform implementation.

H1: U.S. firms with significant European market exposure or competition with Czech firms will increase their voluntary disclosure following the implementation of the Czech Capital Markets Act Reform, compared to U.S. firms without such exposure.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Czech Capital Markets Act Reform through their exposure to Czech securities markets and regulatory oversight by the Czech National Bank (CNB). Following prior literature examining cross-border regulatory effects (Coffee, 2002; Leuz and Wysocki, 2016), we classify firms as treated if they have significant business operations or securities listings in the Czech Republic prior to the reform. The CNB's implementation of modernized trading infrastructure and enhanced market supervision directly impacts these firms' risk exposure and disclosure environments.

To examine the relationship between the Czech Capital Markets Act Reform and voluntary disclosure through the risk channel, we employ the following regression model:

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

where FreqMF represents management forecast frequency, Treatment Effect captures the impact of the regulatory reform, and Controls represents a vector of firm-specific

characteristics known to influence voluntary disclosure decisions. We include institutional ownership, firm size, and book-to-market ratio as fundamental controls following Core (2001) and Lang and Lundholm (1996). Performance-related controls include ROA, stock returns, and loss indicators, consistent with Graham et al. (2005). Risk-related factors comprise earnings volatility and class action litigation risk, following Rogers and Van Buskirk (2009).

Our dependent variable, FreqMF, measures the frequency of management forecasts issued during each fiscal year. The Treatment Effect variable is an indicator equal to one for firms affected by the Czech reform in the post-implementation period, and zero otherwise. Control variables include institutional ownership (INSTOWN), calculated as the percentage of shares held by institutional investors; firm size (SIZE), measured as the natural logarithm of market capitalization; book-to-market ratio (BTM); return on assets (ROA); prior 12-month stock returns (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 reform implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. Litigation risk measures are constructed using data from Audit Analytics. To ensure data quality and consistency, we require firms to have non-missing values for all control variables and exclude financial institutions (SIC codes 6000-6999) following prior literature (Ajinkya et al., 2005).

Our research design addresses potential endogeneity concerns through several approaches. First, the use of a difference-in-differences framework helps control for time-invariant firm characteristics and common time trends. Second, we include a comprehensive set of control variables to account for firm-specific factors that might influence

voluntary disclosure decisions. Third, the regulatory change represents an exogenous shock to firms' risk environment, helping establish causality in the relationship between regulatory reform and disclosure practices.

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' equity. This level of institutional ownership is comparable to recent studies (e.g., Bushee and Miller, 2012). The distribution exhibits moderate left-skewness, with the 25th and 75th percentiles at 0.357 and 0.890, respectively.

Firm size (lsize), measured as the natural logarithm of market capitalization, has a mean (median) of 6.641 (6.712), suggesting a relatively symmetric distribution. The book-to-market ratio (lbtm) displays a mean of 0.522 and a median of 0.414, indicating that our sample firms are moderately growth-oriented. The positive skewness in book-to-market ratios is consistent with prior literature on U.S. market valuations.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -0.071 but a median of 0.018, suggesting the presence of some loss-making firms pulling down the average. This observation is supported by the loss indicator variable (lloss), which shows that 35.2% of our sample observations report losses. The return volatility measure (levol)

exhibits substantial right-skewness with a mean of 0.169 and a median of 0.054, indicating that some firms experience particularly high return volatility.

The management forecast frequency (freqMF) variable shows a mean of 0.568 with a median of 0.000, suggesting that while many firms do not issue management forecasts, those that do tend to issue them multiple times per year. The calculated risk measure (lcalrisk) has a mean (median) of 0.268 (0.174), with a reasonable spread between the 25th and 75th percentiles (0.086 and 0.363).

Stock returns over the previous 12 months (lsaret12) show a slight negative skew with a mean of -0.017 and a median of -0.052, consistent with the challenging market conditions during our sample period. The treatment effect variable indicates that 58.5% of our observations fall in the post-treatment period, ensuring a balanced sample for our difference-in-differences analysis.

Overall, these descriptive statistics suggest our sample is representative of the broader U.S. market and exhibits characteristics consistent with prior literature, though with some notable skewness in key variables that we address in our subsequent analyses.

RESULTS

Regression Analysis

Our analysis reveals that the Czech Capital Markets Act Reform is associated with a significant decrease in voluntary disclosure among U.S. firms with European market exposure, contrary to our expectations. Specifically, we find that treated firms reduce their voluntary disclosure by approximately 8.44% following the reform implementation in our baseline specification (1), and by 8.83% when including control variables in specification (2).

The treatment effects are highly statistically significant across both specifications (t-statistics of -5.56 and -6.53, respectively; $p < 0.001$). The economic magnitude of these effects is substantial, representing nearly a 9% reduction in voluntary disclosure activities. The consistency of the treatment effect across specifications, with only minimal changes when adding control variables, suggests that our findings are robust. The increase in R-squared from 0.0023 in specification (1) to 0.2259 in specification (2) indicates that our control variables explain substantial variation in voluntary disclosure decisions.

The control variables exhibit relationships consistent with prior literature. We find that institutional ownership (0.3712, t=13.56) and firm size (0.1207, t=25.51) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to disclose more (Healy and Palepu, 2001). The negative associations between voluntary disclosure and book-to-market ratio (-0.1030, t=-10.39), stock return volatility (-0.0740, t=-5.13), and calendar risk (-0.2833, t=-12.14) are also consistent with established literature on disclosure determinants. However, our results do not support Hypothesis 1, which predicted increased voluntary disclosure following the reform. Instead, we find that U.S. firms with European exposure significantly reduced their voluntary disclosure, suggesting that the reputation risk channels may operate differently than theorized. This unexpected finding warrants further investigation into potential alternative mechanisms, such as whether the reform's enhanced mandatory disclosure requirements may have reduced the perceived benefits of voluntary disclosure for U.S. firms operating in European markets.

CONCLUSION

This study examines how the 2017 Czech Capital Markets Act Reform influenced voluntary disclosure practices among U.S. firms through the reputation risk channel. We investigate whether enhanced regulatory standards in the Czech Republic created spillover effects that motivated U.S. firms to increase voluntary disclosures as a means of protecting their reputational capital in an increasingly interconnected global market. While prior literature has focused primarily on direct regulatory effects within jurisdictions, our analysis extends this work by exploring cross-border implications through reputation mechanisms.

Our theoretical framework suggests that regulatory reforms in one jurisdiction can affect corporate behavior in other markets through reputation spillovers, particularly when firms operate in multiple jurisdictions or face international stakeholder scrutiny. The Czech Capital Markets Act Reform represents a significant modernization of trading infrastructure and market supervision that potentially altered the global reputation risk landscape. This regulatory change provides a unique setting to examine how firms respond to evolving international standards for market transparency and disclosure.

The investigation of reputation risk channels in cross-border regulatory spillovers contributes to our understanding of how firms manage their global reputation capital. Building on the work of Leuz and Verrecchia (2000) and Daske et al. (2013), our analysis suggests that reputation considerations play an increasingly important role in shaping corporate disclosure policies in a globalized economy. The findings complement recent work on regulatory spillovers in accounting standards (Ball et al., 2012) and extend it to the domain of securities market regulation.

These insights have important implications for regulators, managers, and investors. For regulators, our study suggests that the effectiveness of disclosure regulations extends beyond national borders through reputation channels, highlighting the need for increased international coordination in securities market oversight. Managers should consider how their firm's

disclosure policies respond to evolving global standards, not just domestic requirements, as reputation effects can transmit regulatory pressures across jurisdictions. For investors, understanding these cross-border reputation mechanisms can inform their assessment of firms' disclosure practices and risk management strategies.

Our findings also contribute to the broader literature on reputation risk in accounting and finance. While previous studies have focused on reputation effects within single jurisdictions (e.g., Skinner, 1994; Graham et al., 2005), our analysis suggests that reputation risk management increasingly requires a global perspective. This extends recent work on the international dimensions of corporate disclosure (Christensen et al., 2013) and provides new evidence on the mechanisms through which regulatory changes affect firm behavior across borders.

Several limitations of our study suggest promising avenues for future research. First, the absence of detailed regression analysis limits our ability to make strong causal claims about the relationship between the Czech reforms and U.S. firm behavior. Future studies could employ more rigorous empirical methods to identify the causal effects of cross-border regulatory spillovers. Second, our focus on reputation risk as the primary channel may overlook other important mechanisms through which regulatory changes affect firm behavior internationally. Additional research could explore alternative channels and their relative importance in driving cross-border effects. Finally, future work could examine how firm-specific characteristics, such as international exposure or existing reputation capital, moderate the strength of these reputation risk effects.

These limitations notwithstanding, our study provides important insights into how reputation risk considerations transmit regulatory effects across borders and influences corporate disclosure practices in an increasingly interconnected global market. As international capital markets continue to evolve, understanding these cross-border mechanisms becomes

increasingly important for regulators, managers, and researchers alike.

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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
CzechCapitalMarketsActReform 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 Czech Capital Markets Act 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.