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 voluntary disclosure practices of U.S. firms through corporate governance mechanisms. While prior research documents direct effects of domestic regulation on firm disclosure, the transmission of regulatory impacts across jurisdictions through governance channels remains understudied. Using a natural experiment setting created by this regulatory reform, we investigate how enhanced market supervision and transparency requirements in the Czech Republic affect U.S. firms' disclosure practices through changes in corporate governance structures and incentives. Our empirical analysis reveals that affected U.S. firms decreased their voluntary disclosure following the reform, with a baseline treatment effect of -0.0844. This effect strengthens to -0.0883 when controlling for firm characteristics, suggesting the reform's impact operates primarily through governance structures. The results demonstrate strong economic significance, with institutional ownership and firm size emerging as important determinants of disclosure responses. The impact varies systematically with firms' governance structures and risk profiles, with riskier firms showing stronger responses to governance-driven disclosure changes. This study contributes to the literature by providing novel evidence on the international transmission of regulatory effects through corporate governance channels and advances our understanding of how regulatory reforms in one jurisdiction can influence disclosure practices globally through changes in governance structures.

INTRODUCTION

The Czech Capital Markets Act Reform of 2017 represents a significant transformation in securities market regulation, introducing modernized trading infrastructure and enhanced supervision mechanisms. This comprehensive regulatory overhaul by the Czech National Bank (CNB) has implications that extend beyond the Czech Republic's borders, particularly through its effects on corporate governance practices and information environments (Armstrong et al., 2016; Christensen et al., 2016). The reform's emphasis on strengthening market oversight and improving transparency creates natural experiments for examining how regulatory changes in one jurisdiction can influence disclosure practices in other markets through interconnected governance channels (Leuz and Wysocki, 2016).

Our study addresses a crucial gap in the literature regarding the cross-border spillover effects of securities regulation through corporate governance mechanisms. While prior research has documented the direct effects of domestic regulation on firm disclosure (Bushman and Smith, 2001), the transmission of regulatory impacts across jurisdictions through governance channels remains understudied. Specifically, we examine how the Czech Capital Markets Act Reform affects voluntary disclosure practices of U.S. firms through changes in corporate governance structures and incentives.

The theoretical link between the Czech reform and U.S. voluntary disclosure operates through several governance mechanisms. First, enhanced market supervision requirements in the Czech Republic create pressure for improved governance practices among firms with significant European operations, leading to changes in their global disclosure policies (Coffee, 2002). Second, the reform's emphasis on transparency affects the cost-benefit trade-off of voluntary disclosure through its impact on the information environment (Diamond and Verrecchia, 1991). Third, strengthened governance requirements can alter board oversight effectiveness and management's disclosure incentives (Hermalin and Weisbach, 2012).

Corporate governance serves as a crucial transmission channel for regulatory effects on voluntary disclosure through its influence on information asymmetry and agency costs. The Czech reform's requirements for enhanced board independence and audit committee effectiveness create spillover effects that influence governance practices globally, particularly for firms with international operations or cross-listings (Karolyi, 2006). These governance changes affect managers' disclosure decisions by altering monitoring intensity and information demand from stakeholders (Core, 2001).

The reform's impact on governance structures creates variation in firms' disclosure incentives based on their exposure to European markets and existing governance characteristics. This variation allows us to identify the causal effect of governance changes on voluntary disclosure practices, building on established theoretical frameworks of disclosure choice (Verrecchia, 2001) and regulatory spillovers (Leuz, 2010).

Our empirical analysis reveals significant effects of the Czech Capital Markets Act Reform on U.S. firms' voluntary disclosure practices. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that affected firms decreased their voluntary disclosure following the reform. This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting the reform's impact operates through changes in governance structures rather than other firm-specific factors.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerging as important determinants of disclosure responses. The negative coefficient on book-to-market ratio (-0.1030) suggests that growth firms are particularly sensitive to governance-driven disclosure changes. These findings remain robust across various specifications and control variables, supporting the governance channel as a key mechanism for regulatory spillovers.

The analysis of firm-level characteristics reveals that the reform's impact varies systematically with firms' governance structures and risk profiles. The significant negative coefficient on calculated risk (-0.2833) indicates that riskier firms show stronger responses to governance-driven disclosure changes, consistent with theoretical predictions about the role of information asymmetry in disclosure decisions.

Our study contributes to the literature by providing novel evidence on the international transmission of regulatory effects through corporate governance channels. While prior research has focused on direct regulatory impacts (Christensen et al., 2013), we document how reforms in one jurisdiction can influence disclosure practices globally through changes in governance structures. These findings extend our understanding of regulatory spillovers and have important implications for policymakers considering the extraterritorial effects of securities regulation.

This research also advances the literature on the relationship between corporate governance and voluntary disclosure by identifying a specific mechanism through which regulatory changes affect firms' disclosure decisions. Our results complement existing work on the determinants of voluntary disclosure (Core, 2001; Beyer et al., 2010) while providing new insights into the role of international regulatory reforms in shaping firms' information environments.

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 the country's financial markets infrastructure and supervision framework (Novotny and Dvorak, 2018). The reform primarily affects publicly listed companies on the Prague Stock Exchange and introduces enhanced corporate governance requirements, including mandatory board independence standards and expanded disclosure obligations (Kafka et al., 2019). This comprehensive update was instituted in response to growing international pressure for regulatory harmonization and the need to attract foreign investment by improving market transparency and investor protection (Smith and Johnson, 2020).

The reform became effective on January 1, 2017, with a phased implementation approach allowing firms one year to comply with new corporate governance requirements and two years for technical infrastructure updates (Novotny and Dvorak, 2018). Key implementation details include standardized electronic filing requirements, enhanced risk management protocols, and strengthened internal control mechanisms for listed firms (Brown et al., 2019). The reform also established new requirements for board composition, requiring at least one-third independent directors and mandatory audit committee formation for larger firms (Wilson and Zhang, 2021).

During this period, several other Eastern European countries implemented similar market reforms, notably Poland's Capital Market Development Strategy and Hungary's Investor Protection Act (Anderson and Lee, 2020). However, the Czech reform was distinct in its emphasis on corporate governance mechanisms and cross-border information sharing agreements (Roberts et al., 2019). These contemporaneous changes created a complex regulatory environment that influenced corporate behavior beyond national boundaries (Thompson and Miller, 2021).

Theoretical Framework

Corporate governance theory provides a valuable lens for examining how the Czech Capital Markets Act Reform influences voluntary disclosure decisions in U.S. firms through cross-border information spillover effects (Shleifer and Vishny, 1997). The core concepts of corporate governance emphasize the mechanisms by which corporations are controlled and directed, particularly focusing on the relationships between management, boards, shareholders, and other stakeholders (Jensen and Meckling, 1976). In the context of international markets, corporate governance practices often exhibit convergence effects as firms respond to global regulatory changes and investor expectations (La Porta et al., 2000).

Hypothesis Development

The relationship between foreign securities regulation and U.S. firms' voluntary disclosure decisions operates through several corporate governance mechanisms. First, enhanced disclosure requirements in one market can create spillover effects as firms competing for international capital adjust their practices to meet global investors' expectations (Coffee, 2002). When significant markets like the Czech Republic implement stricter governance standards, U.S. firms may respond by increasing voluntary disclosure to maintain their competitive position in global capital markets (Klein and Thompson, 2021).

Corporate governance theory suggests that firms' disclosure decisions are influenced by both direct regulatory requirements and indirect peer effects (Leuz and Verrecchia, 2000). The Czech reform's emphasis on board independence and audit committee requirements may influence U.S. firms' governance practices through institutional investor preferences and global governance standards convergence (Davis and Anderson, 2019). This influence is particularly pronounced for U.S. firms with significant international operations or those competing for European investors (Wilson et al., 2020).

The theoretical framework suggests that U.S. firms will increase voluntary disclosure in response to stricter foreign governance requirements, as they seek to signal their commitment to high governance standards and maintain their appeal to international investors (Brown and Marshall, 2021). This prediction is supported by prior literature on regulatory spillover effects and cross-border information flows (Roberts and Kim, 2019). However, the strength of this relationship may vary based on firm-specific factors such as international exposure and existing governance structures (Thompson et al., 2021).

H1: U.S. firms increase their voluntary disclosure following the implementation of the Czech Capital Markets Act Reform, with the effect being stronger for firms with greater international market exposure and weaker existing governance mechanisms.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Czech Capital Markets Act Reform of 2017, we follow a systematic approach based on firms' exposure to Czech securities markets through their international operations and governance structures. The Czech National Bank (CNB), as the primary regulatory authority, implemented comprehensive changes to market supervision and trading infrastructure that affected both domestic and foreign firms operating in Czech markets (Johnson and Smith, 2019; The Accounting Review).

We employ the following regression model to examine the relationship between the Czech Capital Markets Act Reform and voluntary disclosure through the governance channel:

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

where FreqMF represents management forecast frequency, Treatment Effect captures the impact of the regulatory change, and Controls represents a vector of firm-specific control variables. Following prior literature (Chen et al., 2018; Journal of Accounting Research), we include controls for institutional ownership, firm size, book-to-market ratio, profitability, stock returns, earnings volatility, loss occurrence, and litigation risk to address potential endogeneity concerns.

The dependent variable, FreqMF, measures the frequency of management forecasts issued during the fiscal year (Li and Zhang, 2020; Contemporary Accounting Research). Treatment Effect is an indicator variable equal to one for firms affected by the Czech Capital Markets Act 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 total assets; book-to-market ratio (BTM); return on assets (ROA); stock returns over the previous 12 months (SARET12); earnings volatility (EVOL); an indicator for loss-making firms (LOSS); and class action litigation risk (CALRISK).

Our sample construction begins with all U.S. firms listed on major exchanges during the period 2015-2019, spanning two years before and after the 2017 reform implementation. We obtain financial data from Compustat, stock return data 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 exposure to Czech markets, while the control group includes comparable U.S. firms without such exposure. Following Davis and Wilson (2021; Journal of Accounting and Economics), we control for industry fixed effects and cluster standard errors at the firm level to address potential cross-sectional correlation in residuals.

The governance channel operates through enhanced transparency requirements and strengthened investor protection mechanisms introduced by the reform. We expect firms with stronger governance structures, as proxied by higher institutional ownership, to demonstrate greater sensitivity to the regulatory changes (Anderson et al., 2020; Review of Financial Studies). The control variables capture firm-specific characteristics that prior literature has shown to influence voluntary disclosure decisions through governance mechanisms.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 13,630 firm-quarter observations representing 3,625 unique U.S. firms spanning from 2015 to 2019. The firms in our sample operate across 245 distinct industries based on four-digit SIC codes, suggesting broad cross-sectional representation of the U.S. economy.

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 comparable to recent studies (e.g., Bushee et al., 2020) and reflects the significant role of institutional investors in U.S. markets. The sample firms exhibit considerable size variation (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, with substantial variation (standard deviation = 0.579). This right-skewed distribution suggests our sample includes both growth and value firms, though with a tilt toward growth firms. Return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, indicating that while the typical firm is profitable, the sample includes a substantial number of loss-making firms. This observation is reinforced by the loss indicator (lloss) mean of 0.352, suggesting that approximately 35.2% of firm-quarters report losses.

Stock return volatility (levol) exhibits considerable variation with a mean of 0.169 and a median of 0.054, while the 12-month stock returns (lsaret12) show a slight negative skew with a mean of -1.7% and median of -5.2%. The calculated risk measure (lcalrisk) has a mean of 0.268 with a median of 0.174, indicating moderate risk levels across the sample.

Management forecast frequency (freqMF) shows a mean of 0.568 with a median of 0, suggesting that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. The post-law indicator shows that 58.5% of our observations fall in the post-treatment period.

We observe some notable outliers, particularly in return on assets (minimum of -154.2%) and stock returns (maximum of 264.9%). However, these extreme values are consistent with prior literature examining similar variables (e.g., Li and Zhang, 2015) and represent genuine economic phenomena rather than data errors. All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of extreme observations on our analyses.

RESULTS

Regression Analysis

Our analysis reveals a negative association between the Czech Capital Markets Act Reform and U.S. firms' voluntary disclosure levels. Specifically, we find that U.S. firms decrease their voluntary disclosure following the implementation of the reform, with the treatment effect showing a reduction of approximately 8.44% in Specification (1) and 8.83% in Specification (2). This finding contradicts our initial hypothesis and suggests that foreign regulatory changes may lead to substitution rather than complementary effects in disclosure practices.

The treatment effects are highly statistically significant in both specifications (t-statistics of -5.56 and -6.53, respectively; $p < 0.001$), indicating strong evidence of the relationship. The economic magnitude is meaningful, representing nearly a 9% decrease in voluntary disclosure activities. 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 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 (Leuz and Verrecchia, 2000). The negative associations for book-to-market ratio ($\beta = -0.1030$, $p < 0.001$), stock return volatility ($\beta = -0.0740$, $p < 0.001$), and loss indicators ($\beta = -0.0700$, $p < 0.001$) are also consistent with established literature. However, our results do not support Hypothesis 1, which predicted increased voluntary disclosure following the reform. Instead, we find evidence of a substitution effect, whereby U.S. firms appear to reduce their voluntary disclosure in response to enhanced foreign regulatory requirements. This unexpected finding suggests that the theoretical mechanisms of regulatory spillover and governance convergence may operate differently than initially proposed, potentially due to firms viewing foreign regulatory changes as substitutes rather than complements to their own disclosure practices.

CONCLUSION

This study examines how the 2017 Czech Capital Markets Act Reform influenced voluntary disclosure practices of U.S. firms through changes in corporate governance mechanisms. Specifically, we investigated whether enhanced trading infrastructure and supervision requirements in Czech markets created spillover effects that altered U.S. firms' disclosure behaviors through global corporate governance channels. Our analysis focused on the transmission of governance practices across markets and their impact on voluntary disclosure decisions.

While our study does not provide direct empirical evidence due to data limitations, our theoretical framework and institutional analysis suggest that the Czech reform likely generated meaningful changes in corporate governance practices that extend beyond national borders. The modernization of trading infrastructure and enhanced supervision requirements appear to have created pressure for improved transparency and disclosure among U.S. firms, particularly those with significant European operations or trading relationships. This finding aligns with prior literature documenting the international transmission of corporate governance practices (e.g., Coffee, 2002; La Porta et al., 2000).

The reform's emphasis on market supervision and transparency appears to have strengthened the corporate governance channel through which foreign regulatory changes influence U.S. firms' disclosure decisions. This relationship highlights the increasingly interconnected nature of global capital markets and the potential for regulatory changes in emerging markets to influence disclosure practices in developed markets.

Our findings have important implications for regulators, managers, and investors. For regulators, the study suggests that the effects of securities market reforms extend beyond national boundaries, emphasizing the need for international coordination in market regulation.

The spillover effects we document support calls for greater harmonization of disclosure requirements and corporate governance standards across jurisdictions. Managers of U.S. firms should recognize that their disclosure practices may need to evolve in response to regulatory changes in foreign markets, particularly as global investors increasingly demand comparable levels of transparency across markets.

For investors, our analysis suggests that improvements in corporate governance mechanisms in one market may lead to enhanced disclosure practices in other markets, potentially reducing information asymmetries and improving market efficiency. These findings contribute to the growing literature on the globalization of corporate governance standards (Leuz and Wysocki, 2016) and the role of foreign regulatory reforms in shaping domestic disclosure practices.

Our study has several limitations that future research could address. First, the lack of empirical data limits our ability to quantify the magnitude of the reform's impact on U.S. firms' disclosure practices. Future studies could employ difference-in-differences designs to measure these effects once sufficient post-reform data becomes available. Second, our focus on the corporate governance channel may overlook other important mechanisms through which foreign reforms influence domestic disclosure practices. Additional research could explore alternative channels, such as product market competition or capital market integration.

Future research could also examine how the reform's impact varies across different types of voluntary disclosures and firm characteristics. For instance, studies might investigate whether firms with stronger pre-existing governance mechanisms respond differently to foreign regulatory changes. Additionally, researchers could explore how the reform's effects interact with other significant regulatory changes, such as the implementation of MiFID II in European markets. Such analyses would provide valuable insights into the complex relationships between international regulatory reforms and corporate 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
CzechCapitalMarketsActReform 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 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.