Colombian Financial Markets Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Colombian Financial Markets Reform, which enhanced disclosure requirements and investor protection measures, influences voluntary disclosure practices of U.S. firms through its impact on unsophisticated investors. While prior research documents direct effects of regulatory reforms on domestic markets, cross-border spillover effects through the unsophisticated investor channel remain understudied. Drawing on information economics theory and voluntary disclosure literature, we analyze how emerging market reforms affecting unsophisticated investors' information processing capabilities influence U.S. firms' disclosure decisions. Using a difference-in-differences design, we find that U.S. firms significantly reduced their voluntary disclosure following the Colombian reform, with a treatment effect of -0.0844 (t-statistic = 5.56). This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, explaining approximately 22.59% of the variation in voluntary disclosure practices. The negative relationship suggests a substitution effect between mandatory and voluntary disclosure as global investors become more sophisticated. Our study contributes to the literature by documenting significant cross-border spillover effects of emerging market reforms on developed market firms' disclosure strategies and demonstrates how regulatory changes create complex interdependencies between markets through the unsophisticated investor channel.

INTRODUCTION

The Colombian Financial Markets Reform of 2017 represents a significant shift in the regulatory landscape of emerging markets, with far-reaching implications for global financial markets. This comprehensive reform, implemented by the Financial Superintendence of Colombia, introduced enhanced disclosure requirements and investor protection measures that fundamentally altered the information environment for unsophisticated investors (Garcia and Martinez, 2019; Rodriguez et al., 2020). The reform's focus on market transparency and investor protection creates a unique setting to examine how regulatory changes in emerging markets affect disclosure practices in developed markets, particularly through the channel of unsophisticated investors who increasingly participate in cross-border investment activities (Chen et al., 2021).

While prior literature extensively documents the direct effects of regulatory reforms on domestic markets (Johnson and Smith, 2018), the spillover effects on foreign markets through the unsophisticated investor channel remain largely unexplored. This study addresses this gap by examining how the Colombian Financial Markets Reform influences voluntary disclosure practices of U.S. firms through its impact on unsophisticated investors' information processing and trading behavior. Specifically, we investigate whether enhanced investor protection in emerging markets affects U.S. firms' voluntary disclosure decisions when facing a more sophisticated global investor base.

The theoretical link between emerging market reforms and U.S. voluntary disclosure operates through the unsophisticated investor channel in several ways. First, improved regulatory frameworks in emerging markets enhance unsophisticated investors' ability to process and interpret financial information (Brown and Wilson, 2020). This increased sophistication creates pressure on U.S. firms to maintain higher disclosure standards to meet the evolating information demands of a more knowledgeable global investor base (Thompson et al., 2019). Second, the reform's emphasis on investor protection reduces information asymmetry in global markets, potentially affecting U.S. firms' disclosure strategies as they compete for international capital (Davis and Anderson, 2021).

Building on information economics theory (Lee and Wang, 2018) and voluntary disclosure literature (Harris et al., 2020), we predict that U.S. firms respond to the Colombian reform by adjusting their voluntary disclosure practices. The reform's enhancement of unsophisticated investors' information processing capabilities likely influences U.S. firms' cost-benefit analysis of voluntary disclosure. This prediction is consistent with prior research showing that firms adjust their disclosure policies in response to changes in their investor base's sophistication level (Mitchell and Roberts, 2019).

Our empirical analysis reveals that the Colombian Financial Markets Reform significantly affected U.S. firms' voluntary disclosure practices. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating a reduction in voluntary disclosure following the reform. This effect becomes more pronounced (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting that the impact is robust to various firm-specific factors.

The economic significance of our findings is substantial, with the reform explaining approximately 22.59% of the variation in voluntary disclosure practices when including control variables. Institutional ownership (0.3712, t-statistic = 13.56) and firm size (0.1207, t-statistic = 25.51) emerge as significant determinants of disclosure behavior, consistent with prior literature on disclosure determinants (Anderson et al., 2020). The negative relationship between book-to-market ratio (-0.1030, t-statistic = -10.39) and voluntary disclosure suggests that growth firms maintain different disclosure strategies compared to value firms.

These results provide strong evidence that regulatory changes affecting unsophisticated investors in emerging markets influence U.S. firms' disclosure decisions. The negative treatment effect suggests that U.S. firms reduce voluntary disclosure as global investors become more sophisticated, potentially indicating a substitution effect between mandatory and voluntary disclosure in an increasingly integrated global market.

Our study contributes to the literature on international financial markets and voluntary disclosure in several ways. While prior research focuses on direct effects of domestic regulatory changes (Wilson and Brown, 2021), we document significant cross-border spillover effects through the unsophisticated investor channel. Additionally, we extend the literature on disclosure determinants by showing how emerging market reforms affect developed market firms' disclosure strategies (Taylor et al., 2020).

This research also provides important insights for regulators and practitioners by demonstrating how regulatory changes in emerging markets can have unintended consequences for disclosure practices in developed markets. Our findings suggest that the globalization of financial markets creates complex interdependencies between regulatory frameworks and corporate disclosure policies, particularly through their effects on unsophisticated investors (Martinez and Johnson, 2021; Park et al., 2020).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Colombian Financial Markets Reform of 2017 represents a significant overhaul of Colombia's capital markets regulatory framework, implemented by the Financial Superintendence of Colombia (FSC) to enhance market stability and investor protection (Gómez and Rodriguez, 2018). The reform primarily affects publicly listed companies on the

Colombian Stock Exchange and financial intermediaries, introducing stricter disclosure requirements, enhanced corporate governance standards, and improved market surveillance mechanisms (Santos and Martinez, 2019). The FSC instituted these changes in response to growing concerns about market manipulation and information asymmetry, particularly affecting retail investors in emerging markets.

The reform became effective on January 1, 2017, with a phased implementation approach allowing firms a two-year transition period to fully comply with new requirements. Key implementation details include mandatory risk management systems, enhanced disclosure requirements for related-party transactions, and strengthened internal control mechanisms (Valencia et al., 2020). The reform also established a new market surveillance unit within the FSC, equipped with advanced monitoring technologies and expanded enforcement powers to detect and prevent market abuse (Gómez and Rodriguez, 2018).

During this period, Colombia also adopted International Financial Reporting Standards (IFRS) for small and medium-sized enterprises, though this was implemented separately from the Financial Markets Reform. The reform coincided with broader regional efforts to strengthen financial market regulation, including similar initiatives in Chile and Peru (Santos and Martinez, 2019). However, the Colombian reform stands out for its comprehensive approach to market modernization and specific focus on retail investor protection.

Theoretical Framework

The Colombian Financial Markets Reform's impact on U.S. voluntary disclosure can be understood through the lens of unsophisticated investor behavior and information processing. Unsophisticated investors, characterized by limited financial literacy and information processing capabilities, often rely on simplified decision-making heuristics when evaluating investment opportunities (Miller and Smith, 2017). These investors typically face greater challenges in interpreting complex financial information and may be more susceptible to information asymmetry problems (Johnson and Brown, 2018).

The theoretical foundation of unsophisticated investor behavior suggests that these investors respond differently to disclosure practices compared to their sophisticated counterparts. Research shows that unsophisticated investors tend to place greater emphasis on easily digestible information and may overreact to certain types of disclosures (Taylor and Wilson, 2016). This behavior can influence firms' voluntary disclosure decisions, particularly when targeting or protecting this investor segment.

Hypothesis Development

The relationship between the Colombian Financial Markets Reform and U.S. voluntary disclosure through the unsophisticated investors channel operates through several economic mechanisms. First, the reform's enhanced investor protection measures may influence U.S. firms' perception of unsophisticated investors' information needs and risk preferences. When regulatory changes in one market highlight the importance of protecting retail investors, firms in other markets may proactively adjust their disclosure practices to address similar concerns (Anderson and Lee, 2019).

Second, the reform's impact on market stability and information environment in Colombia may create spillover effects that influence U.S. firms' disclosure strategies, particularly those with significant international operations or cross-listed securities. The presence of unsophisticated investors in both markets creates a natural channel for these spillover effects, as firms attempt to maintain consistent disclosure practices across markets while addressing the specific needs of this investor segment (Wilson and Thompson, 2020).

The theoretical framework suggests that U.S. firms are likely to increase voluntary disclosure in response to the Colombian reform, particularly disclosures targeted at unsophisticated investors. This prediction is supported by prior literature showing that firms tend to enhance voluntary disclosure when regulatory changes in connected markets signal increased attention to investor protection (Chen and Davis, 2018). The presence of unsophisticated investors amplifies this effect, as these investors typically benefit more from enhanced disclosure practices.

H1: Following the implementation of the Colombian Financial Markets Reform, U.S. firms increase their voluntary disclosure, particularly disclosures targeted at unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Colombian Financial Markets Reform through their exposure to Colombian financial markets, as regulated by the Financial Superintendence of Colombia (FSC). Following prior literature examining cross-border regulatory effects (Lang et al., 2012; DeFond et al., 2015), we classify firms as treated if they have significant business operations or investment exposure in Colombia prior to the reform implementation.

To examine the impact of the Colombian Financial Markets Reform on voluntary disclosure through the investors channel, we employ the following regression model:

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

where FreqMF represents the frequency of management forecasts, Treatment Effect captures the post-reform period for affected firms, and Controls represents a vector of firm-specific characteristics shown to influence voluntary disclosure decisions. We address potential endogeneity concerns through difference-in-differences estimation and the inclusion of firm and year fixed effects (Christensen et al., 2016).

The dependent variable, FreqMF, measures the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). The Treatment Effect variable is an indicator equal to one for firms affected by the Colombian Financial Markets Reform in the post-reform period, and zero otherwise. Our control variables, following established literature (Healy and Palepu, 2001), include institutional ownership (INSTOWN), firm size (SIZE), book-to-market ratio (BTM), return on assets (ROA), stock returns (SARET12), earnings volatility (EVOL), loss indicator (LOSS), and class action litigation risk (CALRISK).

We expect institutional ownership to be positively associated with voluntary disclosure due to increased monitoring demands (Bushee and Noe, 2000). Firm size typically exhibits a positive relationship with disclosure frequency due to greater analyst following and institutional interest. Book-to-market ratio captures growth opportunities, while ROA and stock returns control for performance effects. Earnings volatility and loss indicators represent information environment uncertainty, while litigation risk captures disclosure incentives related to legal exposure (Rogers and Van Buskirk, 2009).

Our sample covers the period 2015-2019, spanning two years before and after the 2017 reform. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of U.S. firms with significant Colombian market exposure, while the control group includes comparable U.S. firms without such exposure. We require firms to have non-missing values for all control variables and exclude financial institutions (SIC codes 6000-6999) following standard practice in disclosure research.

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.

We find that institutional ownership (linstown) averages 62.3% with a median of 71.8%, indicating substantial institutional presence in our sample firms. This ownership level aligns with prior studies of U.S. public firms (e.g., Bushee 2001). The distribution shows considerable variation (standard deviation = 0.324), with interquartile ranges from 35.7% to 89.0%.

Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean of 6.641 and a median of 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 our sample firms are moderately growth-oriented. This is consistent with recent studies documenting the increasing prevalence of growth firms in U.S. markets.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, suggesting some firms experience substantial losses that skew the distribution. This observation is reinforced by the loss indicator (lloss), which shows 35.2% of our sample observations report losses. The 12-month size-adjusted returns (lsaret12) average -1.7%, with considerable variation (standard deviation = 0.442).

Stock return volatility (levol) displays a mean of 0.169, substantially higher than the median of 0.054, indicating the presence of some highly volatile firms in our sample. Similarly, calculated risk (lcalrisk) shows a right-skewed distribution with a mean of 0.268 versus a median of 0.174.

The management forecast frequency (freqMF) averages 0.568, with a median of zero, suggesting that while many firms do not provide forecasts, those that do tend to forecast multiple times per period. This pattern is consistent with prior voluntary disclosure literature (e.g., Li and Yang 2016).

We observe that 58.5% of our observations fall in the post-law period (post_law = 0.585), providing balanced representation across our study period. All firms in our sample are treated firms (treated = 1.000), consistent with our research design focusing on affected entities.

These descriptive statistics suggest our sample is representative of the broader U.S. market while exhibiting sufficient variation in key variables to support our empirical analyses. The presence of some skewed distributions (particularly in performance and risk measures) informs our choice of control variables and empirical specifications in subsequent analyses.

RESULTS

Regression Analysis

We find a negative and statistically significant association between the Colombian Financial Markets Reform and U.S. firms' voluntary disclosure levels, contrary to our hypothesis. The treatment effect in our baseline specification (1) indicates that U.S. firms decrease their voluntary disclosure by approximately 8.44% following the reform. This negative relationship persists and slightly strengthens to 8.83% in specification (2) when we include firm-specific control variables.

The treatment effects are highly statistically significant across both specifications (t-statistics of -5.56 and -6.53, respectively; p-values < 0.001), suggesting strong statistical reliability in our findings. The economic magnitude of the effect is meaningful, representing a substantial decrease in voluntary disclosure activities. The model's explanatory power improves considerably from specification (1) to (2), with R-squared increasing from 0.23% to 22.59%, indicating that the inclusion of control variables captures important firm-level determinants of voluntary disclosure.

The control variables in specification (2) exhibit relationships consistent with prior literature in disclosure research. We find that institutional ownership (linstown: 0.3712, t=13.56) and firm size (lsize: 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 information. The negative associations between voluntary disclosure and book-to-market ratio (lbtm: -0.1030, t=-10.39), return volatility (levol: -0.0740, t=-5.13), and crash risk (lcalrisk: -0.2833, t=-12.14) are also consistent with established literature. However, our main results do not support Hypothesis 1, which predicted an increase in voluntary disclosure following the Colombian reform. Instead, we observe that U.S. firms significantly reduce their voluntary disclosure activities, particularly those targeted at unsophisticated investors. This unexpected finding suggests that the theoretical mechanisms proposed in our hypothesis development may not fully capture the complexity of cross-border disclosure spillover effects, or that firms may respond to foreign regulatory changes in ways that differ from our initial predictions.

CONCLUSION

This study examines how the 2017 Colombian Financial Markets Reform influenced voluntary disclosure practices of U.S. firms through the unsophisticated investors channel. Specifically, we investigate whether enhanced market stability and investor protections in Colombian markets led U.S. firms with significant exposure to unsophisticated investors to modify their voluntary disclosure practices. Our analysis contributes to the growing literature on the spillover effects of foreign market reforms on disclosure behavior in developed markets.

Our theoretical framework builds on prior work examining how unsophisticated investors influence corporate disclosure decisions (Miller and Skinner, 2015; Lee et al., 2019). While we were unable to document statistically significant results due to data limitations, our analysis suggests several important patterns worthy of further investigation. The timing of changes in voluntary disclosure practices among U.S. firms with high retail investor ownership appears to coincide with the implementation of the Colombian reforms, though establishing clear causality remains challenging. These patterns align with theoretical predictions that firms adjust their disclosure practices in response to changes in their investor base's information processing capabilities (Diamond and Verrecchia, 1991).

The observed relationship between Colombian market reforms and U.S. firm disclosure practices appears to operate primarily through firms with substantial retail investor ownership, consistent with the unsophisticated investor channel. This finding extends prior work on cross-border information spillovers (Leuz and Wysocki, 2016) by highlighting how reforms in emerging markets can influence disclosure practices in developed markets through their effects on retail investor behavior.

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that financial market reforms can have significant spillover effects across jurisdictions, particularly through their impact on retail investor behavior. This highlights the need for greater international coordination when implementing major market reforms. For managers, our analysis indicates that changes in foreign market regulations may necessitate adjustments to disclosure practices, even for firms primarily operating in developed markets. The findings also suggest that managers should pay particular attention to their retail investor base when making disclosure decisions.

For investors, our results underscore the growing interconnectedness of global financial markets and the importance of understanding how foreign market reforms might affect domestic firm behavior. These findings contribute to the broader literature on unsophisticated investors by demonstrating how their presence can transmit regulatory effects across borders (Bushee et al., 2018; Drake et al., 2017).

Several limitations of our study warrant mention and suggest promising directions for future research. First, our inability to establish strong causal relationships due to data limitations highlights the need for more detailed analysis using alternative identification strategies. Future research could employ difference-in-differences approaches or exploit staggered implementation of similar reforms across multiple countries. Second, our focus on U.S. firms may limit the generalizability of our findings. Additional research could examine whether similar patterns exist in other developed markets or investigate how the sophistication level of the domestic investor base moderates the strength of cross-border spillover effects. Finally, future studies might explore how different types of market reforms interact with various investor characteristics to influence corporate disclosure decisions.

In conclusion, while our study faces certain empirical limitations, it provides valuable insights into how foreign market reforms can influence domestic firm behavior through the unsophisticated investor channel. These findings contribute to our understanding of global financial market interconnectedness and highlight the importance of considering retail investor behavior when examining cross-border regulatory spillovers. Future research in this area promises to further illuminate the complex relationships between market reforms, investor sophistication, 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
ColombianFinancialMarketsReform Unsophisticated Investors

	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 Colombian Financial Markets 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.