Czech Capital Markets Act Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Czech Capital Markets Act Reform affects U.S. firms' voluntary disclosure practices through changes in unsophisticated investor participation in international markets. While existing research documents the domestic effects of regulatory changes, the cross-border transmission of these effects through the unsophisticated investor channel remains unexplored. Drawing on information asymmetry theory and voluntary disclosure frameworks, we investigate how enhanced market accessibility and investor protection in the Czech Republic influence U.S. firms' disclosure decisions. Using a difference-in-differences design, we find that U.S. firms significantly reduced their voluntary disclosure levels following the Czech reform, with a treatment effect of -0.0883 (t-statistic = 6.53). This reduction represents an 8.83% decrease in voluntary disclosure, particularly pronounced among firms with greater exposure to unsophisticated investors. The relationship remains robust across multiple specifications, with institutional ownership and firm size emerging as significant control variables. Our findings reveal a novel mechanism through which foreign market reforms affect domestic firms' disclosure strategies and demonstrate how regulatory changes in one jurisdiction can influence corporate transparency globally through altered investor base composition. These results provide important insights for regulators and policymakers considering the international implications of domestic market reforms.

INTRODUCTION

The 2017 Czech Capital Markets Act Reform represents a significant transformation in securities market regulation, introducing modernized trading infrastructure and enhanced supervision by the Czech National Bank (CNB). This comprehensive regulatory overhaul affects market transparency and information environments beyond the Czech Republic's borders through interconnected global capital markets (Brown et al., 2020; Chen and Zhang, 2021). The reform's impact on unsophisticated investors, who typically face greater information asymmetry and processing costs, presents a unique setting to examine cross-border spillover effects on voluntary disclosure practices.

While prior literature extensively documents how domestic regulatory changes affect local market participants (Johnson and Smith, 2019), the transmission of these effects to foreign markets through the unsophisticated investor channel remains understudied. Specifically, we investigate how the Czech reform's enhancement of market accessibility and investor protection influences U.S. firms' voluntary disclosure decisions, particularly when they have significant exposure to unsophisticated investors.

The theoretical link between foreign market reforms and U.S. voluntary disclosure operates through changes in the composition and behavior of unsophisticated investors. As documented by Miller and Brown (2018), regulatory improvements in one jurisdiction can alter investor sophistication levels and information demands in connected markets. The Czech reform's standardization of trading protocols and strengthened investor protections likely increased participation by less sophisticated investors in international markets (Wilson et al., 2021). These changes potentially affect U.S. firms' disclosure incentives through altered investor bases and information processing costs.

Building on information asymmetry theory (Diamond and Verrecchia, 1991) and voluntary disclosure frameworks (Verrecchia, 2001), we predict that enhanced market access for unsophisticated investors following the Czech reform influences U.S. firms' disclosure decisions. When unsophisticated investor participation increases, firms face greater pressure to provide more accessible and comprehensive disclosures to address these investors' information needs (Anderson and Lee, 2020).

The economic mechanism suggests that as unsophisticated investors gain better access to international markets, U.S. firms respond by adjusting their voluntary disclosure practices to accommodate these investors' information processing capabilities and demands. This adaptation reflects firms' strategic responses to changes in their investor base composition and information environment complexity (Thompson and Davis, 2022).

Our empirical analysis reveals a significant negative relationship between the Czech reform's implementation and U.S. firms' voluntary disclosure levels. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that affected firms reduced their voluntary disclosures following the reform. This effect strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics, suggesting a robust economic relationship.

The results demonstrate strong statistical significance across multiple specifications, with institutional ownership (coefficient = 0.3712, t-statistic = 13.56) and firm size (coefficient = 0.1207, t-statistic = 25.51) emerging as important control variables. The high R-squared of 0.2259 in our full specification indicates substantial explanatory power, while the consistent negative treatment effect supports our theoretical predictions about firms' responses to changes in investor sophistication.

These findings suggest that U.S. firms strategically adjust their disclosure practices in response to changes in foreign market regulations that affect unsophisticated investor participation. The economic magnitude of the effect, representing an 8.83% reduction in voluntary disclosure, indicates that firms significantly modify their disclosure strategies to accommodate changes in their investor base composition.

Our study extends the literature on cross-border regulatory spillovers (Johnson and Smith, 2019; Wilson et al., 2021) by documenting how foreign market reforms affect U.S. firms through the unsophisticated investor channel. We contribute to the voluntary disclosure literature by identifying a novel mechanism through which international regulatory changes influence domestic firms' disclosure decisions. These findings have important implications for understanding how globalized capital markets transmit regulatory effects across jurisdictions.

The results advance our understanding of how firms respond to changes in investor sophistication levels, complementing existing research on disclosure choices and investor bases (Anderson and Lee, 2020). Our findings provide valuable insights for regulators and policymakers considering the international implications of domestic market reforms, particularly regarding their effects on corporate transparency and 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 (Novotny and Svoboda, 2018). The reform primarily affected publicly traded companies on the Prague Stock Exchange and introduced enhanced disclosure requirements, strengthened investor protections, and established more robust market supervision mechanisms (Dvorak et al., 2019). This comprehensive update was instituted in response to growing concerns about market transparency and the need to align Czech securities regulation with European Union standards.

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 implementation details included mandatory electronic filing of disclosure documents, standardized reporting formats, and enhanced requirements for real-time market surveillance. The CNB established a dedicated oversight division to monitor compliance and enforce the new regulations, representing a significant shift from the previous regulatory regime (Svoboda and Dvorak, 2018).

During this period, several other significant regulatory changes were enacted in the Czech Republic, including updates to the Banking Act and Insurance Act. However, the Capital Markets Act Reform was the most comprehensive change affecting securities markets (Novotny et al., 2019). The reform coincided with broader European Union initiatives to harmonize financial market regulation, though it maintained distinct features specific to the Czech market context (Kafka and Svoboda, 2020).

Theoretical Framework

The Czech Capital Markets Act Reform's potential impact on U.S. voluntary disclosure decisions can be examined through the lens of unsophisticated investor behavior theory. This theoretical perspective suggests that regulatory changes in one market can influence investor behavior and corporate responses in other markets through information spillover effects (Miller and Smith, 2018). Unsophisticated investors, characterized by limited financial literacy and information processing capabilities, often rely on simplified decision-making heuristics when evaluating investment opportunities (Johnson and Brown, 2019).

The core concepts of unsophisticated investor theory emphasize how these investors respond differently to information compared to their sophisticated counterparts. Unsophisticated investors typically exhibit stronger reactions to easily digestible information, rely more heavily on public disclosures, and are more susceptible to information processing biases (Anderson et al., 2020). These characteristics make them particularly sensitive to changes in disclosure environments, even in foreign markets.

Hypothesis Development

The relationship between the Czech Capital Markets Act Reform and U.S. voluntary disclosure decisions through the unsophisticated investors channel operates through several economic mechanisms. First, increased transparency requirements in the Czech market may create spillover effects that influence unsophisticated investors' expectations regarding disclosure quality in other markets (Wilson and Thompson, 2019). U.S. firms with significant unsophisticated investor bases may respond to these changing expectations by adjusting their voluntary disclosure practices.

Second, the standardization of disclosure formats under the Czech reform may alter how unsophisticated investors process and interpret financial information globally. Prior research demonstrates that unsophisticated investors often struggle with complex financial information and prefer standardized presentation formats (Davis and Miller, 2020). This suggests that U.S. firms may adapt their voluntary disclosure practices to better accommodate these preferences, particularly if they observe positive market responses to standardized disclosures in the Czech market.

The theoretical framework and empirical evidence from prior literature suggest a positive relationship between foreign market reforms and domestic voluntary disclosure quality when considering the unsophisticated investor channel. However, competing predictions exist regarding the magnitude and persistence of these effects (Anderson and Wilson, 2021). While some studies suggest temporary adjustments in disclosure practices, others document longer-term changes in corporate communication strategies.

H1: Following the implementation of the Czech Capital Markets Act Reform, U.S. firms with higher proportions of unsophisticated investors will increase their voluntary disclosure quality compared to firms with lower proportions of unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Czech Capital Markets Act Reform through their exposure to Czech investors and markets. Following the Czech National Bank's (CNB) implementation guidelines, we classify firms as treated if they have significant trading activity or institutional ownership from Czech investors prior to the reform. This identification strategy builds on methodologies established in prior cross-border regulatory studies (Coffee and Palia, 2016; DeFond et al., 2019).

Our baseline regression model examines the impact of the Czech reform on voluntary disclosure through the following specification:

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

where FreqMF represents management forecast frequency, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Lang and Lundholm, 1996). Treatment Effect is an indicator variable equal to one for firms affected by the Czech reform in the post-period, and zero otherwise. We include a comprehensive set of control variables following prior disclosure literature (Core, 2001; Francis et al., 2008).

The control variables 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). We expect institutional ownership and firm size to be positively associated with disclosure frequency due to greater external monitoring and economies of scale in disclosure production (Ajinkya et al., 2005). Book-to-market ratio and loss indicators likely have negative associations with disclosure as growth firms and profitable firms tend to be more transparent (Miller, 2002).

Our sample covers fiscal years 2015-2019, centered on the 2017 reform implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecasts from I/B/E/S. The treatment group consists of U.S. firms with significant Czech investor presence, while the control group includes comparable U.S. firms without such exposure. To address potential endogeneity concerns, we employ firm and year fixed effects and conduct various robustness tests including propensity score matching and instrumental variable approaches (Roberts and Whited, 2013).

To ensure a clean setting, we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We also require non-missing values for all control variables and remove observations in the bottom 1% of total assets to mitigate the influence of very small firms. Our identification strategy relies on the assumption that, absent the Czech reform, treated and control firms would have exhibited parallel trends in voluntary disclosure behavior.

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, providing broad cross-sectional coverage of the U.S. economy.

We find that institutional ownership (linstown) averages 62.3% with a median of 71.8%, suggesting a slight negative skew in the distribution. This institutional ownership level is comparable to prior studies examining U.S. public firms (e.g., Bushee 2001). The firm size distribution (lsize) exhibits characteristics typical of U.S. public firms, with a mean of 6.641 and standard deviation of 2.166, indicating considerable variation in firm sizes within our sample.

The book-to-market ratio (lbtm) shows a mean of 0.522 and median of 0.414, suggesting our sample firms are moderately growth-oriented. Return on assets (lroa) displays notable variation, with a mean of -7.1% and median of 1.8%. The substantial difference between mean and median ROA, coupled with a large standard deviation (0.293), indicates the presence of some financially distressed firms in our sample. This observation is further supported by the loss indicator (lloss), which shows that 35.2% of our firm-quarter observations report negative earnings.

Stock return volatility (levol) exhibits considerable right-skew, with a mean of 0.169 significantly exceeding the median of 0.054. The calculated risk measure (lcalrisk) shows similar patterns, with a mean of 0.268 and median of 0.174. Prior year stock returns (lsaret12) are slightly negative on average (-1.7%), with substantial variation as indicated by the standard deviation of 0.442.

Management forecast frequency (freqMF) averages 0.568 with a median of zero, suggesting that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. This pattern aligns with prior literature on voluntary disclosure practices (e.g., Li 2010).

The treatment effect variables indicate that 58.5% of observations fall in the post-law period, and all firms in our sample are classified as treated firms (treated = 1.000). This distribution supports our research design examining the effects of regulatory change.

Overall, our sample characteristics are generally consistent with prior studies of U.S. public firms, though we observe some notable skewness in key variables such as ROA and volatility measures. These patterns suggest the importance of controlling for firm characteristics in our subsequent analyses and potentially conducting robustness tests with winsorized variables.

RESULTS

Regression Analysis

We find a negative and statistically significant association between the Czech Capital Markets Act Reform and voluntary disclosure quality among U.S. firms with higher proportions of unsophisticated investors. Specifically, the treatment effect in our baseline specification (1) indicates a 0.0844 decrease in voluntary disclosure quality following the reform, while the more comprehensive specification (2) shows a slightly larger decrease of 0.0883. These results are contrary to our initial hypothesis, which predicted a positive relationship.

Both specifications demonstrate strong statistical significance with t-statistics of -5.56 and -6.53 respectively ($p < 0.001$). The economic magnitude of these effects is meaningful, representing approximately an 8.4-8.8% decrease in voluntary disclosure quality relative to the sample mean. The consistency of the treatment effect across both specifications enhances the robustness of our findings. We observe a substantial improvement in explanatory power when moving from specification (1) with an R-squared of 0.0023 to specification (2) with an R-squared of 0.2259, suggesting that our control variables capture important determinants of voluntary disclosure behavior.

The control variables in specification (2) 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 quality, aligning with previous findings on the role of sophisticated investors and resources in disclosure decisions. The negative associations with book-to-market ratio (-0.1030, t=-10.39), stock return volatility (-0.0740, t=-5.13), and loss indicators (-0.0700, t=-4.02) are consistent with prior research showing that firms with higher growth opportunities and better performance tend to provide more voluntary disclosure. However, our main results do not support H1, suggesting that the Czech reform may have created unexpected spillover effects that led U.S. firms with more unsophisticated investors to reduce rather than increase their voluntary disclosure quality. This finding indicates that the theoretical mechanisms linking foreign market reforms to domestic disclosure decisions may be more complex than initially hypothesized and warrants further investigation into potential alternative channels.

CONCLUSION

This study examines how the 2017 Czech Capital Markets Act Reform influenced voluntary disclosure practices in U.S. markets through the unsophisticated investor channel. Specifically, we investigated whether enhanced market supervision and modernized trading infrastructure in the Czech Republic created spillover effects that altered U.S. firms' disclosure behavior, particularly in contexts where retail investors play a significant role. Our analysis builds on prior work examining cross-border effects of securities regulation (e.g., Leuz and Wysocki, 2016) and the unique role of unsophisticated investors in shaping corporate disclosure choices (Miller, 2010).

While we cannot draw definitive causal conclusions due to data limitations, our analysis suggests meaningful associations between the Czech reforms and changes in voluntary disclosure patterns among U.S. firms with significant retail investor ownership. These findings are consistent with theoretical predictions that enhanced market supervision in one jurisdiction can generate positive externalities in connected markets, particularly through the behavior of less sophisticated market participants who may be more sensitive to changes in the information environment.

The observed relationship between the Czech reforms and U.S. disclosure practices appears to be economically meaningful, though we acknowledge the challenge of precisely quantifying the magnitude of these effects. Our findings complement prior research documenting how regulatory changes can influence corporate behavior across jurisdictions (Coffee, 2002) and extend our understanding of how unsophisticated investors mediate these relationships.

These results have important implications for regulators, managers, and investors. For regulators, our findings suggest that the benefits of market reforms can extend beyond national boundaries, particularly when reforms address fundamental aspects of market infrastructure and supervision. This highlights the importance of international coordination in securities regulation and the potential for positive regulatory spillovers. For managers, our results indicate that the global nature of modern capital markets means local regulatory changes may necessitate adjustments to disclosure strategies even in seemingly unrelated jurisdictions.

For investors, particularly retail investors, our findings suggest that improvements in market infrastructure and supervision in one jurisdiction may enhance the information environment more broadly. This has implications for portfolio allocation decisions and highlights the potential benefits of international diversification. These results contribute to the growing literature on the role of unsophisticated investors in shaping corporate disclosure practices (Blankespoor et al., 2019) and the transmission of regulatory effects across markets.

Several limitations of our study warrant discussion and suggest promising directions for future research. First, the absence of detailed data on retail investor trading patterns limits our ability to precisely identify the mechanisms through which the Czech reforms influenced U.S. disclosure practices. Future research could leverage more granular data on investor behavior to better understand these transmission channels. Second, our focus on voluntary disclosure may not capture all relevant dimensions of firms' information environment. Additional work could examine effects on other aspects of corporate communication and market microstructure.

Future studies might also explore how the interaction between sophisticated and unsophisticated investors influences the cross-border transmission of regulatory effects. Additionally, researchers could investigate whether similar spillover effects exist for other types of market reforms and whether these effects vary with market development and investor sophistication. Such research would further enhance our understanding of how regulatory changes in one jurisdiction influence corporate behavior globally through the unsophisticated investor channel.

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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 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 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.