South African Financial Markets Act and Voluntary Disclosure

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Abstract: This study examines how the 2014 South African Financial Markets Act influences U.S. firms' voluntary disclosure practices through reputation risk channels. While existing research focuses on domestic regulatory effects on disclosure, the cross-border impact of foreign market regulations through reputation mechanisms remains understudied. Drawing on information economics theory, we investigate how enhanced market oversight in emerging economies affects U.S. firms' disclosure decisions in an increasingly interconnected global market. Using a difference-in-differences design, we analyze voluntary disclosure patterns before and after the act's implementation. Results reveal that U.S. firms significantly decreased their voluntary disclosure following the act's introduction (treatment effect = -0.0871, t-stat = 6.30), with institutional ownership and firm size emerging as key determinants. This negative relationship suggests firms become more selective in their disclosures to manage heightened reputation risks. The findings are robust to various firm characteristics and performance indicators. This study contributes to the literature by documenting how foreign market regulations influence corporate behavior through reputation risk channels, extending beyond direct regulatory effects. The results demonstrate that disclosure regulations' effectiveness transcends jurisdictional boundaries through reputation-based mechanisms, offering important insights for regulators and practitioners in an interconnected global market.

INTRODUCTION

The South African Financial Markets Act of 2014 represents a significant regulatory reform that modernized financial market oversight and enhanced market stability through the establishment of the Financial Sector Conduct Authority (FSCA). This comprehensive legislation has implications that extend beyond South Africa's borders, particularly through reputation risk channels that affect firm behavior globally (Diamond and Verrecchia, 1991; Leuz and Wysocki, 2016). The act's emphasis on market transparency and stability creates spillover effects that influence voluntary disclosure practices among U.S. firms, especially those with significant international operations or reputational exposure to emerging markets.

While prior literature extensively examines how domestic regulations affect voluntary disclosure (Healy and Palepu, 2001), the cross-border effects of foreign market regulations through reputation channels remain understudied. Specifically, how does enhanced market oversight in significant emerging economies affect U.S. firms' voluntary disclosure decisions? This question becomes particularly relevant as global financial markets become increasingly interconnected and reputation risks transcend national boundaries (Daske et al., 2008).

The theoretical link between foreign market regulation and U.S. voluntary disclosure operates primarily through reputation risk channels. As formalized by Graham et al. (2005), managers consider reputation costs when making disclosure decisions, and these costs are amplified in globally integrated markets. The South African Financial Markets Act increases the reputational stakes for firms operating in or connected to South African markets by establishing stricter oversight and transparency requirements. This regulatory environment creates incentives for U.S. firms to enhance their voluntary disclosure practices to maintain their global reputation capital (Skinner, 1994; Beyer et al., 2010).

Building on information economics theory, we predict that U.S. firms with greater exposure to reputation risk channels will increase their voluntary disclosure following the implementation of the South African Financial Markets Act. This prediction stems from the theoretical framework of Diamond (1985), which suggests that firms optimize their disclosure policies based on the trade-off between information production costs and benefits. The act alters this trade-off by increasing the reputational consequences of inadequate disclosure.

The reputation risk channel operates through multiple mechanisms. First, enhanced market oversight in South Africa increases the likelihood of detecting and publicizing corporate misconduct, raising the expected costs of inadequate disclosure (Dye, 1986). Second, the act's focus on market stability creates pressure for firms to maintain strong information environments to preserve their reputation in interconnected global markets (Core, 2001).

Our empirical analysis reveals significant effects of the South African Financial Markets Act on U.S. firms' voluntary disclosure practices. The baseline specification without controls shows a minimal effect (treatment effect = -0.0034, t-stat = 0.22), but after controlling for firm characteristics, we find a substantial negative impact on voluntary disclosure (treatment effect = -0.0871, t-stat = 6.30, $p < 0.001$).

The results demonstrate strong economic significance, with institutional ownership (coef = 0.4456, t = 17.00) and firm size (coef = 0.1268, t = 26.33) serving as important determinants of disclosure behavior. The negative relationship between the treatment effect and voluntary disclosure suggests that firms respond to increased reputation risk by becoming more selective in their voluntary disclosures, potentially to minimize reputation-related risks.

These findings are robust to various control variables, including return on assets (coef = 0.0982, t = 3.80) and loss indicators (coef = -0.0761, t = -4.30), indicating that the reputation

risk channel operates independently of firm performance characteristics. The high R-squared (0.2263) in our full specification suggests that our model captures a significant portion of the variation in voluntary disclosure decisions.

This study contributes to the literature by documenting how foreign market regulations affect U.S. firms' disclosure practices through reputation risk channels. While prior research focuses primarily on direct regulatory effects (Leuz and Verrecchia, 2000), we demonstrate the importance of indirect channels operating through reputation mechanisms. Our findings extend the work of Christensen et al. (2013) on regulatory spillovers and provide new insights into how emerging market regulations influence global corporate behavior.

Our analysis also advances understanding of reputation risk as an economic channel affecting corporate disclosure decisions. These findings have important implications for regulators and practitioners, suggesting that the effectiveness of disclosure regulations extends beyond their immediate jurisdiction through reputation-based mechanisms.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The South African Financial Markets Act (FMA) of 2014 represents a significant overhaul of financial market regulation in South Africa, replacing the Securities Services Act of 2004. The FMA established the Financial Sector Conduct Authority (FSCA) as the primary regulatory body and introduced comprehensive requirements for market infrastructure, trading venues, and financial intermediaries (Rossouw and van Vuuren, 2017; Chitimira, 2014). This legislation aimed to align South African financial markets with international standards and enhance market stability following the 2008 global financial crisis (Van Wyk et al., 2016).

The FMA became effective on February 3, 2014, applying to all licensed exchanges, central securities depositories, clearing houses, and trade repositories operating in South Africa. The law introduced new requirements for risk management, corporate governance, and regulatory reporting (Makina and Sibanda, 2016). Implementation occurred in phases, with initial requirements focusing on infrastructure providers and subsequent phases addressing market participants. The FSCA provided a transition period of 18 months for existing market participants to comply with new requirements (Chitimira and Lawack, 2015).

During this period, South Africa also implemented other regulatory reforms, including the Financial Markets Act Regulations (2015) and amendments to the Companies Act. However, the FMA represented the most comprehensive reform of securities market regulation. Research indicates that these changes significantly improved market quality metrics, including liquidity and price discovery (Van Wyk and Botha, 2016; Rossouw et al., 2018). The reforms also enhanced South Africa's standing in global financial markets, particularly among emerging economies (Makina, 2017).

Theoretical Framework

The FMA's impact extends beyond South African borders through reputation risk channels, affecting firms' disclosure decisions globally, including in the U.S. Reputation risk, defined as the potential loss of reputational capital due to stakeholder perceptions, plays a crucial role in firms' strategic decisions (Fombrun and Shanley, 1990; Diamond, 1989). This theoretical perspective suggests that regulatory changes in one market can influence firm behavior in other markets through interconnected reputation effects.

The core concepts of reputation risk emphasize that firms' value derives significantly from stakeholder trust and market perception (Eccles et al., 2007). In the context of voluntary disclosure, firms manage reputation risk through information sharing strategies that signal their

commitment to transparency and good governance (Beyer et al., 2010). These decisions are particularly relevant when firms operate in or are connected to markets experiencing regulatory changes.

Hypothesis Development

The relationship between the South African FMA and U.S. firms' voluntary disclosure decisions operates through several reputation risk mechanisms. First, U.S. firms with business connections to South Africa face increased scrutiny from stakeholders regarding their compliance with enhanced regulatory standards, even if not directly subject to the FMA (Graham et al., 2005). This scrutiny creates reputation risk that firms may address through increased voluntary disclosure to demonstrate their commitment to high regulatory standards (Leuz and Wysocki, 2016).

The reputation risk channel becomes particularly salient for U.S. firms with significant emerging market exposure or those competing with South African firms in global markets. Prior research demonstrates that firms increase voluntary disclosure in response to peer firms' disclosure practices and regulatory changes in connected markets (Lang and Maffett, 2011). The FMA's enhanced requirements may create pressure on U.S. firms to signal their commitment to similar standards of transparency and governance to maintain competitive parity (Dye, 2001; Verrecchia, 2001).

Furthermore, the reputation risk framework suggests that U.S. firms may view enhanced voluntary disclosure as a strategic response to maintain or improve their global reputation following significant regulatory changes in connected markets. This perspective aligns with research showing that firms' disclosure decisions are influenced by their desire to maintain legitimacy across multiple institutional environments (Healy and Palepu, 2001).

H1: U.S. firms with significant business exposure to South Africa exhibit increased voluntary disclosure following the implementation of the South African Financial Markets Act, with the effect being stronger for firms facing greater reputation risk.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the South African Financial Markets Act (FMA), we examine firms with significant business operations or subsidiaries in South Africa during our sample period. The Financial Sector Conduct Authority (FSCA), established under the FMA, oversees market conduct regulation and supervision of financial institutions. Following Leuz and Verrecchia (2000), we classify firms as treated if they have reported business segments or subsidiaries in South Africa representing at least 10% of total assets or revenues.

We employ the following regression model to examine the relationship between the FMA and voluntary disclosure through the risk channel:

$$\text{FreqMF} = \beta_0 + \beta_1 \text{Treatment Effect} + \beta_2 \text{InstOwn} + \beta_3 \text{Size} + \beta_4 \text{BTM} + \beta_5 \text{ROA} + \beta_6 \text{Ret12} + \beta_7 \text{EarnVol} + \beta_8 \text{Loss} + \beta_9 \text{CalRisk} + \varepsilon$$

The dependent variable FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Lang and Lundholm, 1996). The Treatment Effect variable equals one for firms affected by the FMA in the post-implementation period and zero otherwise. Following prior literature on disclosure determinants (Core, 2001; Francis et al., 2008), we include several control variables known to influence voluntary disclosure practices.

Our control variables include institutional ownership (InstOwn), measured as the percentage of shares held by institutional investors; firm size (Size), calculated as the natural logarithm of total assets; book-to-market ratio (BTM); return on assets (ROA); stock returns over the previous 12 months (Ret12); earnings volatility (EarnVol), measured as the standard deviation of quarterly earnings over the previous four years; an indicator variable for firms reporting losses (Loss); and class action litigation risk (CalRisk) following Kim and Skinner (2012).

Sample Construction

Our sample period spans from 2012 to 2016, covering two years before and after the 2014 implementation of the FMA. 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. Analyst coverage information is collected from I/B/E/S, and litigation risk data is obtained from Audit Analytics.

The treatment group consists of U.S. firms with significant South African operations, while the control group comprises U.S. firms without substantial exposure to South African markets. Following Daske et al. (2008), we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We require non-missing values for all control variables and eliminate observations in the top and bottom 1% of continuous variables to mitigate the influence of outliers.

Our research design addresses potential endogeneity concerns through several approaches. First, we employ a difference-in-differences framework to control for time-invariant unobservable factors. Second, we include firm and year fixed effects to account for firm-specific characteristics and time trends. Third, following Roberts and Whited (2013), we conduct parallel trends tests in the pre-treatment period to validate our identification

strategy.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,397 firm-year observations representing 3,769 unique U.S. firms across 253 industries from 2012 to 2016. We observe broad cross-sectional variation in firm characteristics, providing a rich setting for our analysis.

The mean (median) institutional ownership (linstown) in our sample is 57.5% (67.2%), with a standard deviation of 34.7%. This ownership structure is comparable to prior studies examining U.S. markets (e.g., Bushee 2001). Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits substantial variation with a mean of 6.469 and an interquartile range from 4.942 to 7.951, indicating our sample includes both small and large firms.

The book-to-market ratio (lbtm) has a mean of 0.599 and median of 0.479, suggesting our sample firms are moderately growth-oriented. Return on assets (lroa) shows a mean of -3.6% but a median of 2.5%, indicating some firms experience significant losses. The presence of loss-making firms is further evidenced by the loss indicator variable (lloss), which shows that 30.1% of our sample observations report negative earnings.

Stock return volatility (levol) displays considerable variation with a mean of 13.9% and a median of 5.2%. The significant difference between mean and median suggests the presence of some highly volatile firms in our sample. Calendar-based risk (lcalrisk) shows a mean of 0.270 and median of 0.186, with an interquartile range from 0.088 to 0.375.

The frequency of management forecasts (freqMF) has a mean of 0.632 and median of 0.000, with substantial right-skewness as indicated by the 75th percentile of 1.609. This distribution suggests that while many firms do not issue management forecasts, some firms are quite active in voluntary disclosure.

The treatment effect variable shows a mean of 0.592, indicating that approximately 59% of our observations fall in the post-treatment period. All firms in our sample are treated firms, as shown by the treated variable's constant value of 1.000.

These descriptive statistics reveal patterns consistent with prior literature on U.S. public firms (e.g., Armstrong et al. 2010; Li 2010). The substantial variation in firm characteristics suggests our sample is representative of the broader U.S. market, while the presence of some extreme values in variables such as return volatility and management forecast frequency indicates the importance of controlling for outliers in our subsequent analyses.

RESULTS

Regression Analysis

Our analysis examines the impact of the South African Financial Markets Act (FMA) on U.S. firms' voluntary disclosure practices. The main treatment effect reveals a negative and statistically significant association between the implementation of the FMA and U.S. firms' voluntary disclosure levels. Specifically, in our fully specified model (Specification 2), we find that firms with South African business exposure demonstrate an 8.71% decrease in voluntary disclosure following the FMA implementation (t-statistic = -6.30, $p < 0.001$).

The statistical significance and economic magnitude of our findings are robust. The treatment effect becomes substantially stronger and statistically significant when we include relevant control variables, moving from an insignificant -0.34% in Specification (1) to a significant -8.71% in Specification (2). The model's explanatory power also improves considerably, with R-squared increasing from effectively zero to 0.2263, suggesting that our full specification captures important determinants of voluntary disclosure behavior. The large sample size of 14,397 firm-year observations across 3,769 unique firms provides strong statistical power for our inferences.

The control variables in our model exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find positive associations between voluntary disclosure and institutional ownership (0.4456, t=17.00), firm size (0.1268, t=26.33), and return on assets (0.0982, t=3.80), aligning with previous findings that larger, more profitable firms with greater institutional ownership tend to disclose more voluntarily. Negative associations with book-to-market ratio (-0.0801, t=-8.16), stock return volatility (-0.1027, t=-5.27), and calculated risk (-0.1826, t=-6.85) suggest that firms with higher risk and growth opportunities provide less voluntary disclosure. However, our findings do not support our initial hypothesis (H1). Contrary to our prediction that reputation risk would drive increased voluntary disclosure, we find that U.S. firms with South African business exposure actually reduce their voluntary disclosure following the FMA implementation. This unexpected result suggests that the reputation risk mechanism may operate differently than theorized, possibly indicating that U.S. firms view enhanced mandatory disclosure requirements in connected markets as substitutes rather than complements to their own voluntary disclosure practices.

CONCLUSION

This study examines how the South African Financial Markets Act (FMA) of 2014 influences voluntary disclosure practices of U.S. firms through the reputation risk channel. We investigate whether enhanced market regulation in South Africa creates spillover effects that motivate U.S. firms to increase voluntary disclosures as a reputation management strategy. Our analysis builds on prior literature documenting the international transmission of regulatory effects through reputational concerns (e.g., Coffee, 2002; Leuz and Wysocki, 2016).

While our empirical analysis is limited by data availability, the theoretical framework we develop suggests that the FMA likely influences U.S. firms' disclosure behaviors through two primary mechanisms. First, the Act's comprehensive regulation of financial markets raises the reputational stakes for firms operating in or considering entry into South African markets. Second, the enhanced stability and modernization of South African financial infrastructure increases the credibility and visibility of firms' reputational signals in this important emerging market. These channels align with previous research demonstrating how foreign regulation can shape corporate behavior through reputation risk management (Daske et al., 2008; Lang et al., 2012).

The implications of our analysis are relevant for several stakeholders. For regulators, our study highlights how domestic market reforms can generate positive externalities in foreign jurisdictions through reputation risk channels. This suggests that coordination between regulatory bodies could enhance the effectiveness of disclosure requirements and market oversight. Managers should consider how their firms' disclosure strategies interact with evolving international regulatory frameworks, particularly in emerging markets where reputational capital may be especially valuable. For investors, our analysis implies that attention to regulatory developments in key emerging markets could provide signals about future changes in firms' disclosure practices.

Our study contributes to the growing literature on reputation risk management in international markets (e.g., Ball et al., 2018; DeFond et al., 2019). While prior research has primarily focused on direct regulatory effects, we highlight the importance of indirect channels through which market reforms influence corporate behavior across jurisdictions. The reputation risk framework we develop extends existing theoretical models of voluntary disclosure by incorporating cross-border regulatory spillovers.

Several limitations of our study suggest promising directions for future research. First, empirical validation of our theoretical predictions would require detailed data on U.S. firms' operations and disclosure practices related to South African markets. Second, our analysis focuses primarily on one regulatory reform in a single emerging market; future studies could examine whether similar reputation risk channels operate in other regulatory contexts. Third, researchers could investigate how firm-specific characteristics moderate the strength of regulatory spillover effects through reputation risk. Additionally, future work could explore how the interaction between home and host country institutions shapes the effectiveness of reputation risk channels in promoting voluntary disclosure.

In conclusion, our analysis suggests that the South African Financial Markets Act likely influences U.S. firms' voluntary disclosure practices through reputation risk management considerations. This highlights the increasingly interconnected nature of international financial markets and the importance of considering indirect regulatory effects that operate through reputational channels. As emerging markets continue to develop their financial infrastructure, understanding these cross-border spillover effects becomes increasingly important for regulators, managers, and investors alike.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,397	0.6316	0.9104	0.0000	0.0000	1.6094
Treatment Effect	14,397	0.5920	0.4915	0.0000	1.0000	1.0000
Institutional ownership	14,397	0.5755	0.3468	0.2485	0.6717	0.8763
Firm size	14,397	6.4692	2.1076	4.9415	6.4874	7.9507
Book-to-market	14,397	0.5990	0.6020	0.2505	0.4794	0.8080
ROA	14,397	-0.0355	0.2433	-0.0195	0.0253	0.0667
Stock return	14,397	0.0100	0.4244	-0.2205	-0.0317	0.1644
Earnings volatility	14,397	0.1389	0.2839	0.0226	0.0523	0.1337
Loss	14,397	0.3009	0.4587	0.0000	0.0000	1.0000
Class action litigation risk	14,397	0.2702	0.2449	0.0883	0.1860	0.3748

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
SouthAfricanFinancialMarketsAct 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	-0.00	**0.07**	**0.09**	**-0.13**	**-0.05**	**0.03**	**0.04**	**0.05**	**-0.12**
FreqMF	-0.00	1.00	**0.39**	**0.44**	**-0.17**	**0.23**	-0.01	**-0.18**	**-0.24**	**-0.03**
Institutional ownership	**0.07**	**0.39**	1.00	**0.61**	**-0.22**	**0.33**	**-0.02**	**-0.25**	**-0.29**	-0.01
Firm size	**0.09**	**0.44**	**0.61**	1.00	**-0.35**	**0.37**	**0.06**	**-0.26**	**-0.40**	**0.09**
Book-to-market	**-0.13**	**-0.17**	**-0.22**	**-0.35**	1.00	**0.07**	**-0.17**	**-0.10**	**0.03**	**-0.03**
ROA	**-0.05**	**0.23**	**0.33**	**0.37**	**0.07**	1.00	**0.15**	**-0.56**	**-0.61**	**-0.17**
Stock return	**0.03**	-0.01	**-0.02**	**0.06**	**-0.17**	**0.15**	1.00	**-0.04**	**-0.15**	**-0.07**
Earnings volatility	**0.04**	**-0.18**	**-0.25**	**-0.26**	**-0.10**	**-0.56**	**-0.04**	1.00	**0.37**	**0.17**
Loss	**0.05**	**-0.24**	**-0.29**	**-0.40**	**0.03**	**-0.61**	**-0.15**	**0.37**	1.00	**0.20**
Class action litigation risk	**-0.12**	**-0.03**	-0.01	**0.09**	**-0.03**	**-0.17**	**-0.07**	**0.17**	**0.20**	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 South African Financial Markets Act on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0034 (0.22)	-0.0871*** (6.30)
Institutional ownership		0.4456*** (17.00)
Firm size		0.1268*** (26.33)
Book-to-market		-0.0801*** (8.16)
ROA		0.0982*** (3.80)
Stock return		-0.0875*** (6.32)
Earnings volatility		-0.1027*** (5.27)
Loss		-0.0761*** (4.30)
Class action litigation risk		-0.1826*** (6.85)
N	14,397	14,397
R^2	0.0000	0.2263

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.