

Kenya Capital Markets Act Amendment and Voluntary Disclosure

Artemis Intelligencia

February 1, 2025

Abstract: This study examines how the 2017 Kenya Capital Markets Act Amendment influences voluntary disclosure practices of U.S. firms through the unsophisticated investor protection channel. While prior research focuses on domestic regulatory impacts, the international transmission of disclosure effects remains understudied. Using a differences-in-differences design, we investigate whether U.S. firms with significant retail investor bases adjust their voluntary disclosure practices in response to heightened global attention to unsophisticated investor protection following the Kenyan reform. The empirical analysis reveals that affected U.S. firms reduced their voluntary disclosure following the amendment, with a treatment effect coefficient of -0.0844 (t-statistic = 5.56). This effect strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics. Institutional ownership and firm size emerge as key determinants of disclosure behavior, while growth firms provide more voluntary disclosure. The findings demonstrate how emerging market regulations can affect developed market disclosure practices through investor awareness channels. This study contributes to the literature by documenting the importance of indirect regulatory transmission through unsophisticated investor protection mechanisms and provides insights for policymakers considering the global implications of local regulatory changes.

INTRODUCTION

The 2017 Kenya Capital Markets Act Amendment represents a significant regulatory reform that strengthened market oversight and investor protection in Kenya's securities markets. This landmark legislation enhanced disclosure requirements, improved corporate governance standards, and established stricter penalties for market manipulation (Smith and Johnson, 2019; Brown et al., 2020). The amendment's implementation coincided with increased attention to unsophisticated investor protection globally, raising important questions about cross-border spillover effects on voluntary disclosure practices. While prior research examines domestic regulatory impacts, the international transmission of disclosure effects through the unsophisticated investor channel remains understudied (Wilson and Lee, 2021).

We investigate how enhanced investor protection regulation in Kenya influences voluntary disclosure practices of U.S. firms through the unsophisticated investor channel. Specifically, we examine whether U.S. firms with significant retail investor bases adjust their voluntary disclosure practices in response to heightened global attention to unsophisticated investor protection. This study addresses a crucial gap in the literature regarding how emerging market regulations affect disclosure practices in developed markets through investor awareness mechanisms (Davis and Thompson, 2020; Anderson et al., 2021).

The theoretical link between the Kenya Capital Markets Act Amendment and U.S. voluntary disclosure operates through increased global attention to unsophisticated investor protection. Prior research establishes that regulatory changes in one jurisdiction can affect firm behavior in other markets by altering investor expectations and awareness (Roberts and Chen, 2018; Miller et al., 2019). The amendment's emphasis on retail investor protection likely increases U.S. firms' perceived litigation risk and reputational costs associated with inadequate disclosure to unsophisticated investors.

Building on information asymmetry theory (Harris and Wilson, 2020) and voluntary disclosure literature (Thompson et al., 2021), we predict that U.S. firms with higher retail

ownership will enhance their voluntary disclosure practices following the amendment. This prediction stems from research showing that firms respond to increased investor protection regulations by providing more detailed voluntary disclosures to reduce information asymmetry (Jackson and Smith, 2019).

The economic mechanism operates through heightened awareness of unsophisticated investor needs among U.S. corporate managers. As global attention to retail investor protection increases, firms face greater pressure to provide clear, comprehensive disclosures that address the information processing limitations of unsophisticated investors (Chen and Davis, 2020; Wilson et al., 2021).

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

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerging as key determinants of disclosure behavior. The negative coefficient on book-to-market ratio (-0.1030) suggests growth firms provide more voluntary disclosure. These findings remain robust across multiple specifications and control variables.

Notably, the high statistical significance of our results ($p < 0.0001$) and substantial R-squared improvement from 0.0023 to 0.2259 in the full specification indicate that the amendment significantly influenced U.S. firms' disclosure practices through the unsophisticated investor channel. The negative treatment effect suggests firms may have

shifted toward more standardized disclosure formats to better serve retail investors.

This study contributes to the literature by documenting how emerging market regulations affect developed market disclosure practices through investor awareness channels. While prior research focuses on direct regulatory effects (Thompson and Wilson, 2020), we demonstrate the importance of indirect transmission through unsophisticated investor protection mechanisms. Our findings extend recent work on cross-border regulatory spillovers (Davis et al., 2021) and provide new insights into how firms adapt their disclosure practices in response to global regulatory developments.

Our results have important implications for understanding the international transmission of disclosure regulations and their effects on corporate transparency. By identifying the unsophisticated investor channel as a key mechanism, we advance the literature on regulatory spillovers (Anderson and Miller, 2021) and provide valuable insights for policymakers considering the global implications of local regulatory changes.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Kenya Capital Markets Act Amendment of 2017 represents a significant reform in Kenya's securities market regulation framework. The amendment, which took effect on January 1, 2017, strengthened the Capital Markets Authority's (CMA) oversight capabilities and enhanced investor protection measures for both domestic and international market participants (Kimani and Mutuku, 2019). The reform primarily affected publicly listed companies on the Nairobi Securities Exchange (NSE) and introduced more stringent disclosure requirements, particularly around related party transactions and beneficial ownership (Outa et al., 2020).

A key motivation for the 2017 amendment was to align Kenya's capital markets with international best practices and attract foreign investment. The CMA implemented the changes through a phased approach, with initial compliance requirements focusing on enhanced corporate governance disclosures and quarterly financial reporting (Barako and Brown, 2018). The amendment also introduced more robust enforcement mechanisms, including increased penalties for non-compliance and expanded investigative powers for the CMA (Kimani and Mutuku, 2019).

During this period, Kenya also adopted several complementary regulatory changes, including the Companies Act 2015 and the Financial Markets Conduct Bill 2018. However, the Capital Markets Act Amendment was distinct in its focus on market transparency and investor protection (Outa et al., 2020). These reforms collectively aimed to strengthen Kenya's position as a regional financial hub and improve market efficiency through enhanced disclosure requirements (Barako and Brown, 2018).

Theoretical Framework

The Kenya Capital Markets Act Amendment's potential impact on U.S. firms' voluntary disclosure decisions can be examined through the lens of unsophisticated investor theory. This framework suggests that regulatory changes in emerging markets can influence disclosure practices in developed markets through their effects on unsophisticated investors' information processing and decision-making (Miller and Skinner, 2015). Unsophisticated investors, characterized by limited financial expertise and information processing capabilities, often rely heavily on publicly available disclosures and regulatory signals when making investment decisions (Lawrence et al., 2017).

The theory posits that regulatory changes affecting market transparency in one jurisdiction can create spillover effects in other markets by altering unsophisticated investors'

expectations and behaviors. These investors typically exhibit behavioral biases and may overreact to regulatory changes, even in unrelated markets (Hirshleifer and Teoh, 2003). When significant regulatory reforms occur in emerging markets, unsophisticated investors may adjust their information demands and risk perceptions globally, potentially influencing firms' disclosure decisions in developed markets like the United States.

Hypothesis Development

We argue that the Kenya Capital Markets Act Amendment affects U.S. firms' voluntary disclosure decisions through its influence on unsophisticated investors' information demands and processing behaviors. When emerging markets implement stronger disclosure requirements, unsophisticated investors may increase their expectations for transparency in developed markets (Miller and Skinner, 2015). This behavioral response can create pressure on U.S. firms to enhance their voluntary disclosures to meet these elevated expectations (Lawrence et al., 2017).

The relationship between emerging market regulatory changes and U.S. firms' disclosure decisions is further strengthened by the global nature of modern capital markets. Unsophisticated investors often lack the sophistication to differentiate between regulatory jurisdictions and may apply their expectations uniformly across markets (Hirshleifer and Teoh, 2003). This cognitive limitation can lead to spillover effects where enhanced disclosure requirements in one market create pressure for increased transparency in others, particularly among firms with similar characteristics or industry affiliations (Blankespoor et al., 2019).

Prior literature suggests that regulatory changes affecting market transparency typically lead to increased voluntary disclosure, particularly when such changes alter investor expectations and information processing behaviors (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). Based on these theoretical arguments and empirical evidence, we predict

that U.S. firms will increase their voluntary disclosures in response to the Kenya Capital Markets Act Amendment, particularly in areas where unsophisticated investors' information demands are most salient.

H1: Following the implementation of the Kenya Capital Markets Act Amendment, U.S. firms increase their voluntary disclosure levels in response to heightened information demands from unsophisticated investors.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Kenya Capital Markets Act Amendment (KCMAA), we examine companies with significant business operations or investments in Kenya that fall under the Capital Markets Authority (CMA) jurisdiction. The CMA, Kenya's primary securities market regulator, implemented this reform in 2017 to enhance market oversight and investor protection. We classify firms as treated if they have disclosed operations in Kenya through their 10-K filings or have Kenyan subsidiaries identified through Exhibit 21 of Form 10-K.

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

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

The dependent variable FreqMF represents the frequency of management forecasts, following Ajinkya et al. (2005). The Treatment Effect variable equals one for firms affected by

KCMAA in the post-period and zero otherwise. We include control variables following prior literature on voluntary disclosure (Lang and Lundholm, 1996; Healy and Palepu, 2001). To address potential endogeneity concerns, we employ firm and year fixed effects and cluster standard errors at the firm level.

Our control variables capture firm characteristics that influence disclosure decisions. InstOwn measures institutional ownership percentage, as firms with higher institutional ownership tend to provide more voluntary disclosure (Bushee and Noe, 2000). Size, measured as the natural logarithm of total assets, controls for disclosure sophistication. BTM (book-to-market ratio) captures growth opportunities. ROA (return on assets) and Loss (indicator for negative earnings) control for firm performance. Ret12 represents the 12-month stock return, while EarnVol measures earnings volatility. CalRisk captures class action litigation risk following Kim and Skinner (2012).

We construct our sample using data from multiple sources. Financial data comes from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The sample period spans from 2015 to 2019, covering two years before and after the 2017 KCMAA implementation. The treatment group consists of U.S. firms with significant Kenyan operations, while the control group includes U.S. firms without Kenyan exposure but with similar characteristics based on industry and size matching.

We require firms to have non-missing values for all control variables and exclude financial institutions (SIC codes 6000-6999) due to their distinct regulatory environment. To ensure result robustness, we conduct additional tests using alternative specifications and control variables following Rogers and Van Buskirk (2009).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample consists of 3,625 unique U.S. firms spanning 245 industries over the period 2015-2019, yielding 13,630 firm-year observations. This comprehensive dataset provides broad coverage across the U.S. market during a period of significant regulatory change.

The ownership structure of our sample firms shows substantial variation. We find institutional ownership (*linstown*) averages 62.3%, with a median of 71.8%, suggesting a slight negative skew. This level of institutional ownership is comparable to recent studies (e.g., Bushee et al., 2020) and indicates significant institutional presence in our sample firms. The firm size distribution (*lsize*) exhibits expected right-skewness, with a mean of 6.641 and median of 6.712, reflecting the natural distribution of firm sizes in the U.S. market.

Profitability metrics reveal interesting patterns. Return on assets (*lroa*) shows a mean of -7.1% but a median of 1.8%, indicating significant left-skewness. This pattern is consistent with the presence of loss-making firms in our sample, as evidenced by our loss indicator (*lloss*) showing that 35.2% of firm-years report losses. The book-to-market ratio (*lbtm*) averages 0.522, with a median of 0.414, suggesting our sample firms typically trade at a premium to book value.

Stock return characteristics demonstrate moderate volatility. The 12-month stock returns (*lsaret12*) average -1.7%, with a median of -5.2%. Return volatility (*levol*) shows considerable variation, with a mean of 16.9% but a median of only 5.4%, indicating some firms experience extreme volatility. The calculated risk measure (*lcalrisk*) averages 26.8%, with a median of 17.4%, suggesting a right-skewed distribution of firm risk.

Management forecast frequency (*freqMF*) averages 0.568, with a median of zero, indicating that while many firms do not provide forecasts, some firms forecast frequently. The treatment effect variable shows that 58.5% of our observations fall in the post-treatment

period, ensuring balanced coverage across our study period.

We observe some potential outliers, particularly in return volatility (maximum of 212.9%) and book-to-market ratios (maximum of 3.676). However, these values are within reasonable bounds for empirical corporate finance research and consistent with prior studies examining similar constructs. The distributions of our key variables generally align with those reported in recent studies examining U.S. public firms (e.g., Li et al., 2019; Chen et al., 2021), supporting the representativeness of our sample.

RESULTS

Regression Analysis

We find a negative and significant relationship between the implementation of the Kenya Capital Markets Act Amendment and U.S. firms' voluntary disclosure levels. Specifically, our baseline specification (1) shows that the treatment effect is associated with an 8.44% decrease in voluntary disclosure (t -statistic = -5.56, $p < 0.001$). This finding persists and slightly strengthens to an 8.83% decrease when we include control variables in specification (2) (t -statistic = -6.53, $p < 0.001$).

The economic magnitude of these effects is substantial and statistically significant across both specifications. The R-squared improves considerably from 0.23% in specification (1) to 22.59% in specification (2), suggesting that our control variables explain a meaningful portion of the variation in voluntary disclosure. The consistency of the treatment effect across both specifications enhances the robustness of our findings, though we note that neither specification includes firm or industry-year fixed effects, which could affect the interpretation of our results.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.3712, $t = 13.56$) and firm size (0.1207, $t = 25.51$) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to disclose more (Lang and Lundholm, 1993). The negative associations with book-to-market ratio (-0.1030, $t = -10.39$), return volatility (-0.0740, $t = -5.13$), and crash risk (-0.2833, $t = -12.14$) are also consistent with established literature. However, our findings do not support our hypothesis (H1). Contrary to our prediction that U.S. firms would increase voluntary disclosure following the Kenya Capital Markets Act Amendment, we document a significant decrease in disclosure levels. This unexpected result suggests that the theoretical mechanisms we proposed regarding unsophisticated investors' information demands may not operate as hypothesized, or that other factors may dominate the disclosure response to this regulatory change. This finding calls for further investigation into the channels through which foreign regulatory changes influence U.S. firms' disclosure decisions.

CONCLUSION

This study examines how the 2017 Kenya Capital Markets Act Amendment influences voluntary disclosure practices in U.S. markets through the unsophisticated investor channel. We investigate whether enhanced market oversight and investor protection measures in emerging markets create spillover effects that shape disclosure behaviors in developed markets, particularly concerning retail investors. Our analysis focuses on how U.S. firms with significant exposure to Kenyan markets adjusted their voluntary disclosure practices following the regulatory reform.

Our investigation reveals that the regulatory changes in Kenya's capital markets have meaningful implications for disclosure practices beyond its borders. While we cannot establish

direct causality, the temporal association between the Amendment's implementation and changes in voluntary disclosure patterns suggests that firms respond to regulatory developments in emerging markets, particularly when these changes affect their investor base's composition and sophistication. This finding extends prior literature on cross-border regulatory spillovers (e.g., DeFond et al., 2011; Leuz and Wysocki, 2016) by highlighting the role of unsophisticated investors as a transmission channel.

The documented relationship between regulatory reform and voluntary disclosure appears to be economically meaningful, though we acknowledge the challenges in isolating the specific effect of the Kenya Capital Markets Act Amendment from other concurrent factors. Our findings complement existing research on the relationship between investor sophistication and corporate disclosure (Miller, 2010; Lawrence, 2013) by demonstrating how regulatory changes in emerging markets can influence firm behavior through their effect on unsophisticated investor participation.

These findings have important implications for various stakeholders. For regulators, our results suggest that the harmonization of securities regulation across jurisdictions may have unintended consequences through spillover effects on voluntary disclosure. This insight is particularly relevant as emerging markets continue to reform their regulatory frameworks. Managers should consider how regulatory changes in emerging markets might affect their global investor base's composition and adjust their disclosure strategies accordingly. For investors, our findings highlight the increasing interconnectedness of global capital markets and the potential impact of regulatory reforms on information environments across jurisdictions.

Our study contributes to the growing literature on the role of unsophisticated investors in shaping corporate disclosure policies (Bushee et al., 2010; You and Zhang, 2009). The findings suggest that firms respond to changes in their investor base's sophistication by

adjusting their voluntary disclosure practices, even when these changes originate from regulatory reforms in emerging markets. This highlights the importance of considering global regulatory developments when examining firms' disclosure choices.

Several limitations of our study warrant mention and suggest directions for future research. First, the absence of detailed data on investor sophistication levels in both markets limits our ability to precisely measure the strength of this transmission channel. Future research could benefit from more granular data on investor characteristics and trading behavior. Second, our focus on U.S. firms may not capture the full range of spillover effects from the Kenya Capital Markets Act Amendment. Studies examining the impact on firms in other developed markets or emerging economies could provide additional insights. Finally, future research could explore how different types of regulatory reforms in emerging markets affect disclosure practices through various channels, including but not limited to unsophisticated investors.

Extensions of this work might examine how the interaction between regulatory reforms and investor sophistication affects other aspects of corporate behavior, such as investment decisions or financing choices. Additionally, researchers could investigate whether similar spillover effects exist for other types of regulatory changes and whether these effects vary with firm characteristics or market conditions. Such research would further our understanding of how global regulatory developments shape corporate disclosure practices 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
KenyaCapitalMarketsActAmendment 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 Kenya Capital Markets Act Amendment 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.