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Business Risk Disclosure and Firm Risk: Evidence from Japan

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Highlights

- The introduction of mandatory business risk disclosure has a negative impact on total risk.
- The mandatory business risk disclosure is positively related with total risk across firms and years after the inception.
- The effect of reducing the cost of capital exceed the effects on increasing investors' assessment of firm risk.

Abstract

We take advantage of the introduction phase of business risk disclosure in Japan as a natural experiment to examine the causal effects on firm risk. In contrast to risk factor disclosure that appeared partly in the Management Discussion and Analysis section (MD&A) in the United States, Japanese business risk disclosure is a new, independent disclosure regime, which began in the fiscal year ending March 2004.We find that the introduction of mandatory business risk disclosure has a negative impact on total risk. This suggests that an increase in business risk disclosure contributes to reduce a firm's cost of capital, which is contrary to the results found in previous research. However, we also find that there is a positive relationship across firms and years after the inception between the amount of business risk disclosure and total risk, indicating that mandatory business risk disclosure has an impact on increasing investors' assessment of firm risk.