Corporate Risk Disclosure Consistency or Disparity?

Analysis of Listed Japanese and North American Manufacturing Companies

ST. JOHN'S UNIVERSITY

Center for Excellence in Enterprise Risk Management

St. John's University
Peter J. Tobin College of Business

Dr. Paul L. Walker, Ph.D., CPA
James J. Schiro / Zurich Chair in Enterprise Risk Management
Executive Director, Center for Excellence in Enterprise Risk Management
St. John's University
Peter J. Tobin College of Business

Research Sponsored by:

AIG

FOREWORD

Being able to identify the risks that are present around us and prioritize the ones we could face is a crucial step in effective risk management. Key to identifying this is open and clear communication about a company's risk factors and their potential impact on the choices we make every day in business.

AIG is pleased to sponsor this paper from Dr. Paul L. Walker of the St. John's University Center for Excellence in Enterprise Risk Management. The research performed by Professor Walker compares the risks disclosed by companies listed on the New York Stock Exchange and the Tokyo Stock Exchange, while also examining motivating factors for such disclosure. Identifying apparent similarities and differences in the types of risks disclosed by companies in the U.S. and Japan will help create a broader understanding of corporate risk in a global world, and offers perspectives on opportunities to help mitigate against potential blind spots when evaluating enterprise risk.

Professor Walker's findings suggest the need to have a more holistic, mature enterprise risk management (ERM) framework and board representation that is focused on helping identify risk, which we support for ourselves as well as our clients. Furthermore, Professor Walker's paper indicates that there is greater potential to address certain identified risks such as information security and M&A activities through cyber insurance and M&A insurance.

Through his paper, Professor Walker provides a valuable contribution to the discussion of effective risk management, and adds to our understanding as a leading global insurer with a long history of providing insurance solutions in the North American and Japanese commercial insurance markets.

Lex Baugh, CEO North America, AIG General Insurance

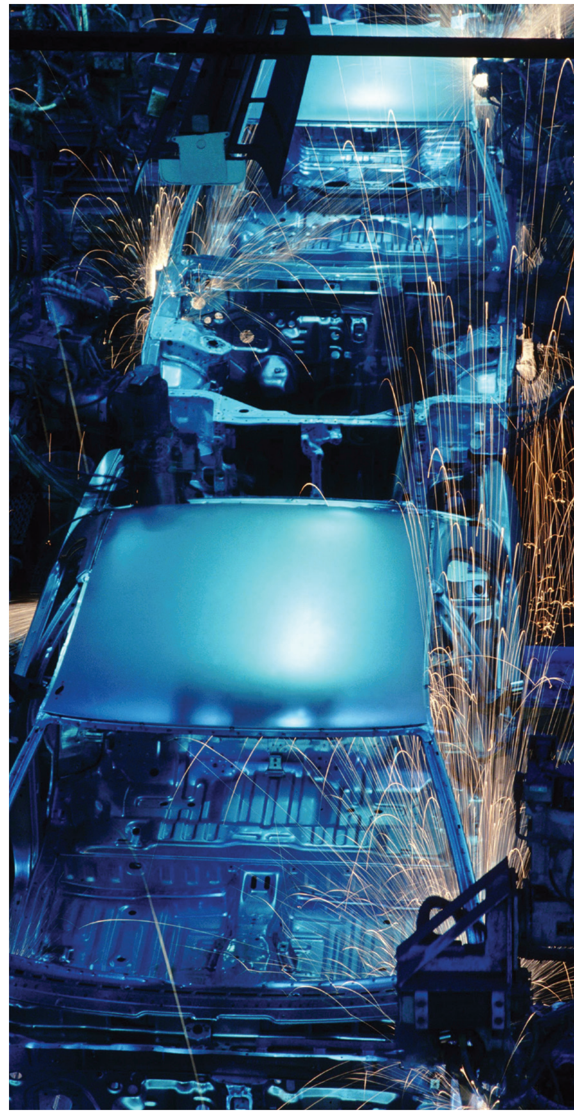
Kenneth Reilly

Ken Reilly, President and CEO, AIG General Insurance Company, Ltd., Japan

1. Executive Summary

A company's annual report offers a description of that organization's business and the risks it faces. Risk disclosures are an important part of that report and should provide external stakeholders with valuable information about significant risks.

This research study represents an analysis of risk factor disclosures from large manufacturing companies on both the Tokyo Stock Exchange (TSE) and the New York Stock Exchange (NYSE). Listed risks and patterns were analyzed and five key findings are evident.



- The most frequently listed risks by each exchange are different. While NYSE companies tend to mention information security and strategic risks such as M&A and competition frequently, TSE companies often mention foreign currency, disasters, and product related risks. Both economic conditions and compliance are frequently mentioned by both NYSE and TSE companies.
- Interestingly, the most frequently listed risks are not necessarily the most important risks, particularly among NYSE companies. While TSE companies tend to be more consistent in listing the same risks frequently and also listing them as their top three risks, there appears to be inconsistency among NYSE companies. Such notable inconsistent risks (most frequently mentioned but not as top three risks) in NYSE companies include information security, M&A, litigation, and tax.
- The average numbers of risk factors and the average number of pages dedicated to risk factors in the annual report are higher among NYSE companies than those of TSE companies. There is also wider dispersion among NYSE companies compared to TSE companies in their disclosure of risk factors — in terms of number of pages given to the subject and percentage of the annual report.
- Broader categorization of risks highlights major differences in companies' views of their top risks between TSE and NYSE exchanges. The largest gaps are in the macro/external risk and compliance risk categories. This suggests that NYSE companies are more concerned about compliance risk than their TSE counterparts, while TSE companies worry more over macro/external risks than NYSE companies.
- Potential internal and external reasons for the patterns of differences noted include ERM practices and maturity, involvement of board members, level of risk awareness and knowledge, regulatory and litigation differences and investor expectations.

2. Risk Disclosure: What is Good Practice?

The SEC requires that companies disclose their most significant risk factors, and registrants are discouraged from simply listing risks that apply to any registrant or offering. Risk factor disclosures are important. For example, a 2018 review of the risk research literature suggests that risk disclosures have both information content and influence capital market participants.[1] In the past, the SEC offered a sample of risks in their guidance (see Appendix A). In 2017, the SEC proposed revising risk factor disclosures. Proposed ideas include removing the risk examples or providing better examples. Commenters to the SEC suggested the SEC requires impact and likelihood requirements on risk factors. One commenter suggested the SEC mandate companies include a top ten risk list.

Corporate governance in the U.S. has evolved over the years and has been directed by state law and federal statutory rules. With respect to risk, these include SEC rules about risk factor disclosures and, more recently, SEC rules mandating disclosure of board risk oversight. The NYSE also has listing requirements with respect to risk management duties. Additional forces that influence corporate governance and board risk oversight come from organizations like the NACD, who published 10 principles for board risk oversight in 2009 and continue to update that guidance. For example, in 2018 the NACD suggested boards spend more time on disruptive risks.

Certain industries in the U.S. and Japan have gone even further and practically mandated enterprise risk management or a version of it (e.g., Dodd-Frank Act for banks and the Own Risk and Solvency Assessment for insurance companies).

The Japanese Financial Services Agency (FSA) offers guidance on risk disclosures for TSE companies. A sample of possible risks is also provided in their guidance (see Appendix A). The guidance describes business risk examples for companies, but also makes it clear that companies can disclose risks that are different from the examples. The FSA also suggests "future risks" as a disclosure. These are described as risks that cast doubt about a company's continuing existence. Examples cited include excessive debt, a decrease in sales, and major business restrictions.

In Japan there has been a push for doing more about managing risks. For example, the 2015 Japanese Corporate Governance Code addresses information disclosure and encourages companies to comply with disclosure laws and regulations, but also to go beyond the law. The Code states, "Companies should appropriately make information disclosure in compliance with the relevant laws and regulations, but should also strive to actively provide information beyond that required by law. This includes both financial information, such as financial standing and operating results, and non-financial information, such as business strategies and business issues, risk, and governance." The Code further notes that such disclosures are the basis for a "constructive dialogue with shareholders."

Beyond disclosures, the Japanese Corporate Governance Code encourages boards to ensure internal control and risk management systems are in place and are effective and proactive in supporting risk taking. Boards are also encouraged to support an environment that fosters appropriate risk taking by senior management. All of which suggest that the expectations for managing risk have gotten higher for most companies around the globe.

An example of one Japanese company that takes these disclosures seriously is the Japan Exchange Group (JPX). Given that JPX manages the security exchange, they might be seen by many as a role model with respect to annual filings. Their 2016 annual report states they must "analyze and identify risks… to instill confidence in investors." They add that to grow globally requires that companies confront their risks. JPX also states that their board effectiveness review noted that risk management needed to be strengthened. Furthermore, JPX has a risk management section in their annual report that describes their CEO's role in risk management, their risk management committee, and their risk management system.

[1] See Elshandidy et al. 2018 (Journal of Accounting Literature).

3. The Approach to Risk Disclosure Analysis

The largest 100 manufacturing sector companies, as defined by market capitalization as of Feb. 1, 2018, were chosen from both the TSE and NYSE to analyze risk disclosures. This included classified manufacturing companies listed in the TSE's first section, and as defined by the securities identification code committee in Japan. Similar industry companies from the NYSE were matched with the sub sectors under the manufacturing section (see Appendix B).

Risk factor disclosures were reviewed for these companies for the most recent fiscal year and each company's risk factors were coded using a risk factor taxonomy. In addition to coding the risk factors, the following data was collected: number of risk factors disclosed in the annual report, number of pages allocated to risk factors in the annual report, and the order in which risk factors were listed in the disclosures. Figure 1 shows some basic information for both stock exchanges.

FIGURE 1 – RISK FACTOR DISCLOSURE AVERAGES

AVERAGES	TSE	NYSE
NUMBER OF RISK FACTORS	17	24
PAGES IN THE ANNUAL REPORT DEDICATED TO RISK FACTORS	3	10
TOTAL PAGES OF THE ANNUAL REPORT	136	176

On average, TSE companies disclose 17 risk factors and spend three pages of their total annual report discussing these factors. NYSE companies disclose 24 risk factors and spend an average of ten pages of their total report discussing these factors.

3.1 RISK FACTOR FOCUS BY COUNTRY

The risk factor focus by companies on each exchange is seen in Figures 2 and 3. The horizontal axis shows the total pages of the risk factor section in each annual report and the vertical axis shows the percentage of the annual report dedicated to risk factors.

FIGURE 2 – TSE RISK FACTOR FOCUS

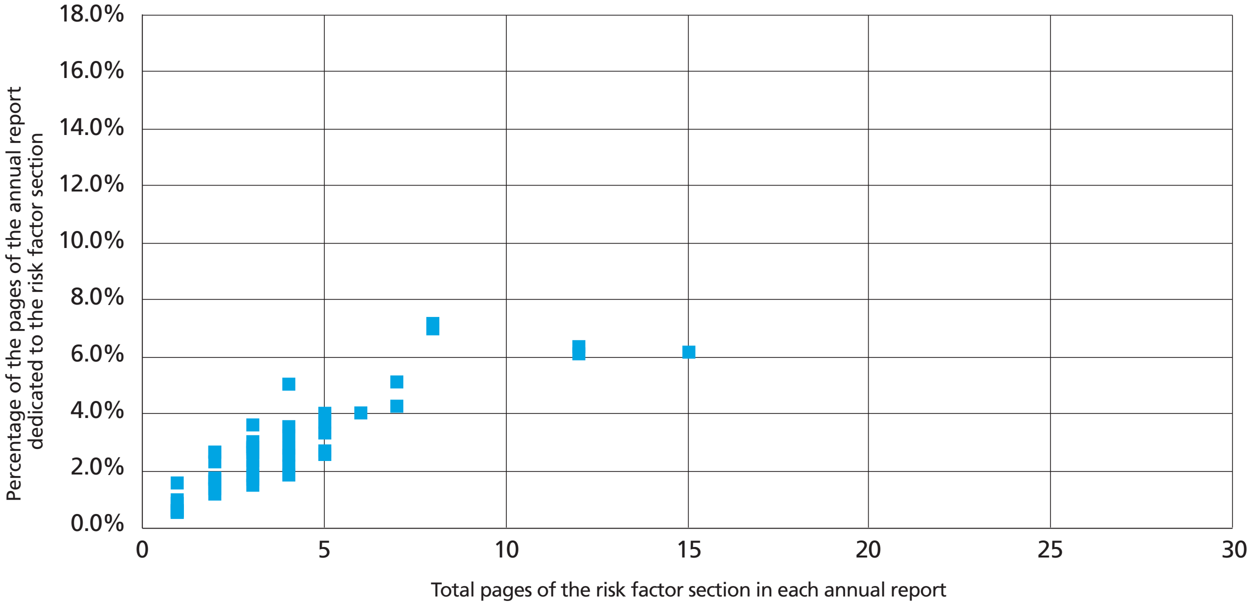
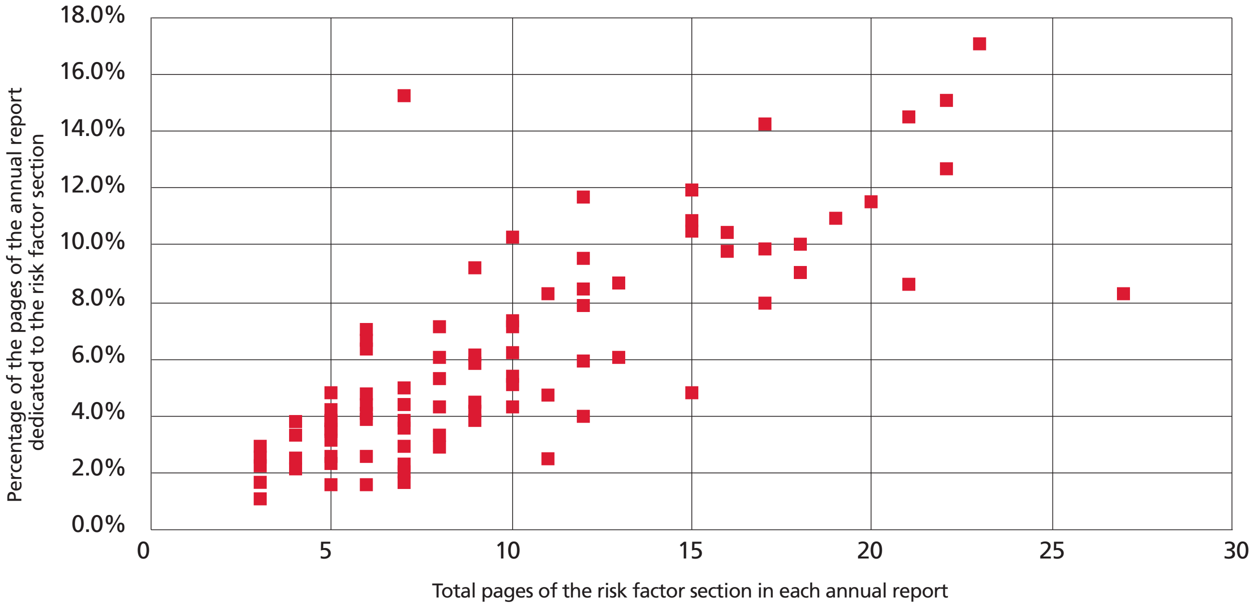


Figure 2 shows that the majority of TSE companies are concentrated in the lower left quadrant, indicating that they use fewer pages and a smaller percentage of the total report on those risk factors. Most TSE companies use fewer than five pages on their risk factors. Additionally, few TSE companies allocate more than 4% of their total annual report to risk factors.

FIGURE 3 – NYSE RISK FACTOR FOCUS



Though some NYSE companies are quite similar to their TSE counterparts, many use more pages to discuss risk factors and show more dispersion in their risk factor disclosures (see Figure 3). The Figure reveals that 18% of NYSE companies spend more than 15 pages on those factors. Furthermore, 43% of NYSE companies use over 6% of their total annual report discussing risk factors, with one company using about 17% of their entire annual report on risk factors.

To explore these differences further, NYSE companies were grouped into two categories and their respective industries were reviewed. Group A is composed of NYSE companies that allocate less than or equal to 8% of their annual report dedicated to risk factors and less than or equal to 15 pages on their risk factors. Group A contains 74 companies. Group B is all others and contains 26 companies. For clarification, Group A is the lower left-hand companies seen in Figure 3. Adding the respective industry makeup by Group results in Figure 4.

FIGURE 4 – INDUSTRY ANALYSIS OF GROUPS A AND B AMONG NYSE COMPANIES

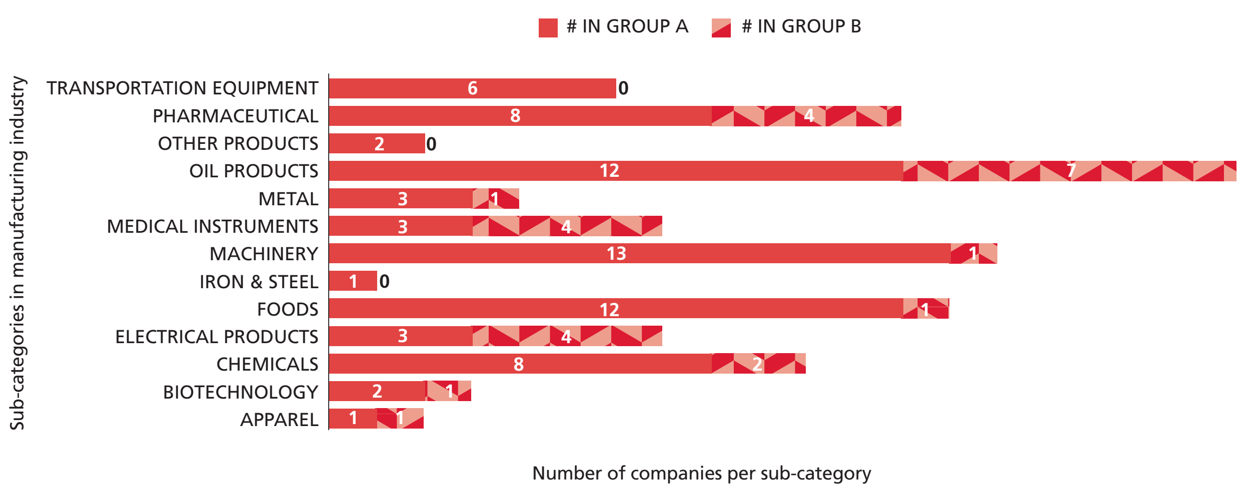


Figure 4 shows that Group B companies, which use more pages and a higher percentage of their annual report on risk factors, are the more regulated companies as a percentage of the total group. For example, Group B contains four pharmaceutical and seven oil companies for a total of 11 out of the 26 (or 42%) total companies in the group. In contrast, Group A has eight and 12 companies in these industries for a total of 20 out of 74 (27%). These results imply that industry differences may drive some of the risk factor dispersion seen in Figures 2 and 3.

3.2 MOST FREQUENTLY LISTED RISKS

Figures 5 and 6 show the top 40 most frequently listed risks for both NYSE and TSE manufacturers', respectively. Specifically, these Figures show how many companies list each identified risk. For example, Figure 5 shows that 96 out of 100 of the largest manufacturing companies on the NYSE identify information security as a risk factor. Since each stock exchange analysis focuses on 100 companies, these mentions also are the percentage of companies that mention the risk. These numbers best reveal industry concern over the risk, meaning that if most companies on the exchange list a particular risk then the risk appears to apply to a broader spectrum of the industry and reflect overall industry concern (or a required disclosure).[2]

FIGURE 5 – NYSE RISK FACTOR MENTIONS

RISK	RANK	MENTIONS
Information security	1	96
Compliance	2	88
M&A	3	85
Competition	4	80
Economic conditions	5	73
Global operations	TIE 6	68
Litigation	TIE 6	68
Financing	8	64
Tax	9	63
Innovation	10	54
Intellectual property	11	51
Material inputs	TIE 12	49
Business disruptions	TIE 12	49
Talent	14	48
Foreign currency	15	42
Third party reliance	16	40
Product	TIE 17	39
Operations (general)	TIE 17	39
Impairments	19	36
Financial (general)	20	34
Pensions	21	33
Key product / customer	22	32
Disasters	23	28
Geo political	24	26
Marketable securities	TIE 25	25
Trends	TIE 25	25
Insurance	TIE 27	24
Strategy (general)	TIE 27	24
Estimates	TIE 27	24
Commodities	30	22
Key supplier	TIE 31	18
Labor matters	TIE 31	18
Climate and weather	TIE 31	18
Restructurings	TIE 31	18
Operational inputs	35	17
Credit	TIE 36	16
Industry consolidation	TIE 36	16
Credit markets	38	15
Conduct	39	13
Environmental matter costs	40	13

FIGURE 6 – TSE RISK FACTORS MENTIONS

RISK	RANK	MENTIONS
Foreign currency	1	92
Disasters	2	86
Compliance	3	83
Product	4	81
Economic conditions	5	75
Intellectual property	6	69
Material inputs	7	68
Information security	8	67
Litigation	9	53
Competition	10	52
Global operations	11	47
M&A	12	43
Innovation	13	41
Pensions	14	36
Talent	15	35
Marketable securities	16	32
Interest rate	17	29
Third party reliance	18	28
Tax	TIE 19	26
Geo political	TIE 19	26
R&D	21	25
Impairment	22	23
Environment / conservation	23	22
Financing	24	20
Operations (general)	TIE 25	18
Key product / customer	TIE 25	18
Trends	27	17
Credit	28	16
Financial (general)	29	15
Key supplier	TIE 30	14
Business disruptions	TIE 30	14
Strategy (general)	32	13
Restructurings	TIE 33	9
Expansion	TIE 33	9
Internal control	TIE 33	9
Operational inputs	TIE 33	9
Brand	TIE 33	9
Labor matters	TIE 38	8
Supply chain (overall)	TIE 38	8
Terrorism	TIE 38	8

[2] A comparison of the required sample risk disclosures (see Appendix A) to actual disclosures shows that neither group of companies on their stock exchanges exactly follow the list provided in regulations.

3.3 COMPARISON OF MOST FREQUENTLY LISTED RISKS

The top five most frequently listed risks on the NYSE and TSE are compared below (see Figure 7) and show both similar and different risk concerns across the two stock exchanges.

FIGURE 7 – TOP FIVE MOST FREQUENTLY LISTED RISKS IN NYSE AND TSE COMPANIES

MOST LISTED RISK FACTOR RANK	NYSE	TSE
1	Information security	Foreign currency
2	Compliance	Disasters
3	M&A	Compliance
4	Competition	Product
5	Economic conditions	Economic conditions

Two of the top five risks are the same (*compliance* and *economic conditions*) and both reveal just how hard it can be to be successful when the world is economically uncertain and the regulations are burdensome. Economic conditions risk factors include: concern over the global economy, economic uncertainty or slowdown, changes in business conditions, changes in overall demand, macro price movements, and recessions. Compliance risk factors include the amount of regulations the companies face. Compliance risk also includes a concern over more specific compliance and regulations related to the environment and healthcare. Additionally, a large number of companies are also concerned about an increase in future regulations that would impact their business.

The other top risks reflect a large contrast in risk and perspective from the respective countries and companies. For example, TSE companies' other most frequently listed risks are *foreign currency*, *disasters*, and *product* related risks while NYSE companies identify *information security*, *M&A*, and *competition, risks*. Foreign currency is a critical risk for TSE companies. According to the World Bank, imports represent 15% and exports represent 16% of Japan's 2016 total GDP.[3] Additionally, some research shows that only 35.9% and 25.0% of Japan's 2015 exports and imports, respectively, are invoiced in Japanese Yen and that the rest are invoiced in non-Yen currencies, heightening the importance of foreign currency risk to TSE companies.[4] Disaster risk for TSE companies is certainly understandable given the earthquake history in Japan. Finally, product risk is an interesting top five risk for TSE companies, but is only listed as 17th for NYSE companies. Product risk disclosures include risks around product quality, product safety, and product recalls.

With regards to other top risks from NYSE companies, information security features most prominently. The SEC has rules addressing cyber security and this could explain why so many NYSE companies (96 out of 100) disclose information security risk. M&A and competition risks are in some ways strategic type risks, with competition being an external and potentially uncontrollable strategic risk, while M&A can be a strategic response to such competition and other disruptive forces. These are risks that can dramatically alter the long-term survival of the company. These risks reflect industry patterns and raises the question as to why NYSE companies are more likely to disclose strategic type risks given that Appendix A (for both stock exchanges) do not show strategic risks as examples.

[3] https://data.worldbank.org/indicator/NE.IMP.GNFS.ZS?locations=JP
[4] See Takatoshi et al., "Choice of Invoice Currency in Japanese Trade: Industry and Commodity Level Analysis" (RIETI Discussion Paper Series 16-E-301).

3.4 OTHER FREQUENTLY LISTED RISKS

The remaining risks are compared below (see Figure 8) and again show the industry risk concerns for each stock exchange.

FIGURE 8 – OTHER LISTED RISKS IN NYSE AND TSE COMPANIES

MOST LISTED RISK FACTOR RANK	NYSE	TSE
T6	Global operations	Intellectual property
T6	Litigation	Material inputs
8	Financing	Information security
9	Tax	Litigation
10	Innovation	Competition
11	Intellectual property	Global operations
TIE 12	Material inputs	M&A
TIE 12	Business disruptions	Innovation
14	Talent	Pensions
15	Foreign Currency	Talent

Key trends are summarized below:

- Most companies in both countries share concern about *litigation* exposure as a risk (T6 on the NYSE and 9th on TSE). More specifically, and as shown in Figures 5 and 6, 68% of NYSE companies and 53% of TSE companies disclose this risk factor
- Both groups share the *global operations* risk, a common risk describing the difficulty in conducting operations around the globe (68% of the NYSE and 47% of the TSE disclosed this risk). The high percentage of companies disclosing this risk suggests that the companies in this study are obviously companies that do business around the globe.
- Both groups are also concerned about *material input* risks as evidenced by 49% of NYSEs and 68% of TSEs disclosing this risk. Material input is an operational risk (and in some ways is also an external risk) and is described in terms of obtaining the input to produce the product, finding new sources for the raw materials, and issues over the rising price of main material input.
- *Talent* risk is also mentioned — companies in both countries share concerns about a potential talent shortage at numerous levels of the organization, although significantly more NYSE companies disclose this risk as compared to TSE (48% vs 35%, respectively). A few TSE companies hint that their talent shortage may be related to birth and aging demographics.
- *Information security* shows up as the eighth most listed risk for TSE companies (67% of TSE listed this risk) compared with a top five listing for NYSE companies (96% of NYSE companies listed this risk). Although both countries have the risk listed quite frequently there are differences in the regulations and approaches. Japan has regulations on the protection of personal information with a requirement that covers data leakage prevention, losses, or other security controls. The SEC rules are broader and may be driving NYSE companies to take a different view and approach. For example, the SEC's Guidance on Public Company Cybersecurity Disclosures defines "cybersecurity" as including both security and theft of information belonging to others. The SEC states that, "It is critical that public companies take all required actions to inform investors about material cybersecurity risks and incidents in a timely fashion, including those companies that are subject to material cybersecurity risks but may not yet have been the target of a cyber-attack." With respect to risk factor disclosures, the SEC asks companies to consider the severity and frequency of prior incidents, the probability and magnitude of incidents, preventative actions, the aspect of the business, the potential for reputational harm, as well as legal and regulatory aspects.

[5] See "We Have Faced the Risk… and it is Us! By Walker et al. (Financial Executive, May 2013) This article also noted that talent and workforce competitiveness was a top risk facing the U.S. economy.

- *Intellectual property* and innovation are listed as risks by both NYSE companies and by TSE companies. Intellectual property is mentioned by 69% of TSE companies and 51% of NYSE companies. There seems to be a genuine concern among companies in both countries around protecting and creating new intellectual property. Several companies also mentioned intellectual property as a litigation risk. Innovation is identified as a risk by 54% of NYSE companies and 41% of TSE companies. The high percentages from innovation and intellectual property risks are consistent with all the news headlines about disruption, innovation, etc. and it appears to show in the company filings about their risks.
- Given the concerns and discussion over culture and conduct by many today it is a little surprising that so few companies mention culture or conduct risk. For example, the 2017 COSO ERM Framework has two principles that address culture. One principle states that organizations consider defining their desired culture and another states that an organization considers reporting on risk, culture, and performance. In fact, the COSO ERM Framework mentions culture more than a hundred times and defines ERM (partially) as the culture, capabilities, and processes of an organization.

3.5 COMPARISON OF THE MOST IMPORTANT RISKS

The key trends analysis discusses the risks based on the frequency they are mentioned. Many believe that companies list their risks in the order of significance, implying that the first risk listed is the most significant. There is support for this position. According to the SEC's guide on how to read a 10-K, risk factors "include information about the most significant risks that apply to the company or to its securities. Companies generally list the risk factors in order of their importance." There does not appear to be a similar rule for TSE companies to mention risks in order though it is assumed, for the analysis purposes, that TSE companies also order their risks in terms of their significance.

This section discusses the risks with the assumption that the order matters and the specific focus and analysis is placed on the first three risks each company identifies – deemed the most important risks. The table (Figure 9) below shows the NYSE risks, rank based on the number of times the risk is mentioned, the number of mentions, and the number of times that risk is listed in the top 3 risks by the hundred companies (assumed to be the most important risks).

FIGURE 9 – NYSE TOP THREE (MOST IMPORTANT) RISKS VS MENTIONS

RISK	RANK	MENTIONS	# TIMES LISTED AS A TOP 3 RISK
Information security	1	96	1
Compliance	2	88	24
M&A	3	85	9
Competition	4	80	25
Economic conditions	5	73	40
Global operations	TIE 6	68	15
Litigation	TIE 6	68	4
Financing	8	64	5
Tax	9	63	2
Innovation	10	54	19
Intellectual property	11	51	8
Material inputs	TIE 12	49	11
Business disruptions	TIE 12	49	6
Talent	14	48	1
Foreign currency	15	42	4

There are some interesting differences between the risks that are mentioned the most frequently and the risks that appear in the top three most important risks. The table shows that there are three risks identified as the most important by several companies and also identified as the most frequently mentioned risks. They are economic conditions (identified in the top three 40 times), competition (identified in the top three 25 times), and compliance (identified in the top three 24 times). These cover a broad spectrum of risk.

Several risks are in the top fifteen most frequently listed risks but are mentioned in the top three most important risks less than ten times. They are: information security, M&A, litigation, financing, tax, intellectual property, business disruptions, talent, and foreign currency. In fact, although information security is mentioned by 96% of the NYSE companies, only one company thinks it is a most important risk.

The TSE most important risks versus mentions are shown in the table (Figure 10) below.

FIGURE 10 – TSE TOP THREE (MOST IMPORTANT) RISKS VS MENTIONS

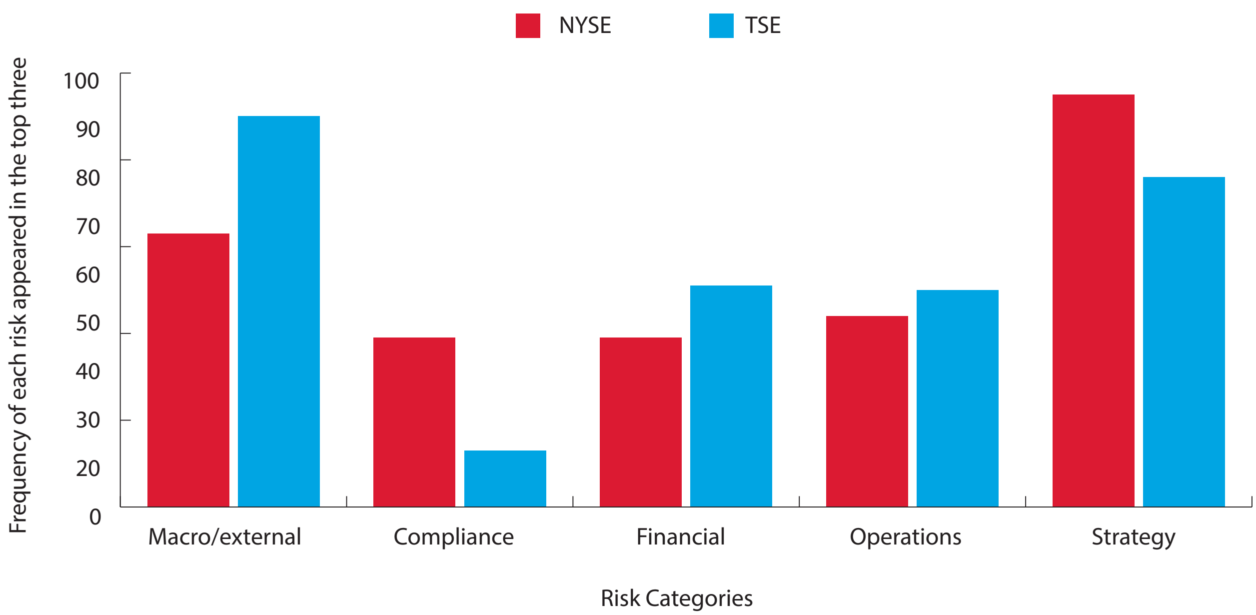
RISK	RANK	MENTIONS	# TIMES LISTED AS A TOP THREE RISK
Foreign currency	1	92	42
Disasters	2	86	11
Compliance	3	83	13
Product	4	81	5
Economic conditions	5	75	68
Intellectual property	6	69	6
Material inputs	7	68	16
Information security	8	67	1
Litigation	9	53	4
Competition	10	52	24
Global operations	11	47	11
M&A	12	43	7
Innovation	13	41	16
Pensions	14	36	0
Talent	15	35	1

The TSE most important risks are *economic conditions* (identified in the top three 68 times), *foreign currency* (identified in the top three 42 times) and *competition* (identified in the top three 24 times). Two of these (economic conditions and competition) are the same as the NYSE's. All of these are also in the top ten risks in terms of the frequency mentioned. Foreign currency is not only the most mentioned risk (92 out of 100 mentioned this risk) but also the second most mentioned risk in the top important risks. It is interesting to note that TSE companies tend to be more consistent in listing the same risks frequently and also listing them as top risks. Again, for purposes of the analysis, it is assumed that order matters. Similar to NYSE companies there are some risks mentioned by a lot of companies, but are noted as the most important risks fewer than ten times. These are: product, intellectual property, information security, litigation, M&A, pensions, and talent.

3.6 RISK CATEGORIZATION

Another perspective can be determined by categorizing the risks. Categorization helps to highlight which type of risks companies think is their biggest. COSO's 2004 ERM framework categorizes risks into areas such as strategy, compliance, reporting, and operations. Additionally, research from the Center for Excellence in ERM shows that companies today still categorize their own risks. The following figure (Figure 11) shows a comparison of the risks by category for each exchange, based on the frequency each risk appeared in the top three.

FIGURE 11 – RISK CATEGORIES DISTRIBUTION IN NYSE AND TSE COMPANIES



The macro/external category is the combined risks of economic conditions, global operations, and disasters. The strategy category is the combined risks of competition, trends, strategy (generally), intellectual property, innovation, and R&D. The categorization of risks highlights the major differences and consistencies in disclosures from each stock exchange.

Both stock exchanges have the most risks in the categories of macro risks and strategic risks. TSE companies list the most risks in macro risks and this is partially driven by disasters and the Japanese economy. NYSE companies list the most risks in the strategic risk category. Again, this strategic risk finding is consistent with earlier Center for Excellence in ERM research showing that strategic risks make up half of a company's total top risks.[6]

There are many reasons why companies are attempting to get better at identifying strategic risks. Numerous studies show that strategic risk is one of the largest destroyers of value. Further, recent work at the Center for Excellence in ERM shows that North American companies list strategic risk connections as the number one area they want to improve. Additionally, the 2017 COSO ERM framework has an emphasis on strategic risk and COSO is used as guidance by many companies.

The two largest gaps in risk categories between NYSE companies and TSE companies are in macro risks and compliance risks. TSE companies not only have the most risks in macro risks but they also have a much larger number of risks there than NYSE companies. Economic and government policy differences between the two economies could be a primary driver of this difference. However, all companies would be wise to understand how macro risks drive performance and influence their business model.[7] The second largest gap is in compliance risks with NYSE companies showing more compliance risks listed in this category than TSE companies.

[6] This white paper is available at: https://static1.squarespace.com/static/57ea5fde440243231bc154b7/t/5aeaf3c72b6a283a9f96b25c/1525347298817/CEERM+White+Paper+Series+Dr+Walker.pdf.

[7] The report by Presmanes and Walker, "Improving Strategic Risk Management Using Macro Risk Analysis (RIMS Professional Report series), highlights the importance of understanding a company from a macro risk perspective.

4. Potential Causes of Risk Factor Disclosure Differences

A variety of reasons and theories could potentially explain risk factor disclosure differences and are also possible future testable empirical questions.

- *External* reasons for these differences could be the actual regulatory differences. That is, the regulations are somewhat (though not dramatically) different (see Appendix A), and this could be the primary cause of these differences in risk factor disclosures. Alternatively, how companies interpret these regulations could impact the implementation and ultimate disclosure. Another theory driving these disclosure differences includes investor expectations. For example, if investors in one country have a higher demand for risk management and risk oversight than in other countries, then management might be influenced to provide more disclosure. Finally, litigation differences could be an issue. If companies in one country are more concerned about litigation exposure then this could influence their risk factors and the amount of disclosures about those factors in an effort to mitigate any litigation related risk.
- Other reasons for these risk factor disclosure differences include some that are more *internally* generated. For example, executives and companies that are more aware of their risks may be more able to see such risks and disclose them. In other words, if executives have more risk knowledge then this could show up in disclosure differences. Additionally, cultural differences by executives in each country could influence the interpretation of disclosure regulations and influence what gets disclosed.
- Another potential driver of risk factor disclosure differences could be the *actual ERM practices and maturity* by the respective companies. It is plausible that companies who build better ERM processes should be able to identify more risks, understand how they are connected, have plans in place to better manage such risks, and potentially have these ERM actions influencing the risk factor disclosures. There is some data to suggest that ERM is becoming more established and practiced. For example, the 2017 ERM Benchmark Survey done by RIMS shows that about 75% of companies surveyed have full or partial ERM programs (up from about 50% in 2013). To the extent that these ERM practices become more mature and help a company to see more risks, then this could lead to better risk factor disclosures to satisfy both investor and regulator expectations.
- Another issue, related to ERM maturity, might be whether the *ERM program is top down or bottom up*. Top-down ERM programs that have senior executives and boards involved are more likely to identify strategy risks since they are the ones that set, oversee, measure, and execute the strategy. Bottom-up ERM programs may be more likely to be less strategic and be much more likely to generate operational type risks. Companies should consider whether a top-down or bottom-up ERM program (or both) helps them identify all of their risks. If all risks are to be identified, then neither approach should be ignored. The 2017 COSO ERM Framework emphasizes that ERM includes the mission, vision, and core values of the organization.
- *Involvement by board members in ERM and risk disclosures* could also influence the results. For example, board risk oversight has been in place longer in the U.S. than in Japan (as evidenced by the 2009 SEC rule vs the more recent 2015 Japanese Corporate Governance Code). Early academic research shows that corporate governance matters and recent preliminary research on board risk oversight also supports the connection between better board risk oversight and company value.[8]

  Although the actual source of the risk disclosure differences is not known, there is considerable evidence that:

  - ERM adds value
  - Board risk oversight is required
  - ERM is of growing importance

  Investors expect good risk management, good risk oversight, and good risk disclosures.

[8] For example, Larcker et al. 2007, Corporate Governance, Accounting Outcomes and Organizational Performance (The Accounting Review, Vol. 82, Issue 4), notes that corporate governance does have some relationship to future performance. Additionally, Barrese, Pooser, and Walker's 2018 working paper (The Value Relevance of Proxy Disclosure Enhancements) shows that board risk oversight is associated with higher performance metrics.

5. Final Perspective

Managing risk is critical for value creation. Risk is almost impossible to manage if it is not identified and understood. In addition to benchmarking and improving their own ERM practices, companies would be wise to compare their own risk disclosures to those of other companies. Such a comparison helps identify the most relevant and complete set of risks. It may also help discover other unidentified risks. Similarly, given the level and pace of global competition, companies would be wise to compare their risk rankings to other global organizations. For example, if many in the industry have one particular risk as a top risk but your own company ranks it as a low-level risk then reasonable questions should arise to ensure the ranking is correct. To the extent that all such risk disclosure gaps represent actual risk management advantages, then these are opportunities for improvement and a potential gain in value for the corporation and its shareholders.

APPENDIX A

JAPAN VERSUS NORTH AMERICAN RISK EXAMPLES IDENTIFIED IN REGULATIONS

FINANCIAL SERVICES AGENCY	SECURITIES EXCHANGE COMMISSION
1. Management policy	1. Lack of operation history
2. Financial condition	2. Lack of profitable operations in recent periods
3. Specific transactions	3. Financial position
4. Specific products	4. Business or proposed business
5. Specific trading practices	5. Lack of a market for common equity securities
6. New products and technologies	
7. Legal restrictions	
8. Legal cases	
9. Officers and employee matters	
10. Transactions between company and officers or shareholders	
11. Future Risks	

APPENDIX B

MANUFACTURING COMPANIES – INDUSTRIES/SECTORS

Companies listed on TSE 1st Section:

MAIN CLASSIFICATION	SUB CLASSIFICATION
1. Manufacturing	Foods
2. Manufacturing	Textiles & Apparels
3. Manufacturing	Pulp & Paper
4. Manufacturing	Chemicals
5. Manufacturing	Pharmaceutical
6. Manufacturing	Oil & Coal Products
7. Manufacturing	Rubber Products
8. Manufacturing	Glass & Ceramics Products
9. Manufacturing	Iron & Steel
10. Manufacturing	Nonferrous Metals
11. Manufacturing	Metal Products
12. Manufacturing	Machinery
13. Manufacturing	Electric Appliances
14. Manufacturing	Transportation Equipment
15. Manufacturing	Precision Instruments
16. Manufacturing	Other Products

APPENDIX B

MANUFACTURING COMPANIES – INDUSTRIES/SECTORS

Companies listed on NYSE:

1.	Aerospace
2.	Agricultural Chemicals
3.	Apparel
4.	Auto Manufacturing
5.	Auto Parts:O.E.M.
6.	Beverages (Production/Distribution)
7.	Biotechnology: Electromedical & Electrotherapeutic Apparatus
8.	Biotechnology: Laboratory Analytical Instruments
9.	Building Materials
10.	Building Products
11.	Computer Communications Equipment
12.	Computer Manufacturing
13.	Computer peripheral equipment
14.	Construction/Ag Equipment/Trucks
15.	Consumer Electronics/Appliances
16.	Consumer Specialties
17.	Consumer: Greeting Cards
18.	Electrical Products
19.	Electronic Components
20.	Farming/Seeds/Milling
21.	Fluid Controls
22.	Forest Products
23.	Industrial Machinery/Components
24.	Industrial Specialties
25.	Integrated oil Companies
26.	Major Chemicals
27.	Major Pharmaceuticals
28.	Meat/Poultry/Fish
29.	Medical/Dental Instruments
30.	Metal Fabrications
31.	Miscellaneous manufacturing industries
32.	Motor Vehicles
33.	Multi-Sector Companies
34.	Oil & Gas Production
35.	Ophthalmic Goods
36.	Ordnance And Accessories
37.	Other Pharmaceuticals
38.	Package Goods/Cosmetics
39.	Packaged Foods
40.	Paints/Coatings
41.	Paper
42.	Plastic Products
43.	Pollution Control Equipment
44.	Recreational Products/Toys
45.	Semiconductors
46.	Shoe Manufacturing
47.	Specialty Chemicals
48.	Specialty Foods
49.	Steel/Iron Ore
50.	Textiles
51.	Tobacco
52.	Tools/Hardware

ST. JOHN'S UNIVERSITY

St. John's University
Peter J. Tobin College of Business
Dr. Paul L. Walker, Ph.D., CPA

Research Sponsored by:
AIG