Voluntary Risk Disclosure and Investor's Behaviour in the Nigerian Capital Market

Sunday A. Okpo
Department of Accounting,
Akwa Ibom State University,
Obio Akpa Campus.
saokpo@gmail.com
08037864947

&

S. A. S. Aruwa
Department of Accounting,
Nasarawa State University,
Keffi.
sasaruwa@gmail.com
08034511107

Abstract
This study examined the relationship between voluntary risk disclosure and behaviour of investors in the Nigerian capital market. The main objective of the study was to examine the extent to which investors in the capital market react to disclosure of information on risk in the annual reports. The study used ex-post facto research design. The population of the study was the 196 firms listed on the floor of the stock exchange. The sample size of 60 was drawn through convenience and stratified sampling techniques. The control variables of the study was the investor's behaviour which was proxied by market capitalization. The independent variable was the risk disclosure in the annual report. Content analysis was used to select the attributes of risk disclosure in the financial statements of the companies based on the disclosure index developed by the researcher for the period 2015 to 2019. The data were analysed using descriptive statistics and simple regression model. The results of the analysis show that the disclosure of information on risk significantly affect the behaviour of investors in the Nigerian capital market. The study concluded that behaviour of investors in the capital market is positively affected by voluntary disclosure of information on risk in annual report of companies. The study recommended, amongst others, that the regulators should as much as possible persuade the preparers of financial statements to include more information of risk in their annual reports.
Key Words: Risk Disclosure; Market Capitalization; Annual Reports; Capital Market.

Introduction

In the last decade, the demand for better reporting of business risk has been on the increase. This arises as a result of the fact that improvement in the understanding of business risks by investors and other users of financial report is expected to lead to better stewardship of firms and to a more efficient allocation of resources (ICAEW, 2011). According to Mardini (2012), companies are required to publish comprehensive information about the risks that they are exposed to such as credit risk, market risk, liquidity risk, compliance risk and strategy risk. Risk management represents the identification, analysis and acceptance or otherwise of uncertainty in the investment decision making process. Investment world is full of risks and every manager is expected to identify risk prevailing in the industry in which it operates. The investors may be keen of knowing the types of risks that exist in the firm they wish to invest in and how such risks are managed.

Risk disclosure is critical to capital allocation decisions. Investors tend to allocate their limited funds to investment opportunities that have the highest expected returns with a determined level

of risk. In finance literature investments is usually described in terms of risk and returns. Thus it is stated that higher return is associated with higher risk. Investors are conscious of the risk-return trade-off in their investment decision making process. Risk is sometimes complex to describe and difficult to quantify, hence disclosure of risk may sometimes be difficult arising from the fact that what is considered risky to one firm may not be seen as risky by another firm. There are risks which are unique to each firm. In line with this, Gentile, Linciano, Lucarelli & Soccorso (2015) argued that financial knowledge, personal traits and investment habits have been found to play important roles in the perception of the complex nature of risk.

According to United Nations Conference on Trade and Development (2017), the economic performance of firms is influenced by several risk factors which are categorised into business, financial and non-financial. Firms are exposed to risk related activities specifically to the nature of uncertainties that surround the activities embarked upon by the firms. Business risk represents changes in returns arising from changes in customer preferences, competition, technological or socioeconomic factors and other firm's specific factors such as human capital, intellectual property, product quality and liability. Financial risk can be described in numerous ways such as solvency, which is the inability of firms to meet their financial obligations such as interest and debt repayments, inability of borrowers to redeem financial obligations due to the firm's liquidity, fluctuations in asset prices and macroeconomic factors such as changes in interest rates. Non-financial risks arise from operational, political, environmental, social and governance related issues. The non-financial factors have the capacity to restrain, limit or disrupt the operation of the firm. Risk can also be classified as primary when it becomes material within a short time period while emerging risks are those which might become material in the long term.

According to Atanasovski, Serafimoska, Jovanovski & Joveski (2015), the disclosure of financial risk in annual reports is to provide potential investors the opportunity to better evaluate financial risk exposure of entities holding material financial assets and liabilities. They further posited that risk disclosure is supposed to increase with the size of the firm recognising that larger firms have higher agency costs than smaller firms. In the same vein Watson & Head (2013) enumerated the importance of risk disclosure by asserting that risk disclosures are fundamental to the efficient operations of capital market enabling investors to assess the risks and uncertainties of firms and their portfolios. Also Moumen, Othman & Hussein (2015) argued that narrative risk disclosure is expected to narrow the information gap between management and stakeholders about business uncertainties and opportunities. This may decrease the firm's perceived risk because enhanced information on corporate risk should result in a better assessment of the firm's future performances.

Risk variability is common among firms. Consequently, the risk exposure is unique and specific to each firm though there are general risks which are common among firms. The risk associated with firms can generally be assessed through financial reports. Some are disclosed in the mandatory section while others are voluntarily disclosed. Some may appear within the narrative section and are qualitative and others are disclosed within the financial statements. Investors have increasingly taken into account non-financial risk factors when assessing companies for investment opportunities. However, risks stemming from non-financial factors are difficult to quantify and timing and severity of such risks are difficult to estimate (Gentile, Linciano, Lucorelli & Soccorso, 2015).

A study by Beretta and Bozolan (2004) revealed that firms focus their risk disclosures on past and present risk rather than future risk. Where future risks are disclosed, the directors are reluctant to indicate the likely impact whether positive or negative. The directors are always attributing the risk outcomes to factors that are external, that is, outside their responsibilities. Risk factors are usually disclosed voluntarily in the narratives section of the financial statements. As an important

factor in the investment decision making process, the importance of risk disclosure cannot be overemphasized. Consequently, firms tend to disclose risk factors as a way of persuading investors that the firm has absolute control of those risk factors and as such the firm is safe to invest in.

The events of the last decade have led to the demand for increased disclosure of information about risks in the firm. The collapse of certain big companies and the loss of investments have heightened the demand by stakeholders to the preparers of financial statement for disclosure of value-relevant non financial information. All these demands made policy makers and regulators of financial reporting globally to initiate arrangements for increased disclosure of business risk. Various organisation such as ACCA, SEC Nigeria, Central Bank of Nigeria have in the past initiated the process of encouraging preparers of annual reports to increase disclosure contents of their annual reports. In furtherance of this initiative, the International Federation of Accountant's Committee (IFAC) issued policy guidelines which was intended to persuade the preparers of financial statements to direct their focus away from mandatory disclosures to voluntary disclosures.

The global meltdown of 2008 dealt a heavy blow not only on the Nigerian capital market, but also on other capital markets all over the world. However, the meltdown receded and the capital market started regaining momentum from 2012. This period coincided with the time when the policy guidelines were issued. This raised a fundamental question as to whether the resurgence in the capital market was connected to the policy guidelines issued by IFAC. This is in view of the fact that capital market at this stage of resuscitation relied heavily on available facts and information provided through the financial reports of companies. This created a puzzle as to whether the picking up of the market was as a result of the injection of new information in the annual reports. This is the gap this work is intended to fill. The disclosure of risk in the voluntary non-financial section of annual report is expected to provide the impetus for investment decision making in the capital market.

The main objective of this study is to examine whether there is any relationship between voluntary risk disclosure in annual reports of companies and behaviour of investors in the capital market. The other objective of the study to examine whether the disclosure of information on risk in annual reports affect the market capitalization of firms in the Nigerian capital market.

Literature Review

Conceptual of Risk Disclosures

Hassan (2009) defined risk disclosure as a set of information which are communicated in financial statements about manager's estimates, judgements, reliance on market-based accounting policies such as impairment, derivative, hedging, financial instruments and fair value as well as the disclosure of concentrated operations, non-financial information about a firm's plan, recruiting strategy and other operational, economic, political and financial risks. Also Pobric (2019) stated that risk reporting involves delivering a wide range of information about the uncertainties that a company faces. These include providing information on sources of risks, that is, chances, opportunities, threats and dangers that affect or can affect performance in the future, the ways in which these risks are managed, as well as management forecast related to the impact of each of the identified risks to the performance of a business entity.

Lin (2011) suggested that risk factors may include, among others, lack of operating history, lack of profitable operations in recent periods, information on financial position of the firm, information on business or proposal on new venture and lack of market for common equity. However, all factors which are considered to hinder the sustainability of the business or threaten the going concern of an entity is supposed to be included as a potential risk factor. On the other

hand, Linsley & Shrives (2006) averred that disclosures are adjudged to be risk disclosures if users of financial statements are informed of any opportunity or prospect, or any hazard, danger, harm, threat or exposure, that has already impacted upon the company or may impact upon the company in the future or of the management of any such opportunity, prospect, hazard, harm threat or exposure.

Overview of the Capital Market

The capital market is described as a market where long term funds can be obtained. It is a medium through which funds are channeled from the surplus sector to the deficit sector in the medium to long term. Osamwonyi (2005) describes the capital market as a market for long term funds and securities whose tenor extends more than one year.

The importance of capital market cannot be overemphasized. Capital market enhances capital formation thereby promoting growth and development. According to Islam, Rahman and Yusuf (2015), capital market is a critical component of the Nigerian economy. The Central Bank of Nigeria (CBN) (2010) documents that the capital market performs crucial role of mobilising funds from the surplus units to the deficit units thereby promoting capital formation. In the same vein Oladejo (2003) documents that a strong capital market is fundamental to the growth and development of any country because it helps the economy to increase capital formation, provides the necessary elements to manage financial risk, ensures continuity of the enterprise after founders and providers of funds to government and companies at more attractive terms. Also Nzekwu (2003) emphasized the importance of capital by asserting that sound capital market provides market signals on current situations and future expectations, ensure efficient and sustainable funding of large-scale or long term projects.

Investor's Behaviour in the Capital Market

Behaviour of investors in the capital market represents the reaction of investors towards certain information or interest. Generally, every rational investor usually makes use of available information for investment decisions. Information of investments could be either positive or negative. Investors react positively to available information when they are persuaded to invest in the stock of such firms. On the hand, investors react negatively when available information enable them to avoid investment in such firms. Moreover, investors are always careful in order to ensure they do not invest in stock that will lead to losses. Consequently, Anao, Osaze & Ekundayo (1993) identified three categories of investors based on their behaviour as defensive investors who are very conservative and extremely averse to risk whenever possible, with emphasis on safety of their investment; enterprising investors who prefer to take calculated risk especially if the stake is high; and lastly, the speculators who are more or less gamblers and risk lovers and willing to take the highest risk in buying and selling most frequently, in an effort to achieve their investment objective.

Penman (2001) was of the view that investors are categorised into three: intuitive investors who rely on their own instincts for their decisions; passive investors who has confidence in efficiency of the market with the belief that the market price is fair and justifies all the risks taken, that market forces have moved the price to the appropriate point; and stock screeners who operate on a rule of thumb. They buy stock only when they assume it is good. Whatever is the category which any investor falls, they rely on information for their actions. Thus the availability of more private information which highlights potential risk or otherwise would trigger the investors to respond appropriately. The investor behaviour in this context has to do with the reaction of investors towards available information.

Investors' behaviour involves the examination of mental processes and emotional disputes individuals, financial experts and traders exhibit in the course of financial planning and

investment management. According to Shafi (2014), investor behaviour could be explained from economist, sociological and psychological standpoints. In this regard, economist explanation of investor behaviour largely focuses on the rationality or irrationality of the decision making process. The sociologists focus on the investor's social environment; and the psychologists look at investors' behaviour from the individual investors attributes.

Empirical Literature

Dominguez and Gamez (2014) conducted a study to ascertain the main risks disclosed by the largest Spanish companies. Data for the study were obtained from the annual and management reports of the companies for the years 2007 to 2009. Data were also taken from Madrid Stock Exchange website. The data were analysed using Tobit regression model. The findings indicated that most of the companies disclosed their compulsory risks in a generic way or lesser degree. Also that many Spanish firms disclosed financial risks minimally, meaning that the companies just revealed only the aspects that are strictly compulsory without the provision of extensive information.

Amah & Amauwa (2018) investigated the impact of financial report contents on stock prices of some listed firms in Nigerian stock exchange. The study was conducted with data from some listed firms in the Nigerian stock market. The regression and student's t-test were used to analyse the data. The result of the analysis showed a strong positive correlation between stock prices and profit after tax, earnings per share and dividend pay-out which were used as proxy for independent variable. The study recommended that investors should look beyond profit and rather look for earnings per share as their basis for decision to invest.

Lambert, Leuz & Verrechia (2006) examined the extent to which accounting information disclosure reduces the firm's non-diversifiable risk in economies with multiple securities. They demonstrated that despite the forces associated with diversification, the firm's accounting information is usually reflected in their cost of capital. They further showed that the cost of capital is influenced by accounting information in two ways. First, that the firm's cash flows per se are not affected by higher quality accounting information but rather the assessment of the market participants in the distribution of future cash flows. Second, is the indirect effect where increase in the quality of accounting information disclosure affects the real decision of the firm, and in turn influences the expected value and covariance of the cash flows of the firm.

Adamu (2013) studied the effect of company leverage on corporate risk disclosure in Nigeria. Taking a sample of 12 randomly selected companies and 2010 annual reports, the study found that risk disclosure is not significantly related to company leverage. It concluded that company size does not influence corporate risk disclosure in Nigeria. Dey, Hossaim & Rezaee (2018) studied the relationship between degree of financial risk disclosure and firm's financial attributes. The researchers constructed risk index and using content analysis extracted data from the annual reports of 48 randomly selected manufacturing companies in Bangladesh for the years 2010 to 2015. The results showed that firm size, financial performance and auditor type are positively and significantly associated with the level of financial risk disclosure.

Yangiong & Xiao (2019) studied the effects of risk disclosure on investment efficiency in forms. They constructed their disclosure index based on textual studies. Their findings indicated that higher disclosure of risk in the management, discussions and analysis (MD&A) section will lead to higher corporate investment efficiency. This effect became more pronounced when the disclosure in MD&A is positive and more so when investors have more demand for information.
Linsley & Shrives (2006) studied risk disclosures among 79 annual reports of selected firms in the UK. Using content analysis and Pearson Correlation coefficients to test the level of

association between the number of risk disclosures, they found a significant association between number of risk disclosure and company size. However, the results showed no association between risk disclosure and other variables such as gearing ratio, asset cover and book to market equity. They identified that there is lack of coherence in the risk narratives indicating existence of gaps which implies that stakeholders are unable to assess the risk profile of the company.

Moumen, Othman & Hussainey (2015) studied the value relevance of risk disclosure in annual reports with evidence from MENA emerging markets. The main objective of the study was to examine whether voluntary disclosure in annual reports contains value-relevant information for investors to predict future earnings. The population of the study included firms in the Middle Eastern and North African countries. The sample included 268 firms selected from the countries. The level of disclosure was linked to the share price anticipation of earnings and accounting returns. The financial information used included stock price, earnings per share, asset growth and profit margin taken from the financial statements of the selected firms for 3 years, 2007 to 2009. The data were analysed using regression models. Their result of the analysis indicated a positive correlation between risk disclosures and share price. The result of their findings suggested that voluntary risk disclosure makes financial data more credible. They concluded that narrative risk disclosure revealed new information about corporate risk opportunities. They suggested that regulators should not acknowledge the proprietary nature of risk disclosure when asking for more corporate transparency.

Appiagyei, agyenim-Boateng & Onumah (2016) studied risk disclosures in the annual reports of firms listed in Ghana Stock Exchange pre and post adoption of IFRS. The population of the study included the companies listed on the Ghana Stock Exchange from which a sample of 21 listed companies was used. Content analysis was used in collating data on risk disclosure in the annual reports. They assigned a value of 1 for each item disclosed and 0 for non-disclosure. They developed a disclosure index of 37 for each firm. A regression model was used to test the data. The control variables included firm size, leverage, profitability and industry type. The results of the analysis indicated that the adoption of IFRS was positively related to the level of disclosure. The result also indicated that the level of risk disclosure by listed firms in Ghana was very low. Though the result is consistent with other prior studies, this study made use of risk disclosure index developed by the researcher and not that universally adopted. The study recommended that regulators of financial reporting in Ghana should encourage firms to disclose more risk related information in their annual reports.

Tahat (2014) studied risk disclosure associated with financial statements reporting of Jordanian public corporation. The population of the study consisted of 227 listed companies of which a sample of 82 companies was selected. The risk disclosure was measured using the disclosure index which was constructed by developing a checklist based on the text of IFRS 7. The proxy for risk disclosure were the three types of risk identified in IAS 7. The data for the study were extracted from the financial statements of listed firms using contents analysis. The data were analysed with regression model and ANOVA. The result of analysis indicated that there were significant differences in risk disclosure within and across sectors. The study provided valuable insight to the Jordanian authorities on the need to ensure full compliance with accounting standards.

Theoretical Framework

This work is anchored on capital needs theory. This theory suggests that companies tend to engage more on voluntary disclosure when they have need to raise capital from the capital market. The main thrust of this theory stems from the fact that when companies want to raise capital from the capital market, they may choose to increase their disclosure levels in order to

increase the perception of investors towards the companies. This theory is hinged on the fact that the company's cost of capital is believed to provide for a premium which captures investor's uncertainty about the adequacy of available information about the company. Therefore, in order to reduce the cost of capital, the investors should be able to interpret the prospect of the company through voluntary disclosure (FASB, 2001).

To that extent, investor's perception of a firm's value is important when firms have need to raise funds from capital market for new investment opportunities. The increased disclosure is necessary for the investors to be able to have a broader view of the prospects of the company. The perception of investors about the company is very crucial as the investors will be convinced that the firm has the capacity to enable them realize their investment objectives. Voluntary disclosure conveys information that will improve the perception of investors and consequently provide the incentive for them to make decision whether to invest or not. However, Bayer & Guttman (2012) argued that in the course of managers disclosing information voluntarily in order to improve the perception of investors about the firm's value, they may choose to engage in suboptimal operating, investing and financing decisions.

The implication of capital need theory is that managers tend to disclose more information voluntarily when they have interest of coming to raise funds from the capital market. The capital need theory applies when managers have intention of approaching the capital market to raise fund, they tend to publicly make more information available voluntarily in order to persuade prospective investors to invest in the firm.

Methodology

The study uses ex-post facto design since the data are obtained from secondary sources and the population of the study consists of the stock of 169 firms listed on the floor of the stock exchange in 2019. However, a sample of 60 was drawn using convenience and stratified sampling techniques. Also listed firms that do not publish their annual reports regularly and whose stocks were not traded regularly were filtered out due to lack of data about them. The data for the study were derived from the analysis of financial statements of the selected firms for the year 2015 to 2019. This period coincided with the gradual recovery period of the stock exchange. Moreover, most studies use a period of three to five years (see Dey, Hossaim & Rezaeee, 2018; Moumen, Othman & Hussainey, 2015; Gamez, 2014).

A disclosure index was constructed by the researcher. This is consistent with the same index developed by Uchenna & Alheri (2013); Botosan (1997); Dey, Hossaim & Rezaee (2018); Yangiong & Xiao (2019). Contents analysis was used in obtaining the necessary data for the study. A score of 0 was assigned to non-disclosure of the attribute of the risk disclosure, while 1 was assigned to the disclosure of the attribute (see Adamu, 2013; Linsey & Shrives (2006) and Moumen, Othman & Hussainey (2015). The dependent variable in the study is the behaviour of the investors in the capital market which is proxied by market capitalization (MKT). Market capitalization is the product of share price and share volume of firms at any particular time. When investors are persuaded through increased disclosure of risk information, they will rush to subscribe to stock of such firms. The increased demand for the stock will push the share price up. Thus increased demand for the stock of the firms will lead to increased volume of stock and ultimately increase in market capitalization of the company. The independent variable is the voluntary risk disclosure which is proxied by disclosure index constructed by the researcher.

The aggregate disclosure score for the control variables was obtained as:

VOLDISCORE =

Table 3.1: Components of Risk Disclosures

Description of Variables	Components
Risk	• Nature of risk • Risk management technique • Risk exposure measures • Natural risk management measures • Internal control policies • External risk factors • Internal risk factors.

Source: Researcher 2020

Results and Discussion

Descriptive Statistics

This section carries the descriptive statistics. The descriptive statistics were minimum, maximum, mean and standard deviation, skewness and Kurtosis. The result is presented in

Table 4.1

Table 4.1 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis		Jarque-Bera	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error	Statistic	Prob.
Risk Disclosure	60	.00	1.00	.2860	.30716	1.036	.309	.142	.608	10.31	0.005
Valid N (listwise)	60										

Source: Researcher's Computation, 2020.

The result of the analysis reveals that the minimum risk disclosures was 0%, maximum risk disclosures was 100%, average risk disclosures was 28.60% and standard deviation was 30.71%. This implies that the selected companies made average risk disclosures of 28.60% and the degree of dispersion of the disclosures from the mean was 30.71%. The value of skewness for risk disclosures was +1.03 which implied that it was moderately skewed, meaning the right tail of the distribution is longer than the left tail. The kurtosis value was 0.142 meaning that it was platykurtic showing that its tails are shorter and thinner; and its central peak is lower and broader

Test of Hypothesis

Ho: Risk factors disclosure has no significant effect on investors' behaviour in the Nigerian stock market.

Table 2 Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	8.862	.413		21.470	.000		
RISK DISCLOSURE	.211	.440	.064	.480	.633	.732	1.365

The result of the analysis shown in Table 2 indicates that the beta value of 0.064 was obtained for risk disclosures while the p-value stood at 0.633. The t-cal was 0.480 while the t-tab was 2.000. In line with the decision rule of the study, the research hypothesis one is accepted and the alternate rejected because t-tab > t-cal. and p-value > 0.05. The implication of the result above is that Risk factors disclosure has no significant effect on investors' behaviour in the Nigerian stock market. This means that the disclosure of information on risk in the annual reports of companies does not significantly affect the behaviour of investors in the Nigerian capital market. The investors in the capital market depend on other sources of information in their investment decision in the Nigerian capital market.

Discussion of Findings

The result indicates that risk factors disclosure does not significantly affect investors' behaviour in the Nigerian Stock Market. This was indicated by the result of the analysis where the beta coefficient was 0.064 or 6.4%. This means that 6.4% variation in investors behaviour is accounted for by risk disclosure made by the companies listed in the Nigerian Stock Exchange. This finding is not in agreement with the findings of most researchers who found that there is significant relationship between risk disclosure and investment decisions (see Moumen, Othman & Hussainey, 2015; Appiayei, Agyenim-Boateng & Onumah, 2016; Mardini, 2012; Tahat, 2014) The result of the findings is no doubt in line with the fact that the regulators of the Nigerian capital market have not placed much emphasis on disclosure of information on risk factors. In the last two decades, emphasis of capital market regulators in Nigeria have been on corporate governance and environmental disclosure practices and the result shows the fact that investors have really used risk disclosure The study concludes that there is a positive correlation between risk disclosure and market capitalization. This implies that disclosure of information on risk in the annual report is significantly related with investor's behaviour.

In view of the importance of information on risk to investors, there is need to deliberately encourage the disclosures of information on risk in the annual reports of firms listed in the Nigerian capital market.

The complex global environments have created uncertainties and these have really brought to fore the urgent need for increased disclosure of risk factors as they affect entities. This is because these factors have the potentials of threatening the existence of such firms. None disclosure of such information would have adverse effect in the decision making of investors. Consequently, it is recommended that policy makers and regulators should adopt any persuasive measure available to encourage preparers of financial statement to disclose as much information as possible about risks in the annual reports of companies. Like it was done for corporate governance, regulators should come up with the risk disclosure indicators which should be disclosed in the annual reports of companies. Also sensitization of stakeholders on the effect of risk and the need for its disclosure in the annual reports should be initiated.

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