

Comments on Sarbanes-Oxley
and Corporate Risk Taking
by
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Basic Idea

- Questions whether SOX causes firms to limit risks (which raise compliance costs) and to decide to stay private if they are risky (instead of doing an IPO).
- Three kinds of tests confirm the idea: accounting risk low relative to UK (low investment in PPE and R&D); low market returns relative to UK; low probability of IPO in US relative to UK.
- First two are measured using difference in difference approach. Third is measured with a probit model (Table 8). Results consistently show important changes since SOX in all three categories.
- This constitutes major progress compared to preceding papers and discussion.

Potential Problems

- Other changes occurring in time (not just US stock market returns).
- Note that R&D, investment, sigma higher in US in all periods.
- In all measures, levels paint a different US-UK comparison than differences in differences (could it be that the UK is *catching up* to US in entrepreneurship and tolerance for taking risk for reasons unrelated to SOX?).
- Investment needs to be modeled to see if there is a residual difference (after taking *flexible accelerator* into account), since business cycle or other influences may explain differences.
- Do results show up less for *private* US firms?
- Weak US R&D results at sectoral levels lead one to want to do more along the above lines.

Other Ideas to Think About

- Betas are rising, while sigmas are falling. Why? *Globalization* could explain both, without any change in firm behavior.
- How might cross-section within the US matter, especially with respect to *corporate governance*? This needs to be modeled (would greater shareholder control increase or decrease effect? Unclear whether we should see this as a problem worsened by agency).
- Table 8 should (a) model both IPO decisions separately, or (b) at least allow country of origin to matter (distinguish cross-country from within-country).

Conclusion

- This paper advances the debate substantially and is the first meaningful evidence of a possible risk effect.
- There are still potential alternative explanations for the difference in difference results, and there are things the authors can do to make the results more convincing.