

SARBANES-OXLEY AND CORPORATE RISK-TAKING
BARGERON, LEHN AND ZUTTER

COMMENT

BY

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Brief Summary

- Measures investment behavior of U.S. firms using a sample of U.K. firms as a benchmark
- Measures the market's assessment of U.S. firms' equity risk again using a sample of U.K. firms as a benchmark

Data

- 5,228 U.S. and 989 U.K. firms, including smaller firms (significantly smaller sample for R&D data)
- Stock data from Datastream: 1994-2006
- Uses MSCI World Index for the global index

Results

- Reduction in R&D expenditures
- Reduction in capital expenditures
- Increases in cash holdings
- U.S. companies less risky vis-à-vis U.K firms after SOX (standard deviation, betas, and root mean square error)
- The higher the R&D the more likely the firm will go public in U.K. after SOX

How to measure firm risk?

Question One: R&D expenditures used as proxy for the risk of a firm's activities

(1) Can imagine situations where more R&D expenditures has a diversifying effect

(2) Significant variation in riskiness of different types of R&D: Composition of R&D

Question Two: Stock-based measures of firm risk

- (1) Variance-bound literature in which reductions in firm-specific volatility can be the result of earlier disclosure of information (West 1988; Leroy and Porter 1981).
- (2) Ang et al (2005) show that idiosyncratic risk may be priced

Is reduction in risk necessarily harmful?

- Offset by private firms?
- Maybe high risk a function of agency problems (stock option incentives to create volatility)

Summary Statistics

Panel A	US	UK	US - UK	p-value
RD/ASSETS				
1995 - 1997	0.0705	0.0189	0.0516	0.000***
1998 - 2000	0.0782	0.0288	0.0494	0.000***
2003 - 2005	0.0720	0.0334	0.0386	0.000***
CAPEX/ASSETS				
1995 - 1997	0.0542	0.0477	0.0065	0.000***
1998 - 2000	0.0488	0.0428	0.0060	0.000***
2003 - 2005	0.0303	0.0253	0.0050	0.000***

Panel B	US	UK	US - UK	p-value
STD RETURNS				
1994 - 1997	0.1291	0.0746	0.0546	0.000***
1998 - 2001	0.2074	0.1225	0.0849	0.000***
2003 - 2006	0.1394	0.0870	0.0524	0.000***

Some Additional Questions

- Economic significance (-.00361 from Table III)
- Normal volatility over time for the U.S./U.K. for these figures? What about trends?
- Other Factors affecting results? Focus on idiosyncratic risk

Brandt, Brav and Graham (2005): decline in idiosyncratic risk from 2000 to 2004 due to decline in speculative trading by individuals

Harvey and Siddique (2004): Firm-specific factors affecting idiosyncratic risk include ROA, firm size, trading volume, inventory growth

- Means and median but can also do value-weighted (more weight to larger firms)