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THE 2001 RECESSION, THE SARBANES-OXLEY ACT, AND DIRECTOR CHARACTERISTICS

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Abstract: *This study examines how director characteristics like age, tenure, remaining tenure, total years, shares held, gender, and ethnicity changed during the run-up to the 2001 Recession as well as during the period that follows the Sarbanes-Oxley (i.e. SOX) Act. The study also examines how the professional affiliation of the directors to the firm had changed during this period. In addition to director characteristics, the paper also focuses on director independence. Has director independence improved after the SOX? Overall, what dimensions of director characteristics and independence improved? The study contributes to two separate streams of literature: the literature on crisis and CEO pay and the literature on CEO pay and firm performance.*

Keywords: *Director, SOX, Sarbanes-Oxley, corporate governance, recession.*

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1. Introduction

This paper examines the effects of the Sarbanes-Oxley (SOX) Act of 2002 on the composition and characteristics of corporate boards in U.S. companies. Specifically, it investigates changes in director attributes such as age, tenure, and gender representation, as well as professional affiliation. The paper also looks at the impact of the SOX on director independence. Did corporate board members become more independent after the SOX was passed?

2. Literature Review

Prior research offers mixed evidence on how the SOX Act influenced board composition. Linck et al. (2009) report that firms increased the presence of outside directors in response to SOX, favoring lawyers, consultants, financial experts, and retired executives while reducing the number of active corporate executives on boards. Uzun et al. (2004) found that firms hiring more external directors experienced a decline in corporate fraud.

To assess the extent of these changes, this study examines director tenure before and after SOX. A decline in average tenure could indicate a shift toward hiring external directors. Hillman and Dalziel (2003) argue that the board's role in monitoring management aligns with agency theory, which suggests that an increased presence of internal directors may weaken oversight due to their dependence on the CEO. Raheja (2005) models the interaction between internal and external board members, concluding that external directors can improve governance by leveraging CEO succession to enhance project decision-making.

Valenti (2008) found that firms adjusted board structures post-SOX to improve monitoring capabilities, while Petra (2005) examined five governance areas, concluding that independent directors contributed to stronger corporate boards, improved firm performance, and increased shareholder wealth. This study builds on these findings by

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analyzing board composition in terms of age, tenure, gender diversity, and the prevalence of dual executive roles.

Research also highlights gender disparities in board assignments. Peterson and Philpot (2007) found that female directors were underrepresented in executive committees and more commonly assigned to public affairs committees. Dalton and Dalton (2010) observed a steady increase in female board participation, including leadership roles, while Bear et al. (2010) noted that female directors typically had diverse educational and professional backgrounds and demonstrated more democratic decision-making styles.

Kesner (1988) examined board committee composition, concluding that membership was significantly influenced by directors' occupation, tenure, and gender. McIntyre et al. (2007) emphasize that age and tenure diversity benefit board effectiveness, with younger directors bringing fresh perspectives (Bere, 1991; Siciliano, 1996) and older, longer-tenured directors providing stability. Similarly, Forbes and Milliken (1999) and John (1995) argue that external board members enhance diversity, introduce cognitive conflicts, and contribute to improved decision-making.

Linck et al. (2008) find that board structures evolved in response to SOX. While large firms had reduced board sizes throughout the 1990s, this trend reversed after SOX's implementation, whereas small and medium-sized firms experienced minimal changes. This study explores whether firms adjusted their board structures by increasing or decreasing the number of internal executives serving on boards in response to SOX reforms.

3. Methodology

The study uses the directorship data from the Investor Responsibility Research Center (IRRC) dataset over the 1999–2003 period. The study examines 25 variables in total. We examine how these variables changed during the run-up to the 2001 recession and also after the SOX was passed.

The variables that we examine include the director's age, tenure, remaining tenure, total years, shares held, gender, ethnicity, professional type, and whether the director was a former employee. We also look at the number of common shares outstanding for the firm and the annual revenue. In terms of director independence, we look at six variables.

We run nonparametric tests as well as regressions to see if any of the director characteristics or independence variables had changed significantly during the run-up period as well as during the post-SOX period.

4. Results and Discussion

When we examine the trend in each variable, we find that corporate governance improved, but not in every area. During the run-up period, age and tenure were both going down, and shares held were going up (worsening). After the SOX was passed, age, tenure, and total years went up, and shares held went down (improved). The percentage of female directors was increasing, it continued to increase. The percentage of former employees among the directors was flat during the run-up and after. Five out of six independence measures improved after the SOX was passed.

Our trend analysis shows that, during the run-up, the percentage of Asian, African American, and Hispanic was going up, and Caucasian was going down. After the SOX was passed, the trends continued except for the percentage of Asian directors. The percentage of Asian directors declined. During the run-up, the percentage in Consulting and Legal was going down, and Financial, Insurance, Other, and Real Estate were going up. After the

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SOX was passed, the trends continued except for Legal and Other. The percentage in Legal went up and the percentage in the "Other" category went down.

Our logistic regressions show that % Female, African American, Hispanic went up Post-SOX, while Caucasian went down and Asian was flat. Our logistic regressions also show that % Financial and Real Estate went up Post-SOX, while Consulting and Other went down.

5. Conclusions

Overall, our results show that, post-SOX, most of the measures improved. Interestingly, the percentage of Asian directors went down after the SOX was passed. Also, the percentage of directors that has a charity-related relationship with the firm went up after the SOX was passed. Those are the two areas that deteriorated, instead of improving, post-SOX. The long-run impacts of the SOX on these variables can be examined. Do these mostly positive impacts continue in the long run? If not, then it will mean that authorities need to observe and control firms' boards more closely.

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