PERSONAL BANKRUPTCY LAWS AND THE FINANCING OF EUROPEAN BUSINESS START-UPS (SUMMARY)

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SUMMARY

PERSONAL BANKRUPTCY LAWS AND THE FINANCING OF EUROPEAN BUSINESS START-UPS

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Principal Topic

The large number of new firms that go bankrupt shortly after founding has increased concerns among policy makers about lengthy bankruptcy procedures, social stigma and lack of support for bankrupt entrepreneurs (Wymenga et al., 2014). As a result, policy makers across the world tend to provide honest bankrupt entrepreneurs with a second chance by implementing a fresh start policy in countries’ personal bankruptcy laws. Such a policy increases debtor protection by permitting bankrupt entrepreneurs to discharge their outstanding credit obligations after a certain period of time (Armour and Cumming, 2008). While a growing literature points to the important impact of debtor protection on entrepreneurship and the credit availability to these entrepreneurs (e.g. Armour and Cumming, 2008; Djankov et al., 2007; Shleifer and Vishny, 1997), to date, the effect of a fresh start policy on the credit availability to start-ups is largely unexplored. In this study, we address these issues by investigating how a fresh start policy influences start-ups’ capital structure.

Method

We study cross-country differences in the capital structure of start-ups in their initial year of operation caused by countries’ fresh start policy, using a unique dataset of 2,849,997 start-ups from 26 European countries founded between 2005 and 2012.

Results and Implications

Our findings show that start-ups’ capital structure in the initial year of operation is in large part driven by time-invariant, country-specific factors. A fresh start policy is found to be an important determinant of start-ups’ capital structure. Using a difference-in-differences setup, we find that start-ups founded after the implementation of a fresh start policy use less debt as compared with what one would expect without the implementation of a fresh start policy. While forgiving personal bankruptcy laws that provide bankrupt entrepreneurs with a second chance have the purpose of enhancing entrepreneurial activity, our results imply that a fresh start policy also has counter effects by making it more difficult for entrepreneurs to get access to debt financing.

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