BEYOND HARSHNESS VERSUS LENIENCY: CORPORATE BANKRUPTCY LAWS, ENTREPRENEURIAL ASPIRATIONS AND RISK AVERSION (INTERACTIVE PAPER)

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INTERACTIVE PAPER

BEYOND HARSHNESS VERSUS LENIENCY: CORPORATE BANKRUPTCY LAWS, ENTREPRENEURIAL ASPIRATIONS AND RISK AVERSION

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Principal Topic

In this paper, we explore how differences in bankruptcy codes across nations influence the likelihood of an individual starting a high growth aspiration business. Bankruptcy laws have an important influence on entrepreneurial outcomes through both the motivation of individuals to become entrepreneurs, and the extent of finance offered. Parallel to this, the theory reflects tensions between entrepreneur oriented and creditor oriented views.

We propose that the tensions between these entrepreneurship and corporate governance views of bankruptcy laws can be resolved if instead of ordering bankruptcy laws from creditor-oriented to debtor-oriented as in previous literature, one focuses on separate elements of the legal code. Some of these elements (e.g. secured creditors’ priority) are likely to encourage creditors and others (e.g. forced removal of management) to de-motivate entrepreneurs.

Moreover, we propose a moderating relationship between risk attitudes and the elements of the bankruptcy code operating primarily through entrepreneurial motivation. Potential entrepreneurs who are more risk averse are more likely to be deterred in environments where the elements of bankruptcy laws affecting the control rights of the owner-manager are harsher.

Methods

We test our hypotheses using a cross country dataset developed by merging the Global Entrepreneurship Monitor (GEM) data with country data about bankruptcy arrangements. We use multi-level modelling on data from 39 countries covering 251,235 individuals over the years 2002-2004 to test the relationship between different elements of bankruptcy laws and the likelihood of an individual being the owner-manager of nascent business with high growth aspirations.

Results and Implications

Our results confirm that the bankruptcy code is indeed an important determinant of high aspiration entrepreneurial activity. However, its impact is differentiated depending on whether the relevant aspect of the code primarily influences perceived entrepreneurial or creditor returns. The results suggest that the bankruptcy code plays a complex role in encouraging entrepreneurship. Neither a creditor- nor debtor-oriented bankruptcy systems in of themselves are more encouraging for entrepreneurship; rather some elements of bankruptcy law matter more to creditors and others matter more to entrepreneurs. This indicates that the optimum design of bankruptcy law may not imply just balancing the advantages of encouraging entrepreneurship directly versus encouraging credit supply.

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