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An Empirical Analysis of the Relationship Between Capital Acquisition and Bankruptcy Laws

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Abstract

Ineffective capital acquisition decisions at start-up may lead to business failure and bankruptcy; a result which is both costly and disruptive to the owners and other stakeholders of the firm. To cope with the risk of failure, owners embark on a variety of risk-reducing activities whereas the U.S. government attempts to moderate the downside effects of such failures through the rules surrounding bankruptcy. Previous studies imply that as owners become more aware of the protections offered through the government regulation of bankruptcy, they should become less concerned with the effects of failure and be willing to raise higher levels of initial capital. Raising higher levels of initial capital, in turn, leads owners to take actions intended to reduce firm risk and to minimize the threat to their personal financial security. Data from a sample of small firms confirm our hypothesis by showing that as the level of initial capital

acquisition increases, owners embark on activities intended to reduce firm risk. However, capital acquisition is not associated with the owner's familiarity with bankruptcy regulations. As a result, governmental objectives in establishing these regulations may not be achieved. Our findings have implications for firms’ owners, consultants, and policymakers, in terms of the relationship between an entrepreneur's knowledge of bankruptcy laws and the financing of their enterprises.

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Notes

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