

Bankruptcy Laws and Entrepreneurship Friendliness in Nigeria

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ABSTRACT

The study explores bankruptcy laws and entrepreneurship development: a real option perspective. The data used were sourced from world development indicators for the period 2011 to 2019. The data collected were analyzed using multiple linear regressions. The result revealed that entrepreneurship development is very important to an economy as it provide room for economic growth; serve as a means of job opportunity and poverty alleviation. Following the findings, it was recommended that government policies should be favourable towards entrepreneurship development and bankruptcy laws should be friendly to debtors.

Keywords: entrepreneurship, bankruptcy laws, Nigerian Bankruptcy laws.

I. INTRODUCTION

Corporate bankruptcies are common. In the 90s, average businesses going bankrupt in Japan was 14,500; in Germany 21,000; Great Britain, was 47,000 (Claessens & Klapper, 2005). As at 2001, 38,540 businesses in U.S. were declared bankruptcy (American Bankruptcy Institute, 2003). Although large firms also went bankrupt, bankruptcy was a common phenomenon among small businesses (Warren & Westbrook, 1999; White, 1990).

Bankruptcy laws are important component of the institutional framework within which entrepreneurs and firms operate (North, 1990; Peng, 2003). Entrepreneurs are thought to act as catalysts for change in the economy through their capacity for innovation and risk-taking. As economies have become increasingly “knowledge-driven,” policymakers around the world have embraced the idea of “entrepreneurship policy” with enthusiasm particularly initiating bankruptcy law. Bankruptcy laws which sought to protect the debtors’ asset from its creditors are thought to foster entrepreneurship because they reduce the risk that creating a new business necessarily entails. Some individuals share a view that most

entrepreneurs prefer sole proprietorship due to generosity, if these laws are encouraging entrepreneurship that is likely to fail, the associated social costs may be larger than the benefits.

The legal procedures for analyzing bankruptcy usually differ in different countries of the world (Alexopoulos & Domowitz, 1998; Claessens & Klapper, 2005). While some countries provide for bankrupt firms may only be limited, other countries may initiate a more entrepreneur-friendly bankruptcy law. Around the world, being entrepreneur-friendly is a relatively new concept in bankruptcy lawmaking, which is in radical contrast with traditional bankruptcy laws and practices that generally favored the creditor and were harsh toward the bankrupt (Halliday & Carruthers, 2007). Recently, governments have realized the benefits of entrepreneur-friendly bankruptcy laws in that it foster entry into entrepreneurship and reduce the number of exit.

Thus, this paper sought to examine the impact of bankruptcy law on entrepreneurship development. The rest of the paper comprise of literature review, methodology, analysis and interpretation of result, conclusion and recommendation.

II. LITERATURE REVIEW

Entrepreneurship

In the neoclassical tradition, an “entrepreneur” is simply the owner-manager of a (small) business who oversees the operations including managing the business costs (Alchian and Demsetz, 1972). From a Schumpeterian perspective, entrepreneurs are primarily innovators, who dissociate from existing organizations in order to be free to pursue radical ideas that may bring about breakthroughs in the process of “creative destruction.”

Several studies have provided proofs on the relationship between entrepreneurship and risk-taking, innovation, and employment growth (e.g. Kortum and Lerner, 2000; Tykvová, 2000).

Governments are fully aware of the importance of entrepreneurship in a nation and as such shown increased concerns calculated initiatives to promote its incidence.

Bankruptcy Law

The bankruptcy code sets out the processes for the debtor and creditors to follow when the debtor becomes insolvent. It provides a collective framework to enable the distribution of the assets of the debtor amongst relevant stakeholders: creditors, tax authorities, employees, and, in corporate bankruptcy, shareholders (White 2007). Importantly, bankruptcy law provides entrepreneurs with insurance enabling them to clear their debts rather than being liable until they are paid off. This limits the downside risks in case of failure (Lee et al. 2007; Posner 2007), and therefore has a critical impact on how entrepreneurs evaluate risks at the point of entry.

Indebted entrepreneurs can be faced with bankruptcy under two scenarios: corporate bankruptcy law or personal bankruptcy law. Under personal bankruptcy, the entrepreneur as an individual is personally liable for all of the firm's debts except for the exemptions that the personal bankruptcy law specifies. However, an entrepreneur who incorporates his/her business would help prevent loss of personal asset when case of bankruptcy occurs because of limited liability.

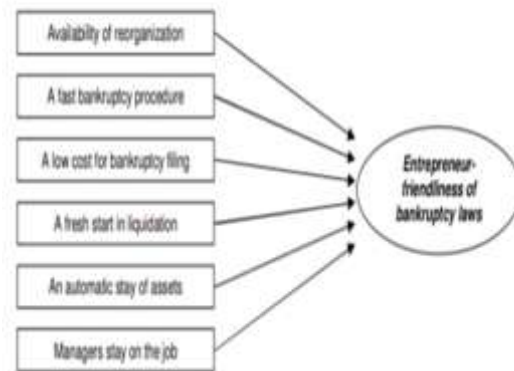
Dimensions of Bankruptcy Laws' Entrepreneur-Friendliness

The purpose of bankruptcy laws is to resolve conflicts among a firm's stakeholders—in particular, creditors, owners (entrepreneurs in the case of entrepreneurial start-ups), managers, employees, and tax authorities—when a firm is financially insolvent (Jackson, 1986; Longhofer & Peters, 2004). From an entrepreneur's viewpoint, bankruptcy laws differ along six dimensions in terms of their entrepreneur-friendliness. These six dimensions are drawn from Lee et al. (2007) as well as from Claessens and Klapper (2005), La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998), and Lee, Yamakawa, Peng, and Barney (2008). They are

1. The availability of a reorganization bankruptcy option,
2. The time spent on bankruptcy procedures,
3. The cost of bankruptcy procedures,
4. The opportunity to have a fresh start in liquidation bankruptcy,
5. The opportunity to have an automatic stay of assets during reorganization bankruptcy, and

6. The opportunity for entrepreneurs and managers to remain on the job after filing for bankruptcy.

FIGURE 1
Components of Bankruptcy Laws and Entrepreneur-Friendliness



Nigeria Bankruptcy Law

Bankruptcy is a creation of statute and therefore the law is primarily statutory. In Nigeria the primary legislation on bankruptcy is Cap 30 as amended by Bankruptcy (Amended) Act.

Locus Stand to Institute Bankruptcy Proceeding

A debtor or a creditor may institute bankruptcy proceeding. Where the petitioner is a debtor, the allegation in the petition is deemed to be an act of bankruptcy and the debtor is not required to have previously filed a declaration of his inability to pay his debts. The court is vested with discretion to refuse to make a receiving order on a debtor's petition in certain circumstances; receiving order will not be made where the debtor has no reasonable grounds for alleging that he is unable to pay his debt.

For creditor to have a standing to present a valid petition, the creditor's petition must disclose the following;

1. That the debtor has committed an act of bankruptcy.
2. That the creditor is entitled to present the petition within the ambit of the provision of Cap 30 as amended.

Acts of Bankruptcy

Under Cap 30, the following four cases were regarded as constituting acts of bankruptcy by a debtor;

1. Creditor obtaining final judgment or final order against a debtor

2. Levying of execution on debtor's goods
 3. Debtor's declaration of inability to pay his debts
 4. Debtor's presentation of bankruptcy petition
- On amendment of cap 30 the categories of act of bankruptcy were extended to include the following:
1. Debtor's suspension or giving notice that he is about to suspend payment of his debts to any of his creditors.
 2. Where the creditor become entitled to file a bankruptcy petition under a credit agreement.
 3. Debtor making of a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditor generally.
 4. Debtor making a fraudulent conveyance, gift delivery or transfer of his property or any part thereof, with an intent to defeat or delay the claim of his creditors.
 5. Debtor making any conveyance or transfer of his property or any part thereof, or creating any charge thereon which would under cap 30 any other Act be void as a fraudulent preference if he were adjudged bankrupt.
 6. Where a debtor, with intent to defeat or delay the claims of his creditors departs out of Nigeria or being out of Nigeria remains out of Nigeria or departs from his dwelling.

It is pertinent to point that parties to a credit transaction may specify the circumstances under which the creditor will become entitled to file a bankruptcy petition, in which case where such circumstances occurred the debtor will be deemed to have committed act of bankruptcy. It is suggested that solicitors can make use of this provision by inserting appropriate bankruptcy clauses in credit agreements.

Entitlement to present petition

In addition to the requirement of disclosing acts of bankruptcy, the creditor must satisfy the following requirements;

1. that the amount of debts owed by the debtor is not less than N2,000;
2. that the debt is a liquidated sum and is payable immediately or at a future time;
3. that the act of bankruptcy upon which the petition is predicated occurred within three months before the presentation of the petition; and
4. that the debtor is ordinarily resident in Nigeria or within a year before the date of the petition has resided, have a dwelling house or place of business, carried out a business in Nigeria or a member of a firm or partnership in Nigeria.

Period of Limitation

It appears that a petition for bankruptcy will be incompetent if filed after three months of the occurrence of the act of bankruptcy upon which the petition is predicated.

Proceedings Subsequent to Presentation of Petition
Subsequent to the presentation of the presentation of petition, a creditor is required to furnish the court with evidence of the debt, service of petition and act or acts of bankruptcy. Upon satisfaction with the evidence on these matters, the court may make a receiving order.

III. EMPIRICAL REVIEW

Dobbie and Song (2015) use half a million bankruptcy filings matched with administrative data to document the impact of debt relief in the US (under Chapter 13 filings). They find that debtor protection has positive effects on earnings and reduces mortality and home foreclosure rates.

Using firm data, Davydenko and Franks (2008) compare the effects of bankruptcy law in France, Germany, and the UK. The results indicate that banks respond to debtor-friendly codes, with, for example, stricter collateral requirements.

Fossen (2014) analyzes the introduction of the Insolvency Code in Germany in 1999, which allowed personal bankruptcy and a subsequent fresh start for the first time, as a quasi-experiment. In a model, he illustrates that potential entrepreneurs are less affected by personal bankruptcy law if they are wealthier. A difference-in-difference analysis based on household panel data shows that the individual probability of entry into entrepreneurship increased for less wealthy persons relative to more wealthy persons when the Insolvency Code was introduced. This shows that entrepreneurship became more attractive for less wealthy individuals and indicates that the insurance effect outweighs the borrowing cost effect.

IV. THEORETICAL FRAMEWORK

Prospect theory

Kahneman and Tversky (1979) developed prospect theory. There are three fundamental propositions of prospect theory. The first fundamental proposition of prospect theory is that individuals view outcomes from decisions under uncertainty as gains or losses relative to a reference point (Kahneman and Tversky 1979). The second fundamental proposition of prospect theory is that '...losses loom larger than gains. This again implies that the initial position matters, as both gains and losses are evaluated with respect to it; a phenomenon that Thaler (1980) labeled as

‘endowment effect.’ The third key element of prospect theory is that the value of outcomes is assessed by decision weights rather than the probabilities used in expected utility theory.

The theory is relevant to this study because for entrepreneurs, risk-taking and high likelihood of failure is inherent: ‘if the manager takes no risks... this individual is no longer an entrepreneur’ (Knight 2009). Empirical evidence indicates that entrepreneurs consider cost of loss much more than profit yields (Dew et al. 2009). Furthermore, loss should not only be defined by financial loss but also by restrictions on choice which would occur for an entrepreneur with loss of decision rights over their venture: as the theory of opportunity cost posits, any restriction of choice is equivalent to an additional cost (Buchanan 1979).

V. METHODOLOGY

Data and the literature for this study were obtained from secondary sources, World Bank open data were instrumental in the collection of statistical information used in carrying out this research.

The study adopts an econometric model in determining bankruptcy law and entrepreneurship development. The Generalised Least Square (multiple linear regression) model was used to evaluate the relationship between bankruptcy laws and entrepreneurship development in Nigeria.

The multiple regression model is stated thus; $Y_i = B_0 + B_1X_{1i} + B_2X_{2i} + B_3X_{3i} + u$ Where; Y is the dependent variable, X_1 , X_2 and X_3 are the explanatory variables, u is the stochastic error term, and i is the ith observation since the data are time series (Porter and Gujarati, 2009).

The model specified in this research work is on the critical assessment of bankruptcy laws, its impact on entrepreneurship development in Nigeria from 2011 to 2019. In this study, self-employed rate (SER) is proxied for entrepreneurship development and is used as the dependent variable while gross domestic product growth (GDP), lending interest rate (INT) and trade (% of GDP) (TRD) are the independent or explanatory variables.

In functional form, the model is specified thus;
 $SER = f(GDP, INT, TRD)$(1)

In a simple equation form model 1 becomes;
 $SER = b_0 + b_1GDP + b_2INT + b_3TRD + u$ (2)

The general error correction model adopted for the study is specified as follows:

$$LnSER = b_0 + \Delta LnGDP_t + \Delta LnINT_t + \Delta LnTRD_t + U_t$$
.....(3)

Where;

SER = self-employed rate

GDP = gross domestic product

INT = lending interest rate

TRD = trade (% of GDP)

U_t = error term at period t

LN = natural log

b_0 = intercept

$b_1, b_2 > 0$ = coefficients of the independent variables.

VI. PRESENTATION AND ANALYSIS OF RESULTS

From the regression result, self-employed rate (SER) was the dependent variable and proxy for entrepreneurship development while gross domestic product (GDP), lending interest rate (INT) and trade (% of GDP) (TRD) were the independent variables. The regression results obtained are presented in the table below.

Table 1: Summary of the Ordinary Least Square Regression Result

Dependent variable: SER

variable	Coefficient	P(alue)	t-statistic	S.E
C	4.5679	0.0092	4.1145	1.1102
GDP	-0.1024	0.3057	-1.1406	0.0897
INT	-0.6734	0.3678	-0.9896	0.0742
TRD	0.0840	0.0436	2.6846	0.0313
$R^2 = 0.83892372$ Adjusted $R^2 = 0.74227795$ F-statistic = 8.680298 P(f-stat) = 0.019952				

Source: Author's computation using excel

Analysis of Result

The intercept of the regression result presented on table 1 was 4.5679. It represents the value of self-employed rate (SER) if gross domestic product (GDP) and lending interest rate (INT) is zero holding trade (% of GDP) (TRD) constant. From the analysis we can tell that TRD

has a positive relationship with self-employment rate and is statistically significant at 5% level of significance given its probability value of 0.0436 which was less than 0.05. GDP and INT have a negative relationship to self-employment rate and are statistically insignificant in determining self-employment rate.

From table 1, the coefficient of determination (R^2) was 0.83892372 which implied that about 84% of systematic variation in self-employment rate (SER) was explained by the explanatory variables. This was further confirmed by the value of the adjusted R^2 (0.74227795) which also indicated that about 74% of systematic variation in self-employment rate (SER) after taking into cognizance the degree of freedom was explained by the explanatory variables. This can be concluded that a high degree of relationship exist between self-employment rate (SER) and the explanatory variables used in the study.

The regression result on table 1 showed that $f_{cal} = 8.680298$ for this study was calculated and tested at 5% level of significance. f_{tab} at 5% level of significance = 3.84. Since $8.680298 > 3.84$, we conclude that there is significant linear relationship between the explanatory variables taken together and the dependent variable in the estimated model. This suggests that the whole regression is statistically significant and has a good fit with a probability value of 0.019952.

Policy Implication of Findings

Entrepreneurship development is very important to an economy as it provide room for economic growth; serve as a means of job opportunity and poverty alleviation. Engaging in friendly-based bankruptcy laws would result in increasing numbers of individuals willing to venture into entrepreneurship.

VII. CONCLUSION AND RECOMMENDATIONS

Conclusion

Findings from this research uncovered that entrepreneurship contributes greatly to the economic growth of a nation. This is done through its role in providing employment opportunities among others. Thus, in the light of the foregoing, this study reliably concludes that bankruptcy laws will influence entrepreneurship development.

Recommendations

On the strength of the observations and findings made, the study recommends that government policies should be favourable towards entrepreneurship development and bankruptcy laws should be friendly to debtors.

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APPENDIX

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.91592779
R Square	0.83892372
Adjusted R Square	0.74227795
Standard Error	0.11935788
Observations	9

ANOVA

	df	SS	MS	F	Significance F
Regression	3	0.37099071	0.123664	8.680398	0.019952
Residual	5	0.07123151	0.014246		
Total	8	0.44222222			

	Coefficients	Standard Error	t Stat	P-value
Intercept	4.56785749	1.11018619	4.114497	0.009223
GDP	-0.10235865	0.08974089	-1.1406	0.305706
INT	-0.0734134	0.07418853	-0.98955	0.367832
TRD	0.08400768	0.03129191	2.684646	0.043577