ARTICLE IN PRESS

Economic Systems xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Economic Systems

journal homepage: www.elsevier.com/locate/ecosys

Do liquidation trustee characteristics matter for firm liquidation outcomes? Evidence from Slovenia[☆]

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ARTICLE INFO

JEL classifications:
G33
K22
P37

Keywords:
Insolvency
Firm liquidations
Debt recovery
Duration
Liquidation trustees
Slovenia

ABSTRACT

We investigate whether insolvency outcomes depend on the characteristics of the trustee entrusted with the administration of insolvency proceedings. To this end, we draw on a novel dataset of firm liquidations from Slovenia and exploit courts' de facto random assignment of firm liquidation cases to licensed liquidation trustees. We find that only a subset of the observed liquidation trustee characteristics matters for only a subset of examined firm liquidation outcomes. The trustee's experience affects the length of proceedings. While the effect is identified off of a small number of observations, the subject of the trustee's education influences the prospects for, but not the amount of, creditors' debt recovery. The trustee's gender, attained level of education, and repeated match with a specific judge exhibit no robust effect on either debt recovery or the length of proceedings. We discuss the broader implications of our results.

1. Introduction

Insolvency laws and procedures play a crucial role in supporting the functioning of markets. At the macro level, bankruptcy laws and their enforcement enable the continuous reallocation of resources from less to more productive uses (White, 1989; Claessens and Klapper, 2005). At the micro level, an effective insolvency regime ensures the resolution of financial distress by encouraging the liquidation of unviable firms or the restructuring of firms that are viable in the long run but suffering from temporary distress (see, e.g., Bris et al., 2006; Wang, 2012). Effective insolvency regimes thus guarantee the protection of creditor rights (see, e.g., Djankov et al., 2008), which in turn facilitates private credit and investment (La Porta et al., 1997, 1998).

From the normative standpoint, the primary objective of bankruptcy proceedings is to attain an ex post efficient outcome, that is, to maximize the value of the financially distressed firm to be divided among the stakeholders (see, e.g., Hart, 2006, p. 4; Blazy and Chopard, 2011; Blazy et al., 2013; Cornelli and Felli, 2012). Since the proceeds available to stakeholders decrease with the incurred bankruptcy costs, which in turn increase with the length of proceedings (see, e.g., Hotchkiss et al., 2008), a congruent and often separately emphasized policy goal concerning bankruptcy proceedings is to resolve them in due course (see, e.g., CEPEJ, 2016; World Bank, 2017). Yet detailed micro-level empirical evidence on the factors influencing the ex post efficiency of insolvency regimes and the duration of insolvency proceedings, especially outside the United States, is scant (Hotchkiss et al., 2008, p. 38; Blazy et al., 2011,

[☆] For helpful comments and suggestions we thank Andrzej Baniak, Giovani Ramello, participants at the 3rd annual conference on the Economic Analysis of Litigation in Montpellier and the 33rd annual conference of the European Association of Law and Economics in Bologna, and two anonymous reviewers.

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http://dx.doi.org/10.1016/j.ecosys.2017.05.002
Received 31 July 2016; Received in revised form 2 May 2017; Accepted 4 May 2017
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2013, p.1937; Sundgren, 1998; Thorburn, 2000; Couwenberg and de Jong, 2008; Dewaelheyns and Van Hulle, 2009; Leyman et al., 2011).[1] Systematic empirical analyses of bankruptcy regimes are especially scarce in the context of post-socialist and emerging market economies (e.g., Blazy and Stef, 2015; Lambert-Mogiliansky et al., 2007; Vukelic et al., 2014; Knot and Vychodil, 2006), even though the design of effective bankruptcy institutions and procedures was identified as a policy priority during transition (see, e.g., Aghion et al., 1994; Estrin, 2000; Pistor, 2000; Csaki, 2002) and continues to be an important policy concern in current reform debates worldwide (see, e.g., Cirmizi et al., 2012; Claessens et al., 2001).

In this paper, we fill the abovementioned gap in the literature by studying the determinants of creditors' debt recovery and the duration of proceedings in the context of firm liquidations in the post-socialist EU member state of Slovenia. We advance the existing empirical literature on insolvency by focusing on the thus far empirically unexplored role of *liquidation trustees* as the agents entrusted with the execution of all key procedural steps in the resolution of firm liquidation cases.

Previous micro-level studies on the functioning of insolvency regimes have focused primarily on the importance of bankruptcy laws and exploited cross-country variations in the applicable codes and procedures (see, e.g., Armour et al., 2008; Davydenko and Franks, 2008; Haselmann et al., 2010; Blazy et al., 2013). Despite the growing evidence on the importance of effective legal institutions for the performance of financial markets (see, e.g., Jappelli et al., 2005; Visaria, 2009; Ponticelli and Alencar, 2016), only a handful of recent empirical studies have examined the role of law enforcement for insolvency outcomes. In particular, the scant existing studies focus on the supervisory role of courts and judges (see, e.g., Claessens and Klapper, 2005; Evans, 2003; Bris et al., 2006; Rachlinski et al., 2007; Blazy et al., 2011; Chang and Schoar, 2013) and demonstrate that judicial decision-making often, though not always and for all outcomes (see, e.g., Evans, 2003; Bris et al., 2006; Blazy et al., 2011), shapes the resolution of bankruptcy. None of the existing micro-level empirical studies of the functioning of insolvency regimes investigate the role of liquidation trustees (also referred to as 'insolvency office holders' or 'insolvency administrators') to whom the courts delegate the task of administering the insolvency proceedings.

In theory, if bankruptcy codes were complete, insolvency outcomes would be independent of who exactly administers the insolvency proceedings. That the law is inherently incomplete (Pistor and Xu, 2003) and that liquidation trustees may hence play a vital role in the resolution of insolvency proceedings, however, has been well understood in insolvency practice (see, e.g., Bridge, 2014). Accordingly, bankruptcy codes worldwide often include provisions governing the appointment of insolvency office holders with the aim of ensuring maximum and timely recovery for the creditors (see, e.g., Granfield et al., 2008). Indeed, in most jurisdictions (see, e.g., Bridge, 2014; Granfield et al., 2008), the appointment of insolvency office holders typically involves a process in which the creditors, the court, and possibly other state bodies, participate directly in the nomination and approval of the candidates. This kind of deliberate matching of insolvency cases to insolvency trustees is intended to ensure favorable insolvency outcomes. From a researcher's standpoint, however, such endogenous selection of insolvency office holders represents an empirical challenge because it blurs the insolvency trustees' causal (ceteris paribus) impact on insolvency outcomes.

To examine the liquidation trustees' impact on insolvency outcomes, we exploit the peculiar institutional setting in post-socialist Slovenia, where concerns about cronyism and corruption in firm liquidations were prevalent throughout the 1990s and early 2000s. In particular, under the old Slovenian insolvency legislation, judges possessed full discretion in allocating firm liquidation cases among liquidation trustees. In the transition environment, such unfettered judicial discretion created scope for illegal quid pro quo transactions between the judges and liquidation trustees eager to get a hold of the cases with the best prospects for private rent extraction.[2] Consequently, in an effort to curb institutional subversion and promote efficiency, in 2008 the drafters of the reformed Slovenian insolvency code included a rare provision (see, e.g., Bridge, 2014) aiming to ensure that firm liquidation cases petitioned in court are assigned to licensed liquidation trustees based on alphabetical order and thus independently of judge, firm, and trustee characteristics.

We make use of this de facto random allocation of firm liquidation cases among liquidation trustees in post-2008 Slovenia as the source of exogenous variation in liquidation trustees' characteristics. By combining a newly assembled dataset on the features and outcomes of Slovenian firm liquidations with available data on liquidation trustees, we are therefore able to provide what is to our knowledge the first empirical analysis of whether, and if so in what way, liquidation trustee characteristics matter for creditors' debt recovery and the duration of liquidation proceedings.

To assess the role of liquidation trustee characteristics for creditors' debt recovery we estimate a lognormal hurdle model (see Wooldridge, 2002) that allows us to differentiate between the outcomes of whether firm liquidation resulted in any debt recovery at all and how much creditors were paid in the aggregate when the total amount paid to creditors at the end of the liquidation proceedings was positive. Our findings indicate that creditors' debt recovery does not vary with trustee's gender, attained level of education, experience, and repeated match with a specific judge. Indeed, the only observable liquidation trustee characteristic that is a statistically significant predictor of at least some aspect of debt recovery in our data is the trustee's subject of university education. Specifically, we find that, all else being equal, the creditors' *prospects* of recovering at least some of their claims are lower when the liquidation proceedings are administered by a trustee who does not hold a degree in law or economics/business than they are when the proceedings are administered by a trustee with a degree in either of these fields. This effect is admittedly identified off of a relatively small number of observations and should thus be interpreted with caution. However, the effect is robust across different

[1] In contrast, the literature on the *ex ante* incentive effects of bankruptcy has been comparatively voluminous (for references, see, e.g., Hotchkiss et al., 2008, footnote 1).

[2] A series of firm liquidation cases, covered extensively by the Slovenian press, had exposed the systemic problems arising from the scope for corrupt ties between judges and liquidation trustees and became known under the heading "Friends in Firm Liquidations" (*Prijatelji v stečajih*). All involved liquidation trustees were eventually acquitted following an investigation of the Chamber of Insolvency Administrators. One of the involved judges faced mild disciplinary sanctions.

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