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A Tractable Model of Limited Enforcement and the Life-cycle Dynamics of Firms

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Abstract

We develop a continuous-time model of optimal lending contracts under limited enforcement and provide closed-form solutions. We characterize the dynamics of firms' growth rate, Tobin's Q , and capital structure over their life cycles.

Key words: Dynamic contract, limited enforcement, firm dynamics, capital structure

JEL codes: G32, D21, D82.

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