The Impact of Delay: Evidence from Formal Out-of-Court Restructuring

Stjepan Srhoj†, Dejan Kovač‡, Jacob N. Shapiro§ & Randall K. Filer¶

This draft August 11, 2021

Abstract

Bankruptcy restructuring procedures are used in most legal systems to decide the fate of businesses facing financial hardship. We study how bargaining failures in such procedures impact the economic performance of participating firms in the context of Croatia, which introduced a “pre-bankruptcy settlement” (PBS) process in the wake of the Great Recession of 2007 - 2009. Local institutions left over from the communist era provide annual financial statements for both sides of more than 180,000 debtor-creditor pairs, enabling us to address selection into failed negotiations by matching a rich set of creditor and debtor characteristics. Failures to settle at the PBS stage due to idiosyncratic bargaining problems, which effectively delays entry into the standard bankruptcy procedure, leads to a lower rate of survival among debtors as well as reduced employment, revenue, and profits. We also track how bargaining failures diffuse through the network of creditors, finding a significant negative effect on small creditors, but not others. Our results highlight the impact of delay and the importance of structuring bankruptcy procedures to rapidly resolve uncertainty about firms’ future prospects.

Keywords: bankruptcy, insolvency, liquidation, restructuring

JEL: G33, G34, D02, L38, P37

*The authors gratefully acknowledge the support of the National Science Foundation of the United States under grant SES-0752760 to the Research Foundation of the City University of New York. All opinions are those of the authors and should not be attributed to the NSF or CUNY. Authors are grateful for comments received by Steffen Müller, and comments by the participants of the ESOC Weekly Lab Meeting at Princeton University. Authors thank their 11 research assistants, Melko, Mihaela, Tena, Marino, Kristina, Tomo, Ante, Sandra, David, Antonija and Nika for their immense support with data collection. We are grateful to Barbara Forbes for editorial support. All errors are our own.

†Department of Economics and Business, University of Dubrovnik

‡Princeton School of Public and International Affairs, Princeton University and Halle Institute for Economic Research (IWH), Germany

§Princeton School of Public and International Affairs, Princeton University

¶Hunter College and The Graduate Center - CUNY, CERGE-EI Prague, IZA Bonn and CESifo Munich