THE FEAR OF FAILURE*

Reflections on business failure and entrepreneurial activity

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Abstract

There is a widely held perception that different attitudes towards entrepreneurial failure are to be found in Sweden and the USA. Academics and journalists often claim that in USA, entrepreneurial failure is seen as part of a learning process. According to the same conception in Sweden, the Swedish culture is less tolerant of failure. It is claimed that in Sweden if an entrepreneur fails, he/she will be stigmatized. The relatively low level of entrepreneurial activity in Sweden is partly explained by socially negative attitudes towards entrepreneurial failure. Up to now no evidence has been provided to support this assertions, which should be a matter of concern to scholars.

But the conception to interpret business failure mainly as a result of insufficient management competency is now being re-examined by new-economy apologists. They argue that in this new world of rapid technological change, old concepts of failure have become irrelevant. The main goal of this explorative study is to investigate whether the views described above are based on empirical observations or if they are rather ideological claims of normative character.

Introduction

Somewhat simplified, most studies distinguish between two fundamentally different views of why firms behave in a particular way. One of these views presumes that the management's decision making plays a central role. The behaviour of a firm is usually the result of conscious, deliberate and targeted-oriented actions. In that sense, organizations behave ”rationally”. The background, competency, motivation, attitudes and cognitive abilities of the management are considered to be central variables when success and survival are to be explained. Partly as a consequence of the microentrepreneurial "traits" approach, entrepreneurial and business failure has until very recently been considered as something negative that should be avoided. Failure has often been connected with insufficient management competency and has thus been considered as something shameful, something not to be talked about and something one would rather forget.

The international research project *Global Entrepreneurship Monitor* (GEM) compares the level of entrepreneurial activity in 21 countries. According to the GEM the level of entrepreneurial activity (measured by start-up activity and by the proportion of adults in each

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economy who are involved in operating a business) differs significantly between countries. In Brazil, 1 in every 8 adults is currently starting a business. This compares with 1 in 25 in Germany and 1 in 50 in Sweden. Amongst the European countries studied this one of the lowest level of entrepreneurial activity. Only Belgium, France and Ireland show lower levels. Sweden fosters all too few entrepreneurs. The relatively low level of entrepreneurial activity in Sweden is among other issues explained by socially negative attitudes towards entrepreneurial failure. Policies should therefore, according to the recommendations given in the GEM, encourage the development of social and cultural values where entrepreneurs are not stigmatized by failure.

The second view considers the behavior of firms to be mainly determined by external factors which the management cannot control. From this perspective, the behavior of firms is not mainly determined by the measures taken by the management but, to a considerable extent, by external limitations and conditions (Anheimer, 1999 and Kimberly, 1987). These two different views have dominated the explanations of how and why (above all small) firms fail or succeed (Hall, 1995).

What are the effects of these two views if we try to enterprete the frequency of business failures in different countries? I will give a brief example but first, I will discuss the concept business failure.

The Concept Business Failure

Despite the fact that some effort has been made to identify signals of imminent business failures and to specify their causes, there is still no generally accepted definition of business failure. A deeper analysis of failures in large populations of firms is usually blocked by problems as concerns statistics and sources.[1] The absence of reliable measures for failures have probably constituted an obstacle, as well as the somewhat careless use of the word failure and its supposed synonyms, such as business mortality, discontinuity, insolvency and bankruptcy. As a rule, the word "failure" is missing in both Swedish and many foreign dictionaries in economics. In the Oxford English Dictionary (1971), the term "failure" is defined as "to become deficient, to be inadequate". In the same work, "business failure" is defined as "bankruptcy, insolvency." It is not surprising that the definition that has mainly been used in studies in business economics (Cochran, 1981, Haswell and Holmes, 1989), economics (Eliasson, 1992) and economic history (Hoppit, 1987; Jobert & Moss, 1990), is the one which equals failure and bankruptcy. Bankruptcy is the dominating but not the only definition of failure. Most such definitions are based on financial criteria (Stettler, 1986). Following Berryman,[2] we meet five definitions of different scope:

> 1) The Bankruptcy Criterion; 2) The Solvency Criterion; 3) Exit in order to avoid expected loss; 4) The Opportunity Cost Criterion (a firm fails if its returns to invested capital are significantly lower than what can be obtained by making similar investments); 5) All kinds of discontinuity (a firm fails if it will terminate its business, irrespective of cause and point in time).

Unfortunately these definitions do not give us an appropriate measure of business failure. Cochran (1981) comments the lack of a reliable measure of failure: “Like the weather, (small) business failure is the subject of much discussion… but unlike the weather…there is…a dearth of timely, reliable, and relevant information on (small)business failure rates.”
Unfortunately no definition is clearly superior and different measures of failure will result in different failure rates.

The first definition equals failure with bankruptcy is the dominating definition of failure. This is partly due to the fact that statistics on bankruptcies are relatively easily accessible and that information about other categories of exit is missing. A problem arises if we compare the number of bankruptcies in different countries. Bankruptcy laws in the nations of the world vary greatly. Most nations have provisions for liquidating and/or rehabilitating or reorganizing bankrupt companies. The emphasis is different, though, in each nation. In contrast to the U.S., many countries, Great Britain for example, place less emphasis on rehabilitating companies in distress and more emphasis on recovering creditor’s money. Likewise, the policies concerning consumer or individual bankruptcies differ greatly. In many nations, personal bankruptcies are discouraged.

The second definition includes all firms terminating their business at a loss. Bankruptcies are included but also other kinds of agreements with outstanding commitments and voluntary compromises with creditors.

The third definition encompasses all kinds of discontinuity in order to avoid losses, and includes the large number of firms that might foresee their future fate in time and can avoid a complete loss, but excludes those merely shifting their resources to a more profitable activity. Since there are, in general, no adequate statistics and the majority of firms have left no archives, researchers generally lack the necessary material for making such an evaluation.

A fourth possible definition might include all firms according to points one, two and three above as well as those terminating their business due to their having failed to be competitive in comparison to the alternative uses of capital and labour. A definition based on opportunity costs must also be dynamic as concerns interest changes and alternative investments. Since this requires a great deal of resources, it seems less suitable for investigations with a longitudinal design.

A general objection to using a definition based on opportunity costs is that the assumption of the profit maximizing goal cannot easily be applied to small firms. Previous studies have shown that small entrepreneurs can be satisfied with lower profits (Kaplan, 1948; Johansson, 1982), as compared to large firms, or even contribute more capital out of their own pockets in order to save the firm (Bechhofer et al, 1974) The creation of large fortunes holds no prominent place in the minds of small entrepreneurs (Beckereus and Roos, 1985, p.38).[3] The business can be pursed for a long period of time even if it is unprofitable according to general measures within business economics (Berglund and Heideken, 1984). Many small firms abstain from profitable expansion, since they do not want to increase their number of employees (Davidsson, 1986; NUTEK 1994:4). There are other goals such as "being your own" that might be more important to the entrepreneur than the profit maximizing goal and which will govern his/her business.

When analyzing large populations of firms, definitions of types two, three and four are difficult to operationalize. They build on a study and possibly an audit of the accounts of the individual firm. These have rarely been kept and very rarely by other firms than large ones.

The widest definition of failure includes all kinds of discontinuity. This definition seems appropriate if we start from a production technical or employment perspective. As a social mechanism, the organization – the firm – generally has an interest in survival. There are several objections to using such a wide definition in the present study. It also includes firms that have been sold at a profit, and is therefore not suitable. Firms that close down because the entrepreneur falls ill or is too old or because resources are moved to areas with larger returns cannot simply be considered as failing. In favour of such a definition is the fact that a firm does not have to maximize its profits or minimize its costs, not endow its members with prestige, power or security, but it must survive in order to be a firm.

The importance of the goal of survival cannot be over-emphasized. Several previous studies assume that an organization that does not survive for a certain period of time has failed. In order to define the criteria for failure from those for different kinds of success, a two-, three- or five-year limit has been chosen (Plaschka, 1986), in general without motivating the definitions. Organizational sociologists but also business economists have already emphasized that the power to survive shall be put before all other goals, even the one of generating profits (Cohn and Lindberg, 1974; Starbuck, 1965). According to this view, the lifetime of a firm can be used as a measure of the extent to which it has failed or succeeded, respectively. A time-related definition has the advantage of being easily applied to relatively large populations of firms. But a firm that goes bankrupt after 30 profitable years can naturally not be considered to have failed from a lifecycle perspective. The firm might have paid back all its investments several times during its existence. In order to avoid such pitfalls, a time dimension can be introduced. It is, however, unclear from what theoretical or logical starting points a time limit shall be set that can distinguish between financially successful and failing firms (Gratzer, 1996).

In theory, a term considering all the above mentioned dimensions would be desirable. In practice, available statistics determine what can actually be achieved. Thus, this study will also measure business failure by the number of bankruptcies. The idea that business failures can be defined in an unambiguous way in population studies or studies with a macroeconomic design must, in my opinion, be postponed.

The new economy's entrepreneurs: dare to fail

The conception to interpret business failure mainly as a result of insufficient management competency is now being re-examined by new-economy apologists. They argue that in this new world of rapid technological change, old concepts of failure have become irrelevant. One 'fact' often asserted in business magazines is that highly successful entrepreneurs are individuals who have previously failed in business. It is also asserted that the experience of business failure constitutes a learning process for that person. Therefore - so it is said - changes in the legal system, which attempt to remove the stigma of personal bankruptcy, must be encouraged. Experience from earlier business failures should, according to this view, be considered an advantage (Claymon, 1999). In the following, I will give some examples of such arguments claiming an ongoing ideological shift in paradigms as concerns the evaluation of business failures.

Academics and journalists in Sweden and other European countries have often regretted that the Swedish and/or the European culture has less understanding of failures than the American culture. Furthermore, they intimate that it has not been possible to start anew as an entrepreneur after a business failure. In Germany it is claimed that insolvency brings about "economic death" to an entrepreneur. This is contrasted to the USA where bankruptcy is seen as a "new chance" (Meister, 2001). Academic writers have echoed the claims that Britain is intolerant of business failure (Birley and MacMillan, 1995), that individuals who have failed and become bankrupt have been too strongly discouraged from starting anew (Storey, 1998) and that failure can leave a durable stigma (Morrison, 2000). One of the few empirical peaces of research in this area is the Study of Cave, Eccles and Rundle (2001). The results of their quantitative study show that differences in attitudes between Britain and USA may not be as distinct as many claim. Respondents from both nations perceived there to be a stigma attached to entrepreneurial failure. The results also showed that even those who believe that failures are stigmatised have been able to move on. All respondents had either started-up a subsequent venture, and/or gained employment since their failure.

According to a similar conception in Sweden, even the Swedish culture is less tolerant of failure and too often, highly talented individuals have not been able to recover from failure. Many people argue that there is little doubt that Sweden has lost many potentially successful entrepreneurs; having failed once, they have not been allowed to recover from that failure, perhaps from an inability to raise capital due to previous bankruptcy. Culture and environment are seen as crucial to tolerance of failure. Real or supposed differences in business climate are emphasized in the media. Swedish newspapers can describe the business climate in the USA as follows: "to start your own business is good, to be a joint owner is god, to go bankrupt is OK – at least ethically" (Weber 2001). One of the industrial newspapers in Sweden claims that failures are considered as suspicious in Sweden (Sundberg, 20001). To have become bankrupt a couple of times is considered as negative, according to the paper. Yet, you learn more through mistakes and failure than through perpetual success, which the US has realized, but not Sweden. If failing one or several times can become accepted, as in the US, more firms can be established (Dagens Industri, 000704). The Economist goes even further and makes the possibility for an entrepreneur to try anew a powerful indicator of the progress a country has made in the new economy: "How many failed entrepreneurs get a second chance will be an important test of whether European business has really 'got' the new economy" (The Economist, 000803).

A change in attitudes as concerns risk-taking, success and failure also characterizes the new economy according to a study that has been made at the Swedish Ministry of Industry. Risk-taking, to try and dare to fail becomes permitted, even admirable. Courage in all things from mountaineering to establishing a firm and courage to stand up for one's beliefs attract attention. According to this study, this encourages more people to entrepreneurship (Sahlman, 1999).

Even the workgroup for simpler conditions for firms (the so-called BEST-group) within the EU drew a similar conclusion. The task of the workgroup was to prepare a report, which was to present suggestions for the measures to be taken by the Commission and the member states in order to increase the quality of legislation and remove the superfluous taxes that check the development in European firms. The workgroup, which focuses on small and middle-size firms, finds the views on failures within the world of business to also be a cultural problem. They claim that this becomes particularly clear if comparing attitudes in Europe those in the US and Canada. In Europe, no value is attached to the instructive experience that a failure can actually provide. The committee thus recommends that there should be a more positive attitude to ”failure” and that the importance of failure as an instructive experience should be emphasized (Report from the Workgroup for Simpler Conditions for Firms, European Commission, 1998).

In summary, it is found that the European and Swedish evaluation of business failures has often been compared to that of the US. Failures are often considered to be a stigma in European countries but a qualification in the US. Furthermore, it is found that those supporting the new economy have a new attitude to, for example, failures. They are not afraid of failures, which they consider as a natural part of a learning curve. Finally, the tolerance towards failure is seen to be fundamental in explaining differences of entrepreneurial activities between countries.

As far as I know we still lack empirical evidence for the hypothesis that the U.S. business culture is more tolerant of failure than the Swedish or European.

Goal and questions

The main goal of this explorative study is to investigate whether the views described above are based on empirical observations or if they are rather ideological claims of a normative character. It is reasonable to assume that we can find differences in attitudes to entrepreneurial- and business failures in various countries. However it is still wrapped in mystery what these differences look like, the multifaceted character of the behavioural patterns in this respect is complex. People with various kinds of personality traits experience failure in disparate ways. The experience of true or supposed stigma can depend on an individuals propensity for self criticism. But stigma can also come from the society. Bankruptcy laws can be more or less punitive in different countries and some cultures can be more intolerant to failures in business than others. An unexplored question is if, how and when attitudes towards failure are correlated to behavior. An even more important question is “Which factors affect the size of the correlation if and when it is found?”.

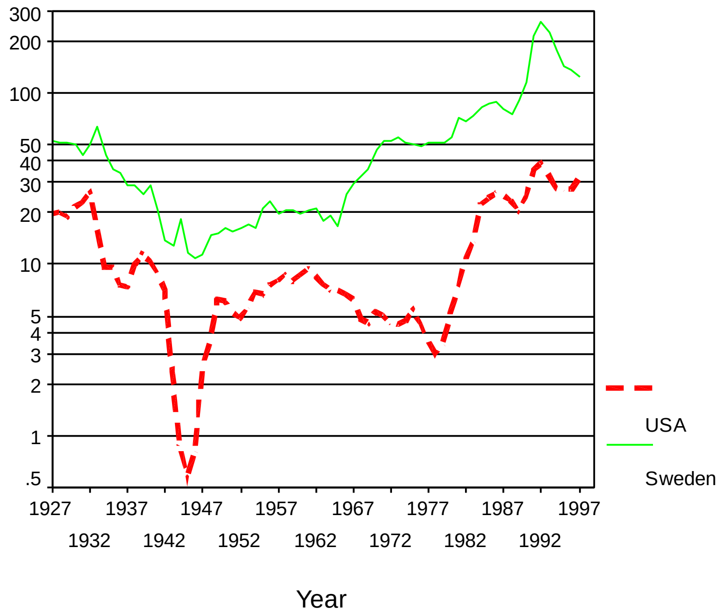
Due to lack of resources, it is not possible to measure the attitudes towards business failure in various countries. It is, however, possible to study whether there is a covariance between attitudes towards business failure and behavior. It can reasonably be assumed that a change in the behavior of entrepreneurs has been preceded by a change in our view of the phenomenon. This can be measured. As a consequence, we should expect a smaller frequency of business failures in Sweden than the US. Furthermore, we should find indicators that Swedish entrepreneurs have been prevented from making new attempts as entrepreneurs through earlier failures. Conversely, examples of entrepreneurs who have experienced several bankruptcies falsify statements of the stigmatizing effect of bankruptcy in Sweden. The number of business failures can be expected to be larger in the US – a country that is more lenient to failures than Sweden – the country where failures are considered to be stigmatizing. Furthermore, the change in attitudes towards failures is assumed to lead to a change in behavior. The number of failures can thus be expected to increase with the emergence of the new economy, which happened in Sweden during the 1990's. We can also expect a larger number of failures in new IT-related ventures than in traditional lines of business. Despite the fact that Sweden has been a member of the EU since 1995, we seldom compare ourselves to other countries in the union. What seems to be a fixation on American conditions might have made comparisons to other countries in Europe more difficult. The Swedish legislation regulating insolvent firms and firms in crisis has its roots in Europe and was, for a long period of time, influenced by, for example, German legislation. In order to create an understanding, the frequency of business failures in Sweden will be compared to that in Germany and Austria with longitudinal data. A comparison of the Swedish bankruptcy frequency with other OECD countries is done to create a broader perspective. From what has been said so far, some questions emanate:

1) Is the share of business failures larger in the US than in Sweden?
2) Are Swedish entrepreneurs stigmatized by failures so that they cannot start anew as entrepreneurs?
3) Has the share of failures increased in Sweden in the last century and if so, how is the Swedish trend related to the trend in other countries?
4) Is the share of failures larger in sectors that are central in the new economy?

Business failure in the US and Sweden

In the US, the definition of business failures includes those businesses that ceased operations following assignment or bankruptcy; ceased with loss to creditors after such actions as execution, foreclosure or attachment; voluntarily withdrew, leaving unpaid obligations; were involved in court actions such as receivership, reorganization or arrangement; or voluntarily compromised with creditors. There is a difference between business termination and business failure. A termination occurs when a business no longer exists. There are many reasons for a business to be terminated. The owner might get an opportunity to sell his or her business to someone else at healthy profit.

Figure 1
Business Failures in the US and Sweden 1927 - 1997



Source: The Dun &Bradstreet Corporation. Business Failure Record (1996). Statistics Sweden.

The owner may be ready to move to a new business or retire, or may simply have lost interest in business. The market for the business's product may have changed or become saturated. The owner might also have decided that it was more attractive to work for someone else, but if his creditors are paid in full, he is not tallied as a failure by the Dun & Bradstreet definition. Failures comprise only a percentage of total discontinuancies, although they represent the most severe impact on the economy and pinpoint the most vulnerable industries and locations in a specific time period (Dun and Bradstreet, 1996). In Sweden, the operational definition of business failure includes only businesses that were closed through bankruptcy. As in other international comparisons, the absence of uniform definitions also creates problems with measurement methods in this study. The Swedish definition of the phenomenon business failure is thus more narrow than the American one. The share of failures might thus be underestimated in the Swedish case.

As appears from *figure 1*, the share of business failures in Sweden has exceeded the same share in the US during the entire period of 1927-1997. This is surprising, considering that the definitions are not identical. In order to evaluate the observed amount of business failures in both countries, they should be related to a common denominator. The business structure is totally different in the two countries as concerns legal types of firms and so on, which is why the size of the population was chosen as a measure for comparison. The scale in the figure is semilogaritmic (which can sometimes mislead the eye). The number of failures per 100 000 inhabitants in the US has increased from 20 in 1927 to 30 in 1997. The corresponding figures in Sweden increased from 50 till 140. The increase in failures in Sweden was thus larger both in absolute and relative terms. Neither in Sweden nor in the US can an increase in business failures starting in the 1990s be found. The curves for both countries showed all times high at the beginning of the 1990's, however. Thus, an increase that had begun many years earlier in both countries came to an end. The statement that the American culture should be more tolerant to failures than the Swedish lacks empirical support. And there are no signs of the breakthrough of the new economy having incurred business failures. On the contrary, the number of business failures has been decreasing in both countries since 1992.

Evidence for post-failure start-ups in the US and Sweden

Very little has been published in the US and Sweden on the proportion of individuals that experiences business failure and starts new ventures. One reason for this can be that people do appear to be able to start anew after a failure, and often also do. In the US, a pilot study was conducted for the Small Business Administration in 1993/94. Unfortunately, a full-scale study has never been undertaken. The study succeeded in contacting and interviewing the owners of 101 small businesses that had filed for Chapter 7 bankruptcy[4] over the period 1989-93. Amongst the main findings of the survey was the fact that 47 percent of all respondents had resumed their careers in business after having filed for bankruptcy (this compares to 41 percent who took up paid employment).[5]

No systematic studies have been made in Sweden of the extent to which a certain individual in his own capacity or as a representative of a juridical person has gone into bankruptcy several times. This has not prevented debaters from establishing certain traits as being characteristic for Sweden.

There are, however, some scattered results. According to Adamson (1996), it was still impossible to use the bankruptcy system as a clever device for avoiding debt at the beginning of the 19th century and it was still very difficult for entrepreneurs to get back into business after a bankruptcy.[6] According to a wide-spread view, it is only lately (the speculative economy of the 1980's is often considered as a borderline to earlier and better times) that the share of so-called convenience- and planned bankruptcies is supposed to have increased. In my opinion, this view has no empirical foundations and studies in this area indicate the opposite.

Already in the mid-19th century, "false bankruptcies" are mentioned (Öhman, 1847).[7] In the latter part of the 19th century, the views on bankruptcy seem to have become more ambiguous. Through the development of the market economy, bankruptcy probably appeared more and more to be the result of impersonal and less easily influenced forces. The culpa perspective (it is mainly the debtor's actions that create insolvency) was beginning to be crowded out by the casus perspective (insolvency occurs when the debtor has made an erroneous prediction about the future, but has not taken any incorrect action in the legal or moral sense) when joint-stock companies and insights about international business cycle fluctuations were introduced.[8] In his study of industrial entrepreneurs in Gothenburg in the 19th century, Åberg (1991) found that the level of tolerance towards those who became bankrupt in the mid-19th century was large. He found no support for the common view that bankruptcy was something ugly and dishonorable. According to him, failures were common, especially due to the inability of the credit market to deal with crises. Åberg found several entrepreneurs who had been involved in more than one bankruptcy. The famous Swedish playwriter August Strindberg (1879) described as early as 1879 in a novel how businessmen used the Swedish bankruptcy system with the aim of enriching themselves.

In an industrial historic study of entrepreneurs active around the turn of the century, bankruptcy already seemed to be a natural part of an entrepreneurial career. The major part of the entrepreneurs investigated had experienced several bankruptcies in their life-time. Everyone who had become bankrupt as a private firm changed type of firm to a joint-stock company in his future business activities. Nobody who had taken part in a joint-stock company bankruptcy later became bankrupt as a private entrepreneur. The results of the study also show that the view that it is normally inefficient firms and entrepreneurs with insufficient competency that are eliminated through bankruptcy must be questioned. The possibility of forming joint-stock companies made it easy for entrepreneurs who had become bankrupt to continue their activities if so desired. It had become possible to shift debts to creditors. An often generous interpretation of the legislation on bankruptcy made such income transfers possible. Thus, already at the turn of the last century entrepreneurs who wanted to stretch the limits of the rules of the game, had the chance to return after a bankruptcy with the same activity in the same or new firms. Bankruptcy was in no way a stigma to them. It is, however, unclear how common such a course of action was among entrepreneurs outside Stockholm (Gratzer, 1998). With clearsightedness and good powers of observation, Henning Berger (1916), a Swedish author, described in a novel about the war- and swindling years (1910-1920) how liquid capital might sometimes have played a secondary part in paying for share-capital and how bankruptcies were used in this activity.

The reports *Företagskonkurser* (*Bankruptcies of Firms*, 1975) and *Etableringar i byggnadsindustrin* (*Establishments in the Building Industry*, 1976) have presented certain material which provides a picture of renewed bankruptcies. *Företagskonkurser* reports a study on the frequency of cases where major shareholders in joint-stock companies and private entrepreneurs, whose firms became bankrupt in 1972 in the Malmöhuslän* area, have earlier been declared bankrupt, personally or have been behind firms that have become bankrupt. The study involved 160 people owning 10 per cent or more of the shares in a joint-stock company and who were also mainly responsible for the management of the firm. 31 of these where private entrepreneurs. Of these, two had been debtors in two earlier bankruptcies each. Among the other 129, 19 had been involved in a previous bankruptcy. No one had been involved in more than three bankruptcies. It appears from the study that about every seventh entrepreneur had been involved in more than one bankruptcy.

Nobody who had been involved in a joint-stock company bankruptcy had then become bankrupt as a private entrepreneur – a pattern that was already established at the turn of the century. Almost half of the former private entrepreneurs who had become bankrupt in that capacity, had started a joint-stock company before their next bankruptcy.

In a series of articles in *Dagens Industri*, (990610 and 11) the firms on the list of small firms, SBI, were scrutinized. Only every fifth firm had no board members that had been involved in a bankruptcy. In all, the board members of the firms on the SBI-list had been involved in 200 bankruptcies. One of the board members had been involved in 22 bankruptcies. One board of directors with ten members had been involved in a total of 27 bankruptcies. In second and third place were firms whose boards had been involved in 26 and 19 bankruptcies, respectively. The pattern with a small number of people being involved in a large number of bankruptcies was also found on another list of small firms.

Table 1
More than 6 000 persons have been involved in at least two bankruptcies

Joint stock company bankruptcies 1994-99	Number of persons	Number of persons currently on boards	Number of persons currently on boards. Percentage
1	33181	8340	25
2-4	5936	2085	35
5-10	401	171	34
11-20	55	23	42
21-50	18	9	50
51-90	5	3	60
Total	39596	10631	27

Source: The Business and Credit Information Agency UC, Sweden. Press Release from UC AB August 27, 1999.

Almost 60 % of the 27 firms quoted on the O-list at the Stockholm Stock Exchange, had board members who had been involved in bankruptcies. The most exact measure of the tendency of Swedish entrepreneurs go into bankruptcy can be found in a study made by Upplysningscentralen AB (UC AB). In the approximately 270 000 joint-stock companies that were registered in the UC database in June 1999, there were a total of 281 267 regular board members. At the same time, there were 10 400 persons who were on at least five boards and more than 1 900 who were on more than 10 boards (85% of whom were men).

More than 6 000 persons have been on the boards of at least two firms that have become bankrupt in the period 1994 – June 1999. 478 persons have been involved in at least five bankruptcies in the same period. Of those who have been involved in five bankruptcies or more, 98 % are men. Of those persons who had been on the board of firms that had become bankrupt, 27% were on boards of active firms in August 1999. According to UC, the risk that a firm will become insolvent is considerable if the managing director or a board member has been involved in several previous bankruptcies.

From table 1 it appears that 39 596 persons have been board members in the joint-stock companies that became bankrupt between July 1994 and June 1999. Board members who have resigned within six months of the bankruptcy are included. Of these 39 596 persons, 10 631 (27%) were registered as board members in active firms in June 1999, with an average of 2.4 appointments per person.

Today, bankruptcy can be a planned part of the strategy in certain lines of business dominated by small firms. Particular attention has been paid to so-called convenience bankruptcies. It is being claimed today that this use of the bankruptcy system constitutes a threat to entire lines of business, private ownership, the market economy and the democratic form of government.[9]

In the 1980’s, it became increasingly accepted for financially stressed firms in the US to negotiate a "prepackaged" bankruptcy (prepack), i.e., a reorganization plan negotiated out-of-court and subsequently approved under Chapter 11. In a similar fashion, claimholders of financially distressed firms in Sweden perform the financial restructuring out-of-court prior to filing for bankruptcy, a procedure according to Thorburn (1998), called auction prepack. An auction prepack is an agreement to sell a firm’s assets as a going concern either prior to bankruptcy filing or immediately upon filing. The agreement must be approved by floating charge claimholders (typically banks) and, subsequent to bankruptcy filing, by the bankrupt trustee. According to Thorburn, in Sweden, 25 percent of the going concern sales are auction prepacks in which the buyer negotiates the purchase of the firm’s assets prior to filing for bankruptcy. This rate of prepacks is similar to the rate reported for publicly traded firms filing for Chapter 11 in the U.S.

In Sweden, convenience bankruptcies are bankruptcies where the firm itself decides to enter into bankruptcy. It is the simplest way of clearing the firm of debt, with the aim of continuing its business in a new firm. This can be done in such a way that the firm, together with the bank where the firm has its credits, removes assets to a value corresponding to the owner’s creditor’s guarantee towards the bank. The transfer is most likely made at an excessive price rather than at a losing price. This conduct means that the other creditors in the firm that has transferred its assets to the new firm are left without any share. Most often, this befalls the state as the tax creditor and the suppliers who have remaining claims on the transferor. This conduct does not conflict with current Swedish legislation. It is evident, however, that this is in conflict with the basic idea of paying one’s way. In these cases, the bankruptcy system is used as a part in a link in a reconstruction procedure, which is not its real purpose.

A Change in the Way of Closing Down Swedish Business Firms?

In this part, the rate of failure of Swedish businesses is investigated. Several birth cohorts or generations of Swedish enterprises are studied. These generations of joint-stock companies were all established in the years 1899, 1909, 1921, 1932, 1940 and 1950. The period of observation is 1899 – 1999. The analysis comprises ten thousand business firms. By analyzing the proportion of bankruptcies in relation to total business mortality, it can be shown whether the use of bankruptcy has increased or decreased in the last century.

In this study, I use uninterrupted longitudinal series of data. This has the advantage that the so-called ”*survival bias*” which is common in other studies (for example in all studies made in retrospect) can be avoided.[10] The database contains six firm cohorts and is mainly based on information from different parts of the register of joint-stock companies and its supplements. Each cohort or generation consists of firms established at the same point in time. The analysis is based on information about a total of 2 019 Swedish joint-stock companies, collected by Box (1997 and 1998) and Gratzer (1992 and 1995). This includes all joint-stock companies established in Stockholm in a certain year, that is in 1899, 1909, 1921, 1930, 1942 and 1950.[11] All firms are followed until the 1990’s in this study. The results for cohort 1987 are preliminary. This cohort contains approximately 24 900 joint-stock companies. The population of firms thus consists of seven birth cohorts or generations of joint-stock companies, including all sizes and all lines of business.

Table 2
Life destinies of Stockholm joint-stock companies

Cohort	Voluntary liquidation	Bankrupt-cy	Merger	Early terminations	Existing firms	Other
1899	60	17	3	2	9	9
1909	53	24	2	4	11	6
1921	49	22	2	7	11	9
1930	46	21	5	6	14	8
1942	39	17,5	3	0,5	23	17
1950	30,5	22,5	4	1	22	20
1987	16	40	3	data missing	40	1

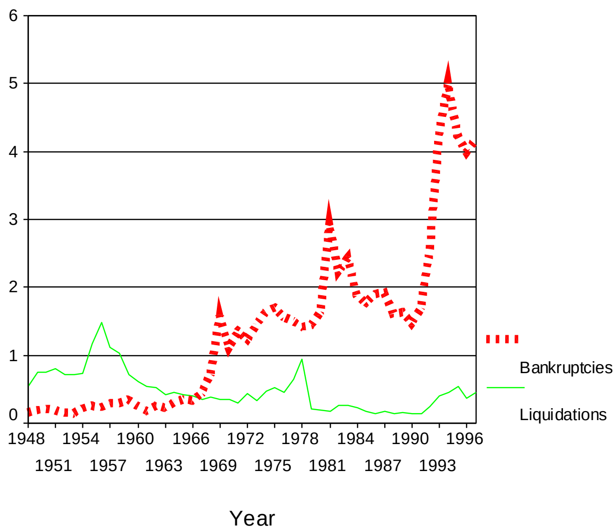
Source: Cohort Database on Swedish Joint-stock Companies (Gratzer & Box).

According to *table 2*, voluntary liquidation has been de largest individual cause for business mortality in the six eldest generations of firms. It was about 50 % for cohort 1909 and cohort 1921, respectively, and about 60% for cohort 1899. In the three youngest groups of firms, the number of voluntary liquidations decreased in steps to about 30 percent. On average, 22 percent of the firms became bankrupt. As appears from *table 2*, the number of bankruptcies varies somewhat between the six eldest cohorts, but never amounts to more than one fourth. The number of firms that survived until 1990 increased from 9 percent in cohort 1899 to 11 percent for the firms that were established in 1909 and 1921, respectively. The corresponding figures for the cohorts from 1930, 1942 and 1950 were 14, 23 and 22 percent.

The number of mergers among the cohort firms remained relatively constant and never exceeded 5 percent. The number of 'early terminations' (that is, firms that were closed down within one year) was at its highest in the crisis years 1921 and 1930 (no information is available for cohort 1987).

In cohort 1987, voluntary liquidations only constitute 16 percent. Bankruptcy has become the most usual way of terminating a firm in the youngest cohort. This implies a basic change in the way Swedish entrepreneurs terminate business. To test whether such a change has taken place and if so, when, data from the official statistics for the whole of Sweden are used once more.

Figure 2
Bankruptcies and voluntary liquidations as a percentage of the number of joint-stock firms in Sweden 1948-97



Source: Database on Bankruptcies (Gratzer)

Figure 2 shows the relation between the different ways of closing down a firm, liquidation (voluntary or by compulsory liquidation) and bankruptcy. The population is the number of joint-stock companies in Sweden 1948-97 (there is unfortunately no data for other types of firms). As appears from figure 2, until 1966, joint-stock companies mainly ceased to exist through liquidation (other ways of closing down firms are of no consequence in this context due to their low frequency). Then, there is a structural change in the pattern of closing down firms. Relatively, bankruptcy becomes an increasingly important way of closing down firms at the same time as total business mortality increases. With the aid of these longitudinal data, it can be established that there was a fundamental change in the way of closing down firms in Sweden in the mid 1960's. The final answer to the interesting question on why this change in behavior occurred can not be given here. A change in the tax regulations, intended for winding up companies, at the end of the 1950's probably played an important role.

The development of bankruptcies in Sweden, Germany and Austria

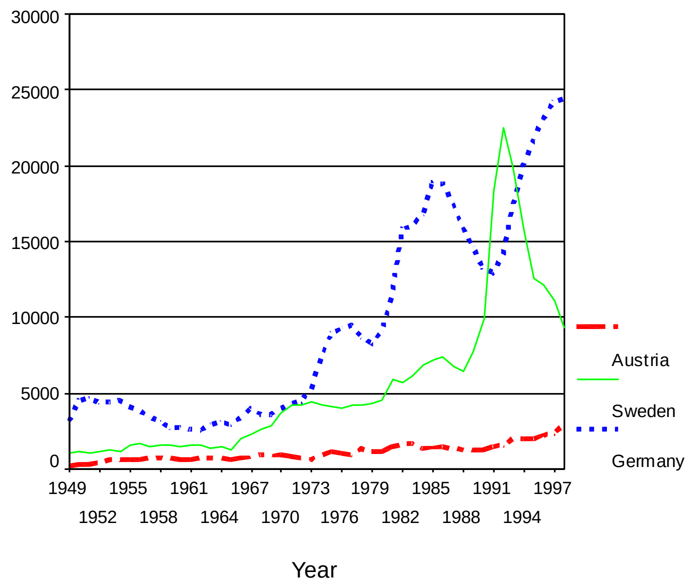
All legislations regulating insolvency must find an acceptable balance between the often contradictory interests of creditors, debtors and employees in the firms. The main interest of those creditors given priority can be assumed to first be to regain their claims, even at the price of the firm being closed down or sold piecemeal. They might gain from filing a bankruptcy petition against the firm as early as possible. Debtors and employees, on the other hand, can be expected to have a larger interest in preserving the firm and its business. The extent to which the authorities intervene in the bankruptcy process and what interests are protected through legislations are thus of great importance. Interventions can incur large direct and indirect costs for the parties involved. A distortion of competition, for example, might be due to the fact that a firm has benefited from aid in a financial reconstruction. If comparing the frequency of bankruptcies in different countries, we should account for how different legislative systems might affect the frequency of bankruptcies. The regulations of insolvency can very roughly be categorized on basis of the degree of intervention and the interests the Bankruptcy Act mainly aims at protecting, for example. [12]

Even if German legislation shows larger similarities with the Swedish one, there are differences. In the German Bankruptcy Act, suppliers have a stronger position than in the Swedish one. Reservation of ownership is respected, and the supplier can thus prevent delivered but non-paid goods from becoming part of a bankruptcy. Banks do not have the same advantage as in Sweden and are thus probably forced to take a larger responsibility for business relations entered into. In Germany, there is no floating charge.

The Austrian Bankruptcy Act contains no equivalent to Swedish priority rights (in the Swedish debate, these have been considered to promote bankruptcies). The Austrian system has therefore been described as the ”classless bankruptcy”.[13] The purpose of the Austrian insolvency practice is that the chances of survival for a firm in a financial crisis are put on trial. An intervention can be made since financial support and continued operation are facilitated during the ongoing investigation. In this way, bankruptcy can be avoided, while too optimistic and unrealistic attempts at clearance are prevented. The overall aim is that firms that are vital and can be cleared should be preserved. This intervention ”*das Vorverfahren*” either works as a completely independent procedure or as an initial procedure, which is then turned into an agreement. We can expect a lower frequency of bankruptcy in countries with a system of insolvency which safeguards the firms’ interests in survival and which uses early forewarning and reconstruction mechanisms. As appears from *figure 3*, Austria can be expected to have a lower frequency of bankruptcies than Sweden and Germany is somewhere in between. The absence of corporate mortgages and priority rights as well as the fact that banks must accept that stocks of goods and customer claims will benefit the suppliers in accordance with the reservation of ownership can be assumed to have an additional dampening effect on bankruptcies in these last two countries.

Sweden had a fairly stable development of bankruptcies between 1949 and 1965 (figure 3). Then, there was a considerable increase in the number of bankruptcies. In 1974-1977, 4 566, 4 305, 4 145 and 3 554 bankruptcies, respectively, were concluded. In this period, the so-called 5 000-kronor firms showed a strong increase. They were most likely formed for fiscal reasons. In 1973, the stipulated minimum amount for share capital was increased from 5 000 to 50 000 kronor. The number of new bankruptcies increased to just over 2000 in the following year.

Figure 3
The number of bankruptcies in Austria, Sweden and Germany 1949-1998



Source: The National Statistics Office of Sweden, Statistisches Bundesamt Deutschland, Kreditschutzverband von 1870 and Zentralamt für Statistik Österreich. *Wirtschaft und Statistik*. StBA. *Statistisches Jahrbuch*. Different Years.

1989 was the beginning of a very turbulent period. In the following years, the number of bankruptcies increased considerably and in 1992, they exceeded 22 000. Since the record year of 1992, the number of bankruptcies has decreased and in 1997, it was almost back at the level of the 1980's.

During the period of reconstruction after World War II, the number of cases of insolvency that were settled through bankruptcies was relatively large in Germany.[14] Until 1954, there was an average of 5 000 bankruptcies per year. From 1955, the bankruptcy frequency decreased. In 1962, only 2 786 bankruptcy petitions were filed to German courts. Despite the fact that the population in Germany is several times the size of the one in Sweden, the number of bankruptcies in Germany was only about 3000 a year in the 1960's. Also in Germany did the number of bankruptcies increase from the end of 1960's to 1985 (with the exception of the years 1978, 1979 and 1980). In 1985, the increase in bankruptcies reached its first peak of approximately 18 800 bankruptcies. Then, the frequency decreased until 1991. Germany shows a strong increasing trend between 1975 and 1998. Neither Sweden nor Austria are similar to Germany. In Austria, the number of bankruptcies has increased from a very low level in 1947 (20 bankruptcies) to approximately 2 000 in 1999. Despite the very strong increase in this period, the country still has a very low bankruptcy frequency – in both absolute and relative terms.

The high Swedish use of the bankruptcy system and the fairly abrupt change in the number of bankruptcies in all countries around 1970 makes it increasingly difficult to imagine that any individual variables might be the main explanation. Swedish and foreign studies find insufficient knowledge, experience and competency in the management to be the most frequent and important reasons for bankruptcy. (Gratzer and Box, 2000). If this explanation were sufficient, the trend might be interpreted as entrepreneurs in these three countries, and Sweden in particular, having become worse at management.

In order to get a broader perspective cross-section data on different countries will be used. In *table 3* the bankruptcy figures are compared to the total number of inhabitants. *Table 3* is based on the following data. The population data are estimates for 1998 and the business bankruptcy data are from the latest available year (in brackets).

Table 3 Business Filings per Million People

Nation	Population (millions)	Business Bankruptcy Filings	Filings per Million People
Switzerland (1996)	7.26	10541	1452
Sweden (1998)	8.89	8799	990
France (1997)	58.80	49568	843
Norway (1995)	4.42	3500	792
Germany (1998) (both West & East)	82.08	33977	414
Canada (1999)	30.68	10026	327
The Netherlands (1996)	15.73	4534	288
Austria (1998)	8.07	1929	239
U.K. (1998)	58.97	13868	235
Australia (1994)	18.61	4335	233
Japan (1998)	125.93	19171	152
U.S. (1999)	270.29	37884	140

Source: Administrative Office of the United States Courts; Australian Bureau of Statistics; Central Statistical Office of the United Kingdom; Institut National de la Statistique et des Études Economiques, France; Japan Statistical Yearbook 2000; Kreditschutzverband von 1870 Austria; The Netherlands Central Bureau of Statistics; Central Bureau of Statistics of Norway; Statistics Canada; Statistical Abstract of Sweden 1999; Statistisches Bundesamt, Germany; Statistisches Jahrbuch der Schweiz 1998; Zentralamt für Statistik Österreich.

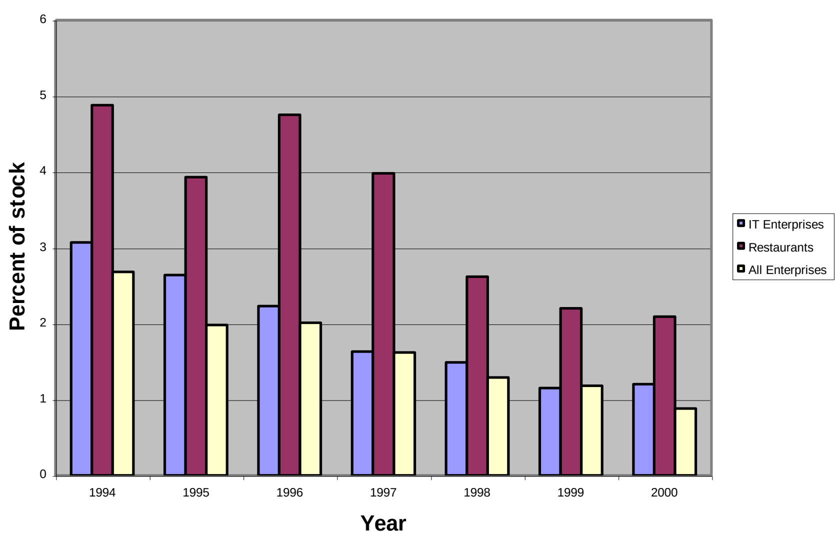
The data in *table 3* shows that Swedish entrepreneurs use the bankruptcy system to a larger extent than their colleagues in other countries except Switzerland. It turns out that U.S. entrepreneurs use bankruptcy the least of all which is unexpected with thought of what academics and journalists have said about the tolerance towards failure in these countries.

Bankruptcies and IT-firms

As appears from *figure 4*, the number of bankruptcies is overall (with exception of year 1999) somewhat larger for IT-enterprises than for all firms. This might be due to the fact that IT-enterprises are younger and smaller than the rest of the population of firms. Service firms are normally smaller than firms in the manufacturing industry, for example. The risk of firm death is often higher at low ages and small sizes than at higher ages and larger sizes. The liability of size and the liability of newness are overlapped and not separated in his study. Furthermore, the number of sole proprietorships is probably larger among other firms than among IT-enterprises. Sole proprietorships and private firms are underrepresented amongst bankrupt firms. In *figure 4*, IT-enterprises are being compared to a more traditional line of business - restaurants. During the entire period, catering enterprises have a considerably higher share of business failures. The assumption that the new economy is characterized by a larger number of business failures has not been confirmed here.

Figure 4

Bankruptcies, IT-Enterprises, Restaurants and All Enterprises



Source: Statistics Sweden.

Results and discussion

The results as concerns business failures presented in this study provide a more varied picture than what has emerged from debaters in economic reviews and in Swedish and European agencies of inquiry. According to a widespread view, business failures are considered as stigmatizing in European countries, which might be due to the fact that they are mainly explained by insufficient management competency as concerns enterprising. For this reason, bankruptcies have been considered as something shameful, something not to be talked about and something one would rather forget. This view is no longer considered to be valid within the so-called new economy.

Advocates of the new economy argue that in this new world of rapid technological change, old concepts of failure have become irrelevant. In this context, debaters and agencies of inquiry in Sweden and the EU have claimed that the Swedish and the European culture, respectively, have been less tolerant to business failures that the American culture. In Sweden, it has been considered to be more difficult to start anew as an entrepreneur after a failure than in the US. According to the debaters, in the US, it is considered as a merit for entrepreneurs to have gained this experience. They are not afraid of failures which they consider as a natural part of a learning curve.

Empirical results show that the share of business failures in Sweden has exceeded the share in the US during the entire period of 1927-1997. The number of failures increased in both countries during the period studied, but the increase in Sweden was larger in both absolute and relative terms. It is more common that Swedish entrepreneurs fail than American ones. It must be emphasized that there is still no empirical evidence given to the statement that entrepreneurs learn more through mistakes and failure than through success.

Despite the absence of systematic studies, the available information indicates that the tolerance towards those who became bankrupt was high in Sweden already around the 1880's. There is no evidence that it is easier to start anew as an entrepreneur in the US after a bankruptcy. There is also no evidence that bankruptcy has been a stigma in Sweden and constituted an obstacle to continued enterprising. On the contrary, joint-stock companies and the wording of the legislation on bankruptcy have made it possible for Swedish entrepreneurs who want to stretch the limits of the rules of the game to shift debts onto creditors.

A structural change in the pattern of closing down firms, probably caused by a change in tax regulations intended for winding up companies, occurred in the mid 1960's. Relatively, bankruptcy becomes an increasingly important way of closing down firms at the same time as total business mortality increases. This increase cannot be connected to the new economy, since its breakthrough in Sweden took place in the 1990's. The number of business failures is not significantly higher for IT-enterprises as a whole than for all other firms. There is, however, a traditional line of business that shows the characteristics attributed to actors in the new economy. Catering enterprises (restaurants) have a considerably higher share of business failures than all firms and IT-enterprises. Swedish entrepreneurs also use bankruptcy as a way of terminating business to a larger extent than their colleagues in Germany and Austria.

A closer analysis of the entire business mortality in Sweden shows that the number of bankruptcies has increased in the twentieth century. There is no empirical evidence of the view that the Swedish culture is less tolerant to business failures than the American culture. The results from the comparison with Germany and Austria also indicate that Sweden rather has too large a number of bankruptcies and not too few. Sweden is on the way towards a remarkable record. Swedish entrepreneurs hold a leading position among those who lead the bankruptcy league. These results make it even more difficult to imagine that any individual factor might be the explanation. If such an explanation were sufficient, the trend might be interpreted as entrepreneurs in these four countries, and Sweden in particular, having become worse at management. The role that has earlier been attributed to "competency" has been toned down and already existing doubts as concerns the scope of microentrepreneurial "traits" explanations are further emphasized. The difference in institutions as compared to the other countries seems to be the main explanation of the higher share of business failures in Sweden. Finally there is no empirical evidence that the relatively low level of entrepreneurial activity in Sweden can be explained by negative attitudes to failure. There is therefore every reason to make a closer study of the relations between business failures and macroeconomic, socio-cultural, institutional and moral factors.

If there is a difference between Swedish and American attitudes towards business failure, it is probably much more complex and subtle than the generalization that failure is seen as seeing a part of a learning process and even a merit in the U.S. but the end of the road for Swedish businessmen.

NOTES

[1] Entrepreneurs who have failed have not shown an interest in documenting their failures in detail. The statistics on bankruptcies are hardly of any use for answering questions about the extent and the causes of business failures. The statistics do usually not contain information about the size of the deficit and the age of the firms that become bankrupt.

[2] For discussion se even Larson and Clute, 1979; Fredland and Morris, 1976.

[3] According to a study by Statistics Sweden, only 7% of the small entrepreneurs stated profits as the reason for establishing their firm. The chance to work independently and realize ones ideas constituted 50% of the motives. Cited in *Nyföretagande i förändring (NewFirms in Change)*, NUTEK B 1993:9, p. 17.

[4] In the U.S. there are four kinds of bankruptcy proceedings. They are referred to by the chapter of the federal Bankruptcy Code that describes them. Chapter 7 is the most common form of bankruptcy. It is a liquidation proceeding in which the debtor's non-exempt assets, if any , are sold by the Chapter 7 trustee and the proceeds distributed to creditors according to the priorities among creditors established in the Code. Chapter 7 is available to individuals, married couples, corporations and partnerships. Individual debtors get a discharge within 4-6 months of filing the case. Chapter 11 is a reorganization proceeding, typically for corporations or partnerships. Individuals, especially those whose debts exceed the limits of Chapter 13, may file Chapter 11. In Chapter 11, the debtor usually remains in possession of his assets and continues to operate any business. The debtor proposes a plan of reorganization which, upon acceptance by a majority of the creditors, is confirmed by the court and binds both the debtor and the creditors to its terms of repayment. Plans can call for repayment out of future profits, sales of some or all of the assets, or a merger or recapitalization. Chapter 12 is a simplified reorganization for family farmers, modeled after Chapter 13, where the debtor retains his property and pays creditors out of future income. Chapter 13 is a repayment plan for individuals with regular income and unsecured debt less than $269,250 and secured debt less than $807,750. The debtor keeps his property and makes regular payments to the Chapter 13 trustee out of future income to pay creditors over the life of the plan (3-5 years). The level of repayment provided for in the Chapter 13 plan can range from 10% to 100% depending on the debtor's income and the make up of the debt.

[5] *Business Failure and Entrepreneurship in the United States*. A report prepared on behalf of EIM International by MICRONOMICS, Inc. Economic Research Consulting, September 20, 1998.

[6] As an example, in 1815 several trading houses in Stockholm suspended their payments. According to the standards of those times, the losses were enormous. Usually, the debtor could not repay these sums in his lifetime. The debts usually exceeded the assets also in the estate of the deceased.

[7] "As concerns false bankruptcies, which is one of the most terrible crimes in the area of stealing, it is well-known how the law can be avoided".

[8] For a discussion of the terms, see Martinsson, C. "Från casusperspektiv till culpaperspektiv i obeståndsrätten" ("From a Casus Perspective to a Culpa Perspective in the Insolvency Legislation") in Gratzer, K & Sjögren, H, 1999, pp. 376-89.

[*] area in the south of Sweden.

[9] See "Företagsstrategi: Gå i konkurs och bli en vinnare" ("The Strategy of Firms: Go Bankrupt and Become a Winner") in *Veckans affärer* 1991:37, pp. 37-38 and "Tuffare tag väntar mot ekobrott" ("Harder Measures to be Taken against Economic Crime) *Dagens Nyheter*, January 27, 1994.

[10] In many studies, there is a selection of firms that have survived the selectional process in the first years. In particular, this applies to retrospective studies where the researcher follows a selection of firms back in time. Despite the fact that the elimination of firms is most intensive in the first years, the consequences of such an approach are seldom discussed.

[11] The cohorts consist, in turn, of 105, 201, 350, 452, 407 and 504 firms.

[12] For discussion se *The European Observatory for SMEs*. Fourth Annual Report (1996).

[13] The "classless bankruptcy" was introduced in Austria through a reform in 1982. All general priority rights were abolished, among these the priority rights of the state as concerns tax claims and the priority rights of employees as concerns salaries, SOU 1992:113 and SOU 1999:1.

[14] Here, Germany is only considered to include areas that were part of the BRD, that is, West Germany at that time.

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