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FINANCIAL CONSTRAINTS AND MODES OF MARKET EXIT IN SLOVENIAN MANUFACTURING AND SERVICE FIRMS

Abstract:

The recent financial and economic crisis has brought back the attention to studying the characteristics of surviving firms and those exiting the market. Among these characteristics the access to finance has received large attention, since the economic crisis decreased the availability of finance and increased its costs. Further, literature from industrial organization, entrepreneurship and strategic management all show that factors behind different types of firm exit decisions, such as bankruptcy, voluntary liquidation, mergers and acquisitions (M&A) differ.

Our paper studies factors that influence the firm’s decision to exit the market by explicitly considering alternative firm exit modes. Our competing risk models are estimated with a standard multinomial logit model and the alternative multinomial probit model on the population of Slovenian firms in 2006-2012. We distinguish between (1) court driven exit as a result of bankruptcy or forced liquidation; (2) voluntary liquidation, (3) disappearances from the dataset as a result of mergers and acquisitions, and (4) termination based on a resolution/decision of the registration agency or according to the law. We argue that decision over whether to close down a business or to sell out to another company is influenced by financial constraints, firm specific characteristics (size, age, productivity, capital intensity), and industry factors. The paper tests whether different facets of financial constraints and other firm and industry level characteristics hold different degrees of relevance for alternative routes of the firm operations termination. In measuring financial constraints as antecedent to an exit event, we propose the exploratory factor analysis and derive to three dimensions of the financial constraint measure, i.e. liquidity, operational-efficiency factor, and profitability factor and in this way contribute to the financial constraints literature.

We contribute to the firm exit literature by showing that court-driven exit, voluntary liquidation and M&A follow diverse exit routes driven by different firm level and industry characteristics. We find that the main difference between bankrupt and liquidated firms is that the choice of exiting through voluntary liquidation is characterized by economic distress while firms choosing to exit by bankruptcy are firms in financial and economic distress. Economically distressed firms have bad prospects because of low or negative profitability and little opportunity for improvement. The main characteristic of financially distressed firms is high leverage level causing problems in repaying debts. Firms that decided to exit by M&A usually have profitability problems, but are not financially distressed.

Keywords:

firm exit, financial constraints, bankruptcy, liquidation, merger and acquisition (M&A)

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