Bankruptcy law will chill entrepreneurship

By JEFFREY FREEDMAN

Being an entrepreneur has always been a high-risk business, but as of Oct. 17, 2005—when the new bankruptcy reform law takes effect—it will be even riskier. This bill removes a safety net for entrepreneurs who may have a business fail through no fault of their own. And this new vulnerability for small business could have a significant negative impact on our economy because there are many more bankruptcies filed by small business than the government acknowledges.

Harvard Law School professor Elizabeth Warren and Robert Lawless, a law professor at the University of Nevada, Las Vegas, recently completed a study funded by the Ewing Marion Kauffman Foundation that showed bankruptcy filings connected to failed small businesses, independent contractors and self-employed individuals are severely underreported.

According to the study published in the *California Law Review*, owners of small businesses file an estimated 260,000 to 315,000 bankruptcies each year. The government reports only 37,000 business bankruptcies annually.

Lawless says the underreporting is due to computer software the bankruptcy courts began to use in the mid-1980s. A change in the forms filed by attorneys reclassifies entrepreneurs as consumer cases instead of business cases. Only corporations and other legal business entities are counted as business bankruptcies by the government.

The Kauffman study indicates that 19.5 percent of consumer bankruptcy filings are actually related to a failed business.

Statistics compiled by Dun & Bradstreet and the U.S. Small Business Administration back up the findings of the study. Where the government reports a drop in business filings since the mid-1980s from 18 percent of the total cases filed to 2 percent of total cases filed, D&B and the SBA report significant increases.

The differences in the numbers is surprising, Lawless says, but what is even more surprising is how long it took to discover there was such a disconnect between government figures and reality. He adds that the fact our senators and representatives voted on a bill that will have huge impact on small businesses based on misinformation is disturbing—to say the least.

This new information also shows the commonly held belief that the high rate of bankruptcy filings is due to irresponsible consumer spending is a major misconception.

The new bankruptcy legislation (HR 256, Pub. Law 109-8), which institutes a tough means test and increased costs related to filing, will make it more difficult for consumers —and entrepreneurs—to file bankruptcy.

Carl Schramm, president and CEO of the Kauffman Foundation, which is a leader in the advancement of entrepreneurship, is concerned this could seriously affect the economy by discouraging entrepreneurs to start new businesses. And most new jobs are created by businesses that are less than 3 years old.

"We need to appreciate the enormous risks that entrepreneurs take on, and the number of times many of them must try, fail and try again until they hit the right idea at the right moment," Schramm says.

Entrepreneurs who cannot afford to protect themselves by forming corporations will be thinking twice about taking on personal liability for the businesses they start.

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