

Contract Completeness of Company Bylaws and Entrepreneurial Success

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in progress!

Motivation

- Theory assigns a key role to **financial contracts** in entrepreneurial success
 - ▶ Allocation of cash-flow rights and control rights to mitigate agency problems
- Real-world contracts may need to be **complex** (Kaplan and Stromberg 2003)
 - ▶ Complex contracts may foster performance
 - ▶ May also increase risk of mistakes and exploitation of biased entrepreneurs (Landier and Thesmar 2009)

This paper

1. Do entrepreneurs write **complex contracts** with their financiers?

▶ Beyond VC-backed firms

2. What is the impact of more complete financial contracts on **entrepreneurial success**?

This paper

1. Do entrepreneurs write complex contracts with their financiers?
 - ▶ Beyond VC-backed firms
 - ▶ Analyze bylaws of the universe of French startups 2003–2013 (in progress)
2. What is the impact of more complete financial contracts on entrepreneurial success?
 - ▶ Study a reform that reduced the cost of writing more complete bylaws (some results)

Restricted bylaws vs. Flexible bylaws

- French entrepreneurs choose between two legal forms
 - ▶ **SARL** imposes boilerplate bylaws (**restricted bylaws**)
 - ▶ **SAS** allows for customized bylaws (**flexible bylaws**)
 - ▶ Same taxes. Same regulations after 2008 reform

	SARL (restricted bylaws)	SAS (flexible bylaws)
Multiple share classes	Not allowed.	Allowed.
Sales of shares	Required shareholders approval. Bylaws specify majority rule, but at least 2/3 and less than unanimity.	May be freely tradable or subject to any customized constraints and approval.
Governance	One or several managing directors.	May have board of directors, supervisory board, executive committee, etc. Customizable rules. Only requirement: CEO.
Voting	One share-one vote.	Customized voting rights and majority rules.

Road map

1. Do entrepreneur write complex contracts?
2. Impact on entrepreneurial success

Data

- Bylaws of every company started in France over 2003–2013 downloaded using government API
- 1.2 Mns pdfs
- 60k startups per year
- 2 documents per firm on average (incl. updates of bylaws)

Exemple – Mas de Grille

ARTICLE 1 - Forme

La Société est une Société par actions simplifiée régie par les dispositions légales applicables et par les présents statuts.

Elle fonctionne indifféremment sous la même forme avec un ou plusieurs associés.

Elle ne peut faire appel public à l'épargne sous sa forme actuelle de Société par actions simplifiée.

Elle peut émettre toutes valeurs mobilières définies à l'article L 211-2 du Code monétaire et financier, donnant accès au capital ou à l'attribution de titres de créances, dans les conditions prévues par la loi et les présents statuts.

ARTICLE 2 - Dénomination sociale

La dénomination sociale est :

MAS DE GRILLE

Sur tous les actes et documents émanant de la Société, la dénomination sociale doit être précédée ou suivie immédiatement des mots «Société par actions simplifiée» ou des initiales «S.A.S.» et de l'énonciation du capital social.

ARTICLE 3 - Siège social

Le siège social est fixé :

Zone Industrielle les Trouyaux 34560 POUSSAN

Il peut être transféré en France métropolitaine par décision du Président qui est habilité à modifier les statuts en conséquence ; et partout ailleurs par décision des associés.

ARTICLE 4 - Objet

La Société a pour objet directement ou indirectement, tant en France qu'à l'étranger :

L'acquisition, la création, la gestion et l'exploitation sous quelle forme que ce soit de tous fonds de commerce d'hôtellerie, de restauration, de débits de boissons, préparations de plats à emporter.

Example – Mas de Grille

Article 1: Legal form

*“The Company is a **simplified joint stock company [SAS, flexible bylaws]** governed by the applicable legal provisions and by these bylaws.*

It operates indifferently in the same form with one or more shareholders.

It may not issue shares to the public in its current form as a simplified joint stock company.

*It may issue **any securities** as defined in Article L 211-2 of the French Monetary and Financial Code, **giving access to capital or the allocation of debt securities**, under the conditions provided for by law and these bylaws.”*

Article 4: Purpose

*“The purpose of the Company is the acquisition, creation, management and operation, in any form whatsoever, of all **hotel, restaurant, beverage and takeaway businesses**.”*

The Originals City, Le Mas De Grille, Montpellier Sud

458 reviews

#3 of 9 hotels in Saint-Jean-de-Vedas

93 Rue Theophraste Renaudot, 34430 Saint-Jean-de-Vedas France

[Write a review](#)



[View all photos \(175\)](#)

Example – Mas de Grille

Article 7: Capital

“The share capital is set at 40,000 euros, divided into:

- 3,000 Class A shares with a par value of 10 euros allotted to SARL AUBRAC HOTEL*
- 1,000 Class B shares with a par value of 10 euros allotted to Mr Christian Dalle”*

Example – Mas de Grille

Differential shares selling rights

- Approval:

“Class A shares are freely transferable.”

“Class B shares may only be transferred to third parties with the approval of Class A shareholders.”

- Preemptive rights:

“Each shareholder has a preemptive right to the Class B shares to be sold.”

- Tag-along rights:

“If one of the shareholders intends to sell all or part of its shares to a third party, thereby reducing its ownership share to less than 5% (...), the selling shareholder must allow the other shareholders, if they so wish, to sell their shares under the same conditions and in the same proportions.”

Example – Mas de Grille

Article 23: Majority rules

*“Quorum: (...) **at least half of the Class A shares** (...)”*

*“In order to be approved, any decision must receive both **two-thirds of** the votes of the shareholders present or represented and owning **Class A shares, and two-thirds of** the votes of the shareholders present or represented and owning **Class B shares.**”*

Example - Mas de Grille

Article 30: Distribution of earnings

“(...) Class A shares are entitled to a cumulative preferential dividend limited to 100,000 euros. Once the cumulative preferential dividend has been paid, Class A shares and Class B shares will be entitled to the same dividend. (...)”

Summary statistics (in progress)

- Before the 2008 reform, 5% of entrepreneurs opt for the flexible bylaws legal form
- Among them:
 - ▶ 10% issue multiple classes of shares
 - ▶ 5% have no restrictions, no required approval on sales of shares
 - ▶ 50% have a lockup period on the sales of shares. Average length 4 years
- In progress: NLP to detect additional provisions in bylaws

Road map

1. Do entrepreneur write complex contracts?
2. Impact on entrepreneurial success

Ideal experiment

- Q: Does the possibility to write more complete contracts foster entrepreneurial success?
- Ideal experiment: compare firms that can write complex contracts to firms that can't
- Our experiment: a reform that reduced the cost to start a SAS (flexible bylaws) relative to a SARL (restricted bylaws)

The 2008 reform

The 2008 Economy Modernization Act reduced the costs of flexible bylaws and aligned them on restricted bylaws firms:

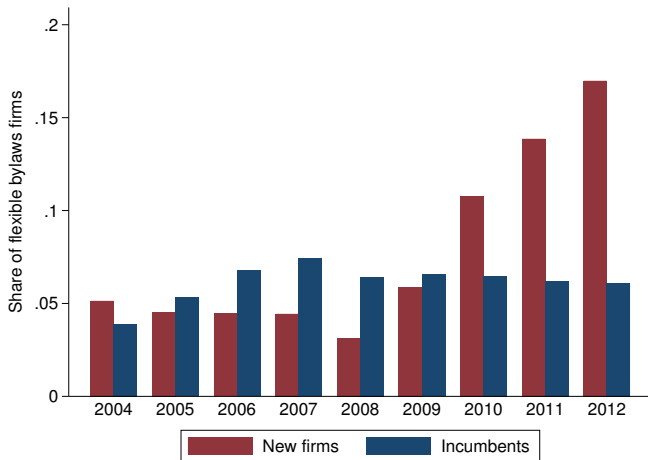
1. Minimum equity requirement

- ▶ Before: minimum equity of 37 k€ to start a flexible bylaws firm vs. 1€ for a restricted bylaws firm
- ▶ After: 1€ for both
- ▶ Pre-reform requirement was binding: 4 years after the reform, 90% of flexible bylaws firms are started with equity <37 k€

2. Reduced taxes on capital gains for flexible bylaws firms

3. Relaxed audit requirements for flexible bylaws firms

Adoption of flexible bylaws legal form



Adoption of flexible bylaws legal form

- Large take-up of flexible bylaws by new firms
- No take-up by incumbents
 - ▶ Organizational inertia, legal costs
 - ▶ Consistent with literature (MacKie-Mason 1994, Giroud and Rauh 2018, Matray 2023)

⇒ Use incumbents as control group

Data

- Administrative data from Statistical Office and Ministry of Finance
 - ▶ Business registry: startup date, legal form
 - ▶ Corporate tax filings: annual financial statements
 - ▶ Payroll tax filings: worker-level occupations, wages and demographics
- Main sample
 - ▶ SARL and SAS, 2004–2012
 - ▶ New firms
 - ▶ Incumbents aged 5-10

Isolating the effect of flexible bylaws

- The reform makes some firms choose flexible bylaws (**marginal firms**)
- But it also reduces costs for firms that would have chosen flexible bylaws anyway (**inframarginal firms**)
- Average firm outcome in sector j :

$$\Delta \text{Firm outcome}_{j, Pre \rightarrow Post} =$$

$$\underbrace{\beta \times \Delta \text{Share of flexible bylaws}_{j, Pre \rightarrow Post}}_{\text{Effect of flexible bylaws on marginal firms}} + \underbrace{\gamma \times \text{Share of flexible bylaws}_{j, Pre}}_{\text{Effect of removing requirements on inframarginal firms}}$$

Specification

$$Y_{i,j,t \rightarrow t+3}^k = \beta \text{ Exposure}_j \times \text{Post}_t + \alpha_j + \delta_{j_2,t} + \gamma X_{i,t} + \epsilon_{i,j,t}$$

- $Y_{i,j,t \rightarrow t+3}^k = 1$ if firm i , in sector j , started in year t , is in the top $k\%$ of the distribution of firm outcome in year $t + 3$
- Exposure_j : Δ share of flexible bylaws firms $_{j, \text{Pre} \rightarrow \text{Post}}$
- Post_t : Year ≥ 2009
- α_j : 5-digit sector FE
- $\delta_{j_2,t}$: 2-digit sector \times year FE
- $X_{i,t}$: pre-reform share of flexible bylaws firms \times Post

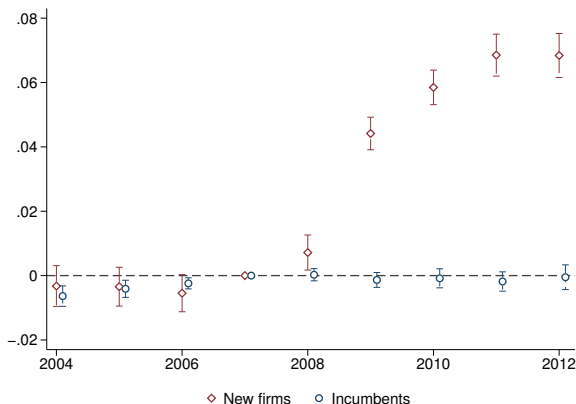
Threat to identification

- Change in sector-level share of flexible bylaws could be correlated with sectoral shocks
- Solutions:
 1. Pre-reform parallel trends
 2. Compare new and incumbent firms in the same 5-digit sectors
 - ▶ Incumbents (aged 5-10) are exposed to the same sectoral shocks, but not to the reform

First stage: Flexible bylaws adoption

- Higher take-up in more exposed sectors ← mechanical
- No pre-trend & no effect on incumbents ← not mechanical

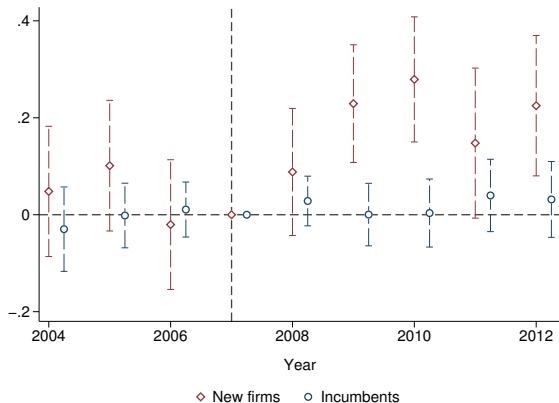
$Y = 1$ if flexible bylaws legal form
Coefficient on $Exposure_j$



Second stage: Fixed assets

New firms: $Y = 1$ if top 20% of fixed assets in year $t + 3$

Incumbents: $Y = 1$ if top 20% of fixed assets growth from t to $t + 3$



Magnitudes

- Coef. on triple interaction $Exposure_j \times Post_t \times NewFirm_i$: 0.14**
- $Exposure_j$ scaled by first stage coef \Rightarrow IV interpretation
- Flexible bylaws increase the probability of reaching the top quintile of fixed assets by 14 pp (i.e., +29% given baseline proba is 48%)
- The effect is concentrated in top quantiles
 - ▶ Probability of reaching p50 increases by 5 pp
 - p66 16** pp
 - p75 18** pp
 - p80 14** pp
 - p90 18*** pp

Other results

- Effect at 3-year horizon comes from both larger size at entry and higher post-entry growth
- Employment increases
- Sales increase
- Equity issuance increases

Preliminary conclusions

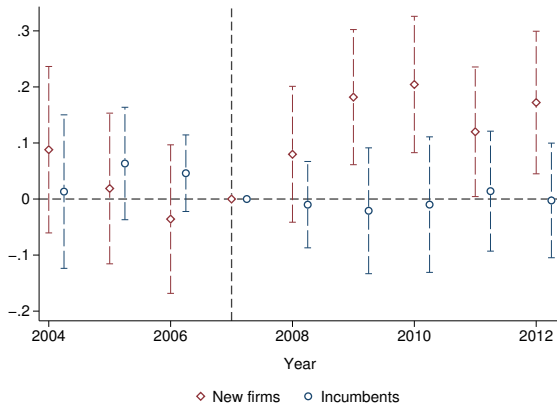
- Entrepreneurs beyond VC-backed ones use complex contracts
- It seems to foster entrepreneurial success

... and next steps

- Does contract complexity increase after the reform?
- Which contract features are associated with entrepreneurial success?
- ...

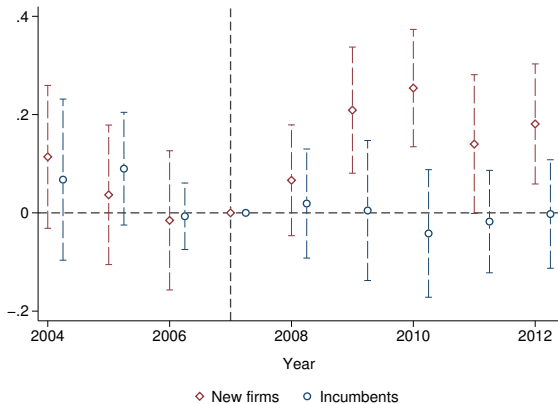
Employment

Top 20% of total wage bill (growth for incumbents)



Sales

Top 20% of total sales (growth for incumbents)



Size at entry vs. Post-entry growth

Panel A: Size at entry.						
<i>Dependent variables:</i>	Pr[$K_{t+1} > p80$]		Pr[$L_{t+1} > p80$]		Pr[$Y_{t+1} > p80$]	
<i>Sample:</i>	New firms	All	New firms	All	New firms	All
	(1)	(2)	(3)	(4)	(5)	(6)
Exposure×Post	0.14*** (0.046)		0.24*** (0.049)		0.11** (0.047)	
Exposure×Post×New firm		0.19*** (0.053)		0.21*** (0.058)		0.15*** (0.048)
Panel B: Post-entry growth.						
<i>Dependent variables:</i>	Pr[$\Delta K_{t+1 \rightarrow t+3} > p80$]		Pr[$\Delta L_{t+1 \rightarrow t+3} > p80$]		Pr[$\Delta Y_{t+1 \rightarrow t+3} > p80$]	
<i>Sample:</i>	New firms	All	New firms	All	New firms	All
	(1)	(2)	(3)	(4)	(5)	(6)
Exposure×Post	0.10** (0.044)		0.26*** (0.042)		0.040 (0.043)	
Exposure×Post×New firm		0.14*** (0.056)		0.18*** (0.044)		0.071 (0.057)