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The Law Businessman and the Trade Credit Decision

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Abstract

This study analyzes the impact of private and public order institutions on the provision of trade credit in Russia. It shows, ceteris paribus, that managers' perception of their own ability to use legal terminology and their perception of lawyers' effectiveness in the solution of commercial conflicts have a significant impact on the provision of trade credit to clients. The perception of the effectiveness of commercial courts and law enforcement has little or no impact at all on the provision of trade credit. 246 managers in three towns in northwest Russia participated in the survey. The results propose that internal legal determinants in the form of legal consciousness better explain provision of trade credit than do external legal determinants in contrast to current theory. This observation suggest that human legal capital has unexploited potential for explaining financial transactional behaviour.

Keywords: Legal self-efficacy, self-efficacy, self-concept, lawyers, legal consciousness, trade associations, courts, law enforcement agencies, trade credit, Russia, contract enforcement mechanisms.

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This study compares private and public order contract enforcement mechanisms and their effect on the managers' trade credit decision in Russian enterprises. It shows that human legal capital both in the form of managers' legal self-efficacy and their appreciation of lawyers' ability to solve commercial conflicts have an impact on the trade credit decision that is equal to or greater than the public order mechanisms of courts and law enforcement. The paper also adds to the theory of law and finance in that it surveys the issue of external funding of enterprises from a legal consciousness perspective and compares it to external legal institutions. It is also a reaction and
comment to McMillan and Woodruff’s (2000) study that surveys various mechanisms of private order in Eastern Europe.¹

Previous research by Jörgensen & Svanberg (forthcoming) has demonstrated a strong positive and significant correlation between legal self-efficacy and the use of sanctions against other firms. The purpose of the study is to test the impact of human legal capital on contracting; legal self-efficacy and the perception of lawyers in comparison to other common mechanisms of contract enforcement. This paper tests five mechanisms that support contractual assurance on trade credit of Russian managers. The mechanisms are divided into two groups, the first one is private order mechanisms; legal human capital in the form of legal self-efficacy, and the perception in lawyers’ ability to solve commercial conflicts. The third factor in this category is social network capital in the form of trade associations. The second group is that of public order mechanisms; the perception of effectiveness of courts and that of law enforcement agencies on the trade credit decision of Russian enterprises.

Law as a means of communication – coined legal self-efficacy in doing business is at least as important for reducing transaction costs for enterprises as the institutions of private and public order, such as trade associations, law enforcement, and courts. Legal self-efficacy is used as a measure of legal capital of the individual. It’s an application of Torpman and Jörgensen’s (2005) and Jörgensen & Svanberg (forthcoming) new theory of legal efficacy.² According to this definition of legal efficacy individuals tend to accept legal communication if they believe they comprehend it and feel at ease with legal terminology. Laymen’s use of law diverges from that of professionals. Professionals are familiar with the exact phrasing of laws. Laymen on the other hand structure their relationships with their private and often confused understanding of abstract concepts, i.e. rights, debts, contract, and property. Knowledge of legal concepts makes communication with them more likely and consequently law will be more frequently referred to. According to the definition of legal efficacy of Torpman and Jörgensen (2005), which can be referred to as the “application perspective” on legal efficacy, law is effective when users feel confident in their ability to use legal terminology and in the acceptance of the communication as law. Businessmen who have a high level of legal self-efficacy are labelled law businessmen. Almost all businesses in Russia receive trade credit.

Trade credit is the single most important source of external financing of Russian firms. 51 percent of total debt by Russian firms (23 percent of firms’ total assets) is in the form of trade credit. 97 percent of all Russian enterprises receive trade credit from their suppliers. Yet only 41 percent of firms report having bank credit. Even among the enterprises that have bank loans, it is only the second most important source of credit after trade credit.³ The trade credit decision is affected by many firm specific factors, the most cited being information asymmetry – suppliers

¹McMillan, J., Woodruff, C., (2000) “Private Order under Dysfunctional Public Order” Michigan Law Review 98(8) p. 2421-2458. This study surveys various mechanisms of private order contractual assurance mechanism with the aim of finding out if and how private order mechanism can act in the place of a faulty public order in five former Soviet republics and Eastern Europe. They find that social networks, such as a trade association, and informal gossip substitute for the formal legal system, while business networks and trade associations work in conjunction with the formal legal system.


know more about their client enterprises than other lenders, such as banks. Other cited factors are price reduction as a measure to stifle competition, and the maintenance of a beneficial corporate image. Only a handful of studies have looked at the determinants of supply of trade credit in developing countries. The factors that affect managers’ trade credit decisions in Russia have not received a lot of research attention. One study concludes that the quality of courts has an impact on the trade credit; however the effect is more significant on bank finance. The research field of law and finance, which studies the relationship between legal systems and the external financing of enterprises, has received increasing attention. Individual human perception

4 Cheng, N.S., Pike R. (2003) “The Trade Credit Decision: Evidence of UK Firms”, Managerial and Decision Economics 24 (6-7) p. 419-438. Schwartz R.A., Whitcomb, D.K. (1979). The trade credit decision. In Handbook of Financial Economics. Bickler J.L. (ed.) North-Holland: Amsterdam, 257-273. Other factors include the financing motive; trade credit can be considered an interest free loan, for which the monitoring costs are lower than for banks. Especially if the seller is wealthy and buyer has poor financing this motive becomes especially strong. Very wealthy entrepreneurs don’t need trade credit, and the conditions for granting of trade credit to very poor entrepreneurs are similar to that of the granting of bank credit. Meltzer, A. H., (1960), “Mercantile Credit, Monetary Policy, and Size of Firms”, The Review of Economics and Statistics, 42(4) p. 429-37. Suppliers may lend more liberally than banks, since it is less lucrative for an opportunistic borrower to reroute direct inputs than to divert cash. This is true especially in countries with an imperfect legal protection of creditors, since trade credit loses its advantage since it becomes as difficult to divert cash as to redirect trade inputs. Perhaps this is why trade credit is relatively more prevalent in countries with worse legal institutions. Burkart, M., Ellingsen, T., Giannetti, M. (2004) “What You Sell is What you Lend? Explaining Trade Credit Contracts” Stockholm School of Economics Working Paper. This study shows that ceteris paribus, service suppliers offer as much trade credit as suppliers of differentiated goods and significantly more than suppliers of standardized products. It also shows that the most important product characteristic for explaining trade credit contracts is the ease with which the input can be diverted. Demirguc-Kunt, A., V. Maksimovic, et al. (2002). Firms as Financial Intermediaries: Evidence from Trade Credit Data. World Bank Working Paper. The investment motive: receivables, such as trade credit, should be treated as an investment rather than a passive consequence for sales. Copeland and Khoury (1980) “A Theory of Credit Extensions with Default Risk and Systematic Risk”, The Engineering Economist, 26(1), p. 35 – 52. It signals an intention from the seller to keep an on-going relationship with the customer. It also allows the seller to invest in the buyers business to this end. It signals an intention from the seller to keep an on-going relationship with the customer. It also allows the seller to invest in the buyers business to this end. Finally there are marketing and competitiveness motives behind the granting of trade credit. Trade credit forms a part of a package deal, which stimulates demand. The lengthening of trade credit can also be considered a price reduction, and when competition is strong, the granting of trade credit can be considered a tool for competition with other similar sellers. Finally, trade credit can be seen as a part of keeping a beneficial corporate image (Cheng and Pike 2003).

5 Johnson, S., J. McMillan, and C. Woodruff (1999) “Contract Enforcement in Transition,” CEPR Discussion Paper No. 2081. This paper shows that firms that have more confidence in courts are more willing to extend trade credit to customers. Fisman, R., Raturi, M. (2003) Does Competition Encourage Trade Credit Provision? Evidence from African Trade Credit Relationships, NBER Working paper 9659. This study examines the relationship between monopoly power and credit provision, using data on the supply relationships of firms in five African countries. It finds that monopoly power is negatively associated with credit provision. Fafchamps, M. (1996). “The enforcement of commercial contracts in Ghana.” World Development 24: 427-48. The paper documents how commercial contracts are enforced in Ghana. Results show that compliance with contractual obligations is mostly motivated by the desire to preserve personalized relationships based on mutual trust. Harassment is the main form of debt collection. Other enforcement mechanisms — court action, reputation effects, use of illegitimate force — are less important. McMillan, J. and Woodruff, C. (1999) “Interfirm relationship and informal credit in Vietnam” The Quarterly Journal of Economics, 114(4) p. 1285-1320. This study shows that firms belonging to business networks receive more trade credit. Networks are used to sanction customers that default on the payment of trade credit. If a customer finds it hard to locate alternate suppliers, it is easier to get trade credit. The length of the trade relationship is positively correlated to the granting of trade credit. The more information a supplier has about a customer, the more trade credit is granted.


of legal institutions and its impact on external financing of enterprises has not been extensively studied. Instead the macro level variables of contract enforcement and legal systems have been employed. The advantage of studying legal consciousness on the level of the individual is that we can study the perceptions of businessmen and they affect transactional behaviour regardless of the characteristics of external legal institutions. As this paper argues, the perceptions of institutions predict behaviour better than the innate character of institutions themselves.

The context of this study is in the cross-section between legal sociology, law and economics and law and finance. It also related to the research fields of law and society and law and development. Research in the field of law and economics and law and finance has focused mainly on law as a phenomenon external to the individual and has not studied the legal consciousness on the individual level. The law and development school has assumed that better law enforcement, more efficient legal institutions, and modernized legal provisions are the key instruments to legal efficacy.\(^8\) The legal consciousness in relation to economic transactions has not been entirely avoided in previous research: sociolegal scholars have looked into the legal consciousness of individuals and studied it as factor that has an impact on economic behaviour of managers and brokers etc.\(^9\)

The “New Law Merchant” is a reaction to the focus only on formal legal institutions as mechanisms of change in the process of improving contractual assurance in society. The “New Law Merchant” is the collection of trade associations, business networks, and social norms that regulate economic exchange. The argument is that it should be more extensively utilized in transition economies, at the expense of investing in formal public legal infrastructure.\(^10\) The World Bank proposes that the New Law Merchant be used because private associations are often thought to facilitate relational contracting, provide third-party contract enforcement mechanisms, or provide dispute resolution to firms, the new law merchant has proven a favorite prescription

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for facilitating market exchanges when the courts are weak. Underlying this prescription is an implicit assumption that private order is a viable substitute for public order. Research and evidence on the interactions of public and private order is in short supply.

La Porta (1998) pointed out that we really do not know which features of the contractual environments that matter and in which combinations. There is a significant gap in the literature on how the factors that provide contractual support differs both inside and between legal systems. The central question in the framework of transaction cost economics is Williamson’s “Which governance mechanism best coordinates the disparate plans and interests of the various individuals making up society?” This study is a partial answer to this question in the Russian context.

The key message of Ronald Coase is that individuals who are free to bargain about the price and distribution of external effects will come up with more socially efficient solutions than courts, since it is far more costly to use courts and the court’s distribution of private property rights and external effects may not become socially optimal. The cost of negotiation about private property rights between two parties decreases if the parties have confidence in the use of legal terminology, i.e. they are law businessmen and therefore possess legal self-efficacy. In the case of managers’ trade credit decision legal self-efficacy has double effect. First, they will have a fuller understanding of private property rights and the legal terminology needed to protect it. The costs for filing a claim and pursuing it in the legal system are therefore lower. Secondly, they will have lower costs for communicating with legal terminology with the client creditor. The effect being that the client understands that the costs of default will rise. The sum of the effect of legal self-efficacy on the trade credit decision is that transaction costs for borrowing to clients are lowered. Legal self-efficacy is relevant to transactions costs, for example in the protection of private property rights, both in the case of trade credit and in the case of Ronald Coase’s trains and herds


13 La Porta 1998 see note 3. La Porta’s study only included law on the books and not law in action i.e. how law is actually perceived and understood by its users.

14 See Katz (2000) note 12

15 Coase, R. (1960)”The Problem of Social Cost” Journal of Law and Economics, 3(1) p. 1-44. In this paper Coase addressed a problem that had previously been unsolved – the problem of the allocation of external effects in the socially most efficient way. He gave two examples to illustrate the problem; the first was that of a rancher whose cattle drift onto the cropland of his neighbour. If the rancher is made to contain his cattle, he is harmed just as the farmer is if the cattle remain unrestrained. Coase argued that with no transaction costs it is economically unrelated who is assigned original property rights; the rancher and farmer will work out an agreement about whether to restrict the cattle or not based on the economic efficiency of doing so. By letting the related parties work out the distribution of external effects among themselves and not going to court, the most optimal social solution to the problem of external costs can be found. In this paper Coase also uses another example of a train that lets out sparks onto adjacent farmland. The costs of burnt farmland have to be weighed against the social interest of keeping the train running. How can running of trains on a railway track and the costs for farmers be optimized? Coase’s answer was that the farmers and the train company should solve the problems by negotiating the costs themselves, without third party or government intervention. The train company will adjust its train schedules to the optimal time table, and farmers will be reimbursed for damage caused by the trains.

16 There may be more effects; such as law becoming a focal point when doing business. Businessmen with a high degree of legal self-efficacy can easier spot other such businessmen and therefore use law as a tool for communicating social expectations.
of cattle. The difference is that Ronald Coase assumed that all people have perfect understanding and knowledge of law and know how to find the law and, which they don’t. This study shows that legal consciousness matters for transaction costs. Legal self-efficacy improves the chances of businessmen protect their private property rights.

The dilemma of contract enforcement and indirectly transaction costs is extensively acknowledged as a key issue in transition of formerly planned economies. The common view is that under communist times these countries have relied on state to enforce dealings among state-owned enterprises. Once the economies became decentralized and privatized, the mechanisms of contract enforcement were lacking. The post-Soviet legal systems were universally viewed as insufficient for the more demanding requirements of market economies. Many scholars thought that a more hurried upgrading of the institutions of law enforcement was the most crucial ingredient to achieve success in transition. The absence of contract enforcement may lead to selection into less efficient contracts, and put a ceiling on aggregate productivity. This problem has been particularly prevalent in Russia and Ukraine. Survey evidence shows that the insecure contractual environment and lacking private property rights in Russia and Ukraine impede investment. Mechanisms of contract enforcement have always existed in the days of the Soviet Union, legal as well as non-legal. However as Russia embraced market economy and a new civil code was launched in 1995 the need for legal competence has increased, as a result legal proficiency has increased.

Legal proficiency is low among managers; the average score on the legal test performed in another part of the survey was 4 out of 7 (57 percent) questions on credit law, the best proxy for knowing civil law. Yet this is somewhat higher than in a previous study with similar questions. The questions are found in appendix 1. The average score at that time was 2.3 out of 6 (38 percent). We might attribute this increase in legal proficiency to a greater demand of law, and more contact with law over time. Legal self-efficacy and legal proficiency are not correlated. Legal proficiency has little to do with legal self-efficacy. Legal self-efficacy has more to do in an individual’s belief in his/her ability to use legal terminology and less to do with actual knowledge of current law.

17 Ellickson (2001) see note 9. He argues that most people do not know law and regularly avoid it.
19 Johnson, S., McMillan, J. and Woodruff, C. (1999). “Property rights, finance, and entrepreneurship”. CEPR discussion paper. The authors argue that property rights were more of an impediment to growth than lack of access to external finance in the early years of transition.
20 These questions pertain to civil law promulgated in 1995, thus it had only been effective for about two years in 1997. In 1997 when the questions were first asked, the mean score out of six questions was 2.3 (38%). In 2005 (now 10 years after promulgation), the average knowledge of law was a mean of 4 out of 7 (57%). This increase in legal proficiency suggests that it takes time for the population to get acquainted with law, and also that present commercial law is in demand in Russia. The first six questions are identical to the questions asked in 1997 for the article Hendley, K., Murrell P. & Ryterman, R. Law Works in Russia: The Role of Law in Inter-Enterprise Transactions in Peter Murrell, ed. Assessing the Value of the Rule of Law in Transition Economies, Ann Arbor: University of Michigan Press, 2002. The seventh question is ours. My gratitude to Professor Peter Murrell for allowing me to use these questions.
22 An unreported correlation was not significant.
We mean that law is efficient when managers’ feel that they can use the law. Only then there will be a true demand for law, and demand for law is also a prerequisite for legal efficacy. Previous theory on legal efficacy has used obedience to law as the sole measure. Legal efficacy has been measured by the characteristics of legal institutions, such as speed of trial, days to register a firm. The results from this study on the effect of legal self-efficacy challenge theories that resort to solely analyze external legal institutions as the mechanisms of contract enforcement.

**Mechanisms of Contract Enforcement**

The selection of private order mechanisms such as legal self-efficacy is motivated by previous studies which have shown that it has a more significant impact on the use of law than do perception of courts and the effectiveness of the legal system. The public order mechanisms of courts and law enforcement are selected as they are the most observable public order mechanisms to which all managers have a relationship. The most popular method of conflict resolution with a client or supplier is without outside intervention. Lawyers are the most popular choice among third parties, and the legal system the second choice. Trade associations and informal organizations linger far behind, see figure 1 below and table 2 in the appendix.

![Figure 1. In order to solve a commercial conflict, my firm;](image)

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23 See Hendley, K. (2001) “Beyond the Tip of the Iceberg,” in *Assessing the Value of the Rule of Law in Transition Economies* Ann Arbor: University of Michigan Press. P. 20-55. She states: “Most of the scholarly attention has been devoted to analyzing the content of these reforms, rather than to investigating their impact on the day-to-day lives of ordinary Russians.” She goes on “…demand” has taken on a more expansive meaning, standing for the bundle of attitudes and behaviour toward law as affected by historical experience, both personal and societal. It goes beyond seeking victory in specific categories of cases to encompass a broad acceptance of law as a means of both protecting and advancing one’s interests”. Hendley thus has captured the use of law that this paper wishes to convey, law as a tool for advancing the interest of the individual in society.

24 See Hendley, K. (2001) P. 20-55 note 21. She states: “Most of the scholarly attention has been devoted to analyzing the content of these reforms, rather than to investigating their impact on the day-to-day lives of ordinary Russians.” She goes on “…demand” has taken on a more expansive meaning, standing for the bundle of attitudes and behaviour toward law as affected by historical experience, both personal and societal. It goes beyond seeking victory in specific categories of cases to encompass a broad acceptance of law as a means of both protecting and advancing one’s interests”. Hendley thus has captured the use of law that this paper wishes to convey, law as a tool for advancing the interest of the individual in society.


Private Order Mechanisms: Legal Self-efficacy, lawyers, and trade associations.

Private order in Russia has evolved in response to deficient public order. Private order fosters economic efficiency by making gains from trade realizable. It is a supplement to law, yet it cannot entirely replace it. In order for private order to be able to realize gains from trade, there need be a democratic public order that can help curb the potential for private order inefficiencies. Private order norms can produce benefits that the public realm cannot produce effectively. When the public order mechanisms such as courts and law enforcement failed, private order mechanisms in the form of trade associations, private networks and reputation were take their place. Yet there are ample reasons not to rely entirely on private order despite dysfunctional public order. Private order, such as trade associations can discriminate traders on various grounds. Price collusion among closed groups of traders is another problematic feature of the public order. Private-order organizations’ enforcement techniques can overflow into criminal violence. Legal self-efficacy cannot replace a faulty legal system, lawyers cannot replace judges, and trade associations cannot replace courts to achieve contractual assurance.

Legal Self-efficacy

This study may be conceived of as a study of legal self-efficacy, and is, as such, an application of a tried and tested theory of cognitive psychology on individuals’ use of law. Legal self-efficacy has not been discussed previously in relation to transactional behaviour. Jörgensen & Svanberg (forthcoming) demonstrates that legal self-efficacy is a stronger determinant of managers’ use of law than perception of formal legal institutions. This study is the first study on the impact of legal self-efficacy on managers’ transactional behaviour.

Legal self-efficacy may be a very useful concept for understanding laymens’ use of law. Legal professionals are familiar with the exact phrasing, connotations and implications of laws. Laymen

28Katz (2000), note 12 p. 2488
30See note 1
however, structure their thinking along more symbolic paths of reasoning. Their understanding of abstract legal concepts such as obligation, rights, debt, and contract may not always be clear. However familiarity with these concepts makes their use more likely and as a result they will be uses in communication more easily. According to the Torpman & Jørgensen definition of legal efficacy, the effectiveness of law is a direct result of their ability to use legal terminology and in their acceptance of law as a means of communication.

It is reasonable to assume that self-efficacy is relevant for the choice to apply a legal perspective to a situation. Although there is presently no prior research on self-efficacy regarding the use of law, self-efficacy assessments mediate the influence on other predictors of behaviour on particular performance. Earlier experience and performance help create self-efficacy perceptions, which are strong predictors of subsequent performance. Self-efficacy is a mediating mechanism of personal agency that mediates between the sources of its creation and subsequent outcomes.

The foretelling and mediational role of self-efficacy has received support from a growing body of findings from diverse fields and applications. Self-efficacy has been proven to be effective in; lessening alcohol and drugs abstinence, exercise, avoidance of tobacco smoke, personal and social development of youth, weight loss, parental skills, knowledge-sharing, computer use at work. The role of intellectual abilities for self-efficacy is found to have a significant

32 Ibid.
36 Chen, C.M., Ching-Min, L., PH, et al. (2007) “Avoidance of environmental tobacco smoke among pregnant Taiwanese women: Knowledge, self-efficacy, and Behaviour” Journal of Women’s Health 16 (6) p.869-878. A multiple regression revealed that overall avoidance of environmental tobacco smoke was positively associated with self-efficacy, with a no-smoking policy at home, and with both a woman and her partner’s educational levels.
39 Leerkes, E.M, Burney, R.V, et al. (2007) “The development of parenting efficacy among new mothers and fathers” Infancy, 12 (1) p. 45-67. Prenatal self-efficacy for mothers was significantly related to postnatal self-efficacy. For fathers this was not the case, whose postnatal self-efficacy was primarily a function of their amount of involvement in parenting tasks and social support.
correlation. Students’ self-efficacy was found to be a useful predictor of perceived competence in science. Self-efficacy has been proven to be a strong predictor of behaviour in numerous fields.

Self-efficacy reflects beliefs about one’s ability to organize and execute courses of action necessary for attainment of a goal. Self-efficacy relates to an individual’s beliefs about personal control and agency. Efficacy beliefs heighten the likelihood that people will strive to attain certain goals and be persistent in their goal-directed behaviour, and be successful in their pursuit of these goals. Self-efficacy is only the faith in one’s ability to do something, yet there is significant support for a positive correspondence between self-efficacy and performance. Persons with high level of self-efficacy view circumstances as presenting achievable scenarios. They envisage success scenarios that provide guides for winning performance. Those who judge themselves of low self-efficacy conversely view situations as perilous and cannot seem to visualize affirmative prospects.

Law shapes the individual’s expectations, calculations of action and understandings. Lindenberg (1990) stresses the role of “framing effects” the preferences and action space available to a manager depends on the way a situation is framed. In many disputes people may choose between several different types of norms. Claims, during both formation and processing, may be framed or transformed in ways that reject law, or include it. Legal self-efficacy is facilitative.

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43 Beghetto, R.A. (2007) “Factors associated with middle and secondary students’ perceived science competence” Journal of Research in Science Teaching 44 (6) p.800-814. Students’ self-perceptions of their ability to generate creative ideas (i.e., creative self-efficacy) was related to students’ perceived science competence.


and enables the individual with the means to construct meaning and negotiate relations with other enterprises; it also helps the individual frame a conflict about private property rights in a legal perspective.

It is important to understand the perceptive quality of legal self-efficacy and that the individual discernment of institutions, rules and sanctions plays a larger role for behaviour than do the inherent qualities of institutions themselves. Legal self-efficacy is also a measure of how much an individual has internalized legal norms. Internalised legal norms are closely related to emotions – non-legal sanctions of the individual upon himself in terms of shame, guilt, and remorse. Emotions of the individual are the sanctions that internal norms impose on the individual. This is helpful or enforcing second and third party sanctions as well. Norms enjoy a scale economy, i.e. a person who has internalised norms, will be willing to pay a price in order to ensure that other people if not internalise these norms, and then at least adheres to them. It is therefore less costly to transact with a person, or firm, who uses similar norms, as there will be no need to teach them or enforce them. An individual can communicate legal norms in various forms; a typical one is that of the use of contract, or oral communication with a client. Legal norms can also be communicated in oral communication with customers and clients. Typically, a manager who has internalised legal norms is comfortable with using them in the line of business. The implications are that legal self-efficacy has an emotional side, of self-punishment when legal norms are breached. It also helps in written and oral communication with clients. A businessman who has a high level of legal self-efficacy finds it less costly to communicate with other likeminded businessmen. Legal self-efficacy can therefore help make law a focal point when doing business.

Businessmen’s use of law is a self-reinforcing mechanism. The more law is used and the more successful the use, the more loyal businessmen will be to law. Hirschman (1970) findings that customer loyalty is based on the ability to communicate shares many common qualities of the concept of legal self-efficacy as a measure on the belief in law as a means of structuring social expectations as well as a means to structure business. Loyalty to the legal system is created by the ability of managers to communicate in legal terms as a way of doing business. It is possible to make a comparison of the impact of legal self-efficacy and the impact of public legal institutions. From this reasoning follows the proposition:

P1: Legal self-efficacy has a larger impact on the provision of trade credit than do the perceptions of public order institutions such as courts and law enforcement.


1.2 The Role of the Lawyer in Russian Enterprises

Lawyers are a very flexible and versatile part of the private order; their aid in provision of contract security is unequalled. Commercial lawyers create value by creating transactional arrangement that reduce insecurity. Lawyers reduce transaction costs by bridging the cognitive cap of businessmen when structuring transactions. Lawyers are transaction cost engineers. They also function as contractual support for businessmen in legal recourse. Commercial lawyers do more than just law; they are at least as often involved in matters of financial, accounting and business nature. Lawyers are engaged in developing approaches to private ordering that minimize transaction costs. Their function is also symbolic, in the notion that if laymen have confidence in commercial lawyers, they are more likely to take more risks, as they know that they can rely on their commercial lawyer for contractual support, both by structuring the deal, and as a legal aid in court. In this paper we measure just to what extent they reduce transaction costs, in comparison with judges, trade associations, and law enforcement.

Not much is known about the role of Russian lawyers in the provision of contractual support to firms. Hendley et al. (2001) find that lawyers are marginalized within the enterprise. Lawyers focus on established, routine tasks, such as labour relations or drafting form contracts, rather than on shaping enterprise strategies in the newer areas created by the transition, such as corporate governance or securities law. She further stipulates that the failure of in-house lawyers to emerge as agents of change in Russia reflects a continuation of their low status during the Soviet era and the lack of professional identity among these company lawyers. In Soviet times, lawyers played a diminutive role for doing business. The mechanisms of trade were placed mainly outside of the firms, in the central planning committees and inside the Communist party. After the breakup of the Soviet Union, however, the need for lawyers has increased, as they now serve to coordinate among other things firm transactions. In Russia, lawyers are an advantage, yet they are not quite as pivotal as lawyers in the United States. No more than about half of the cases in courts are unrepresented by legal counsel. This is evidence that lawyers play a greater part when structuring business outside of court than inside in Russian business. Hadfield stresses that lawyers are carriers of legal human capital. In her context legal human capital implies the shared knowledge accumulated within the legal profession – judges, lawyers, legislators, and law

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57 Ibid p. 255
58 Ibid p. 295
59 It is possible to empirically measure the impact of commercial lawyers, as we do in this paper, in contrast to what Gilson (1984) stated „A truly empirical approach to measuring the impact of a commercial lawyer’s participation seems impossible for a number of reasons. It is unlikely that we could find data covering both a sample of transactions in which a commercial lawyer did participate and a control group of transactions which were accomplished without a lawyer.‟
Lawyers do have the potential to act as agents of transformation in economies that undergo reform.\textsuperscript{63} When there is a commercial conflict, the choice of norms to solve the conflict depends on a variety of factors; such as the efficiency and effectiveness of the norm.\textsuperscript{64} The lawyer’s role can be interpreted as a mediator between social and legal norms, between private norms and public order norms. As such the lawyer becomes very valuable in a changing legal climate. Managers in our survey appreciate lawyers more than judges as agents of conflict resolution. A client who knows how to use legal terminology will be more likely to be able to communicate with a lawyer and will not be screened out. The lawyer can serve as a gatekeeper as to which cases end up in court.\textsuperscript{66} Legal aid attorneys in Chicago screen out clients with which they had difficulties communicating and clients perceived as shifty, of questionable moral character and credibility.\textsuperscript{67} Lawyers are repeat players in both drafting contracts as well as representing their clients in court.\textsuperscript{68} In comparison to judges, it may very well be so that lawyers are the most trusted legal players surpassing judges, and to some extent substitute for the lack of this essential part of the public order. Porat (2000) argues that if judges, being the most important part of the court system, deviate from their function, all sorts of compensation need to be performed by private order.\textsuperscript{69} I argue that lawyers are one very palpable substitute, which this analysis demonstrates. It is possible to make comparison the impact of legal self-efficacy and the impact of public legal institutions. We therefore make the proposition:

P2: Belief in lawyers’ efficiency in solving commercial conflicts has a larger impact on the provision of trade credit than do the perceptions of public order institutions such as courts and law enforcement.

1.3 Trade Associations

Trade associations pool resources among members and can be seen as an uncertainty-reducing device. An example of private order is the trade association, which facilitates contracts under uncertainty. Trade associations do four things: a) they coordinate information about their members, b) they can apply sanctions against members when necessary c) they can often act as forum for conflict resolution d) they can promote the interests of the members in society, such as


\textsuperscript{68} Trubek and Galanter (1974) see note 8

lobbying etc.\textsuperscript{70} The vast changes in trading patterns that have occurred in transition countries have led to firms to find new clients and networks. These networks differ in degree of openness and competition.\textsuperscript{71} Guilds, throughout history, created rules for transactions, with multilateral enforcement.\textsuperscript{72}

The main raison-d’être of trade associations is the provision contractual assurance and trade partners for its members. Trade associations coordinate information and serve as norm standardisers. Firms that have a special interest can form trade groups; there are prevalent business norms in the trade association. Trade associations proved information about their industry to others; it can act as a representative for its industry to the government in lobbying. It can serve as an expert when the government creates new legislation. In addition to this, trade association coordinate sanctions to members in breach of association norms. They also coordinate information between members. In short, they provide several versatile functions to their members.\textsuperscript{73} Membership in a formal organization can, among other things, formulate the law in ways advantageous to its membership.\textsuperscript{74} Some people belong to organizations that are regularly counselled by lawyers and others about their legal problems.\textsuperscript{75} Trade associations help raise the confidence in trade between firms, especially if that organisation offers contractual support, to solve a conflict. Another function of trade organisations is to disseminate information about contractual breaches and coordinates the community’s reaction to breaches. Trade associations and networks lower the costs of information gathering, resulting in better-informed manufacturers. Both business and social networks are significantly associated with trading locally, which suggests that geographic immediacy makes repute easier to communicate. Fafchamps and Minten (2000) conceptualize membership networks as social network capital.\textsuperscript{76} They find that it has a strong positive effect on trade. They divide social networks into three categories – relationships with other traders, which help economize on transaction costs, relations with individuals who can help in times of financial difficulties and insure traders against liquidity risks, and family relationships, which reduce efficiency, as opposed to the former two groups. They also find that the density of interpersonal relationships is significantly related to trust and information flows. One study finds no evidence that courts or trade associations support long-distance trade.\textsuperscript{77} Firms that believe that courts are effective are more likely to trade locally, and that those who are members of trade associations are more likely to sell to distant buyers, but these results are not significant.

A previous study found that the marginal value of business associations increases when the parties are in different cities.\textsuperscript{78} The role of business association in promoting flow of information

\textsuperscript{70}There are various forms of trade associations, some which are very strong in all of these areas, and the other extreme, which performs virtually none of the functions above except granting membership to its members.


\textsuperscript{73}While trade associations provide many different functions to their members, courts can provide far less services. This is an example of the richness of private order in comparison to public order.


\textsuperscript{76} For a brief introduction to social capital, see p. 1-3 in Fafchamps, M., and Minten, B., (2000). “Returns to Social Network Capital Among Traders.” Centro Studi Luca D’Agliano Development Studies Working Papers No. 145

\textsuperscript{77}see note 1.

is sensitive to the degree of local competition in the members’ markets. On the other hand, another study found that business associations only play a marginal role in helping enforce contracts and spread information on prospective customers’ ability to pay. Trade associations have many roles that reduce uncertainty for enterprises; they coordinate information about suppliers and clients. They inform about contractual breaches and some even provide contractual support in case of conflict with a client. All of these roles can be useful for an enterprise that decides to provide trade credit to a client. In light of the benefits of membership in a trade association the following proposition is formulated:

P3: Membership in trade associations has a larger impact on the provision of trade credit than do the perceptions of public order institutions such as courts and law enforcement.

### 1.4 Public order mechanisms

Some researchers seem to think that private enforcement is inferior to state enforcement of contracts, since private enforcement is more costly, creates competition of violence and is more difficult to monitor and often inhibits changes in economic institutions that may increase efficiency. Others seem to think that private substitutes to law can take the place of legal arrangements and create the environment that enables economic growth. Katz (2000) stresses that nevertheless, public order institutions are needed to provide public legitimacy of well-functioning private order norms. Efficient public order norms give legitimacy to private order norms and efficient private order norms can serve as examples for norms that the public order can adopt. Private and public order can complement and substitute, but they cannot entirely replace one another.

### 1.5 Courts

Courts serve as beacons of legal norms. The strongest impact of courts on the general population of enterprises is that of norm communication which informs about which expectations to have on breaches of contract. The vast majority of firms are never sued, and likewise do not adjudicate other firms to court. The results from this survey show that Russian managers consider courts to function rather well. Many scholars agree with these findings. They also show that private firms

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81 See note 54

82 See note 12.

find that suing another private firm to have reasonable prospects. They refrain however from
suing state enterprises due to court bias.\textsuperscript{84} When Russian managers compare judges and lawyers in
the role agents of resolution of commercial conflicts lawyers come out ahead, see figure 2, below.

The innate characteristics of courts matter for enterprises, in both positive ways and negative.
Previous research has shown that the most important features of courts are fairness and honesty
as opposed to their efficiency or ability to enforce decisions.\textsuperscript{85} Powerful economic interest groups
avert weak firms from the justice system.\textsuperscript{86} The inequality of influence over government
institutions has a strong negative impact on weak firms’ use of the legal system.\textsuperscript{87} This can imply
that weak private firms are less likely to sue a large state company for unpaid trade credit.

Measuring perception of courts effectiveness, controlling for court use, is the most effective way
to assess court impact on trade credit.\textsuperscript{88} Perception of courts’ effectiveness has previously been
shown to have a positive significant effect on the granting of trade credit to clients.\textsuperscript{89} Courts have
also shown to have a direct impact on banks’ lending to enterprises; the effect on trade credit is
less significant.\textsuperscript{90} Other effects of the perception of courts have been shown, such as significant
positive effect on the level of trust shown in new relationships between firms and their
customers.\textsuperscript{91} One study found that court effectiveness has a significant impact on local, not

\textsuperscript{84} These results are corroborated by the findings of Frye, T (2002) “The Two Faces of Russian Courts: Evidence
from a Survey of Company Managers”, 11(1/2) \textit{East European Constitutional Review}.

9150. The authors point out that when justice is subverted by powerful economic interest groups, other businesses
tend to turn away from the justice system, with negative consequences for the whole economy. In many countries,
the operation of legal, political and regulatory institutions is subverted by the wealthy and the politically powerful for
their own benefit. This subversion takes the form of corruption, intimidation, and other forms of influence.

\textsuperscript{87} \textsuperscript{88} \textsuperscript{89} Hellman, J. and Kaufmann, D. (2004) “Political Inequality and the Subversion of Institutions in Transition
Economies” in \textit{In Trust in Post- Socialist Transition} Kornai, J. and Rose-Ackerman, S. (eds) provide a preliminary
investigation of the determinants of enterprise perceptions of the quality of the courts in the BEEPS, taking into
account the role of interest groups and capture. The paper shows a consistent pattern in which the inequality of
influence over government institutions has a strongly negative impact on assessments of public institutions that
ultimately affects the behaviour of firms towards those institutions. The data suggest that the inequality of influence
of weak firms not only damages their trust in these institutions, it also affects the likelihood that they will use and
provide tax resources to support such institutions.

\textsuperscript{90} \textsuperscript{91} Johnson, S., J. McMillan, and Woodruff, C. (2001). “Courts and relational contracts” National Bureau of Economic

\textsuperscript{92} See also Shvets note 6. In this study Shvets shows that the immediate effect of improvement of quality courts is
that more firms get access to bank finance, not that more credit is granted to those firms that already have credit.
Trade credit also responds to changes in quality of courts. However bank credit is much more sensitive to quality of
courts than is trade credit. Chemin, M. (2004) “Does the Quality of the Judiciary Shape Economic Activity?
Evidence from India,” mimeo, LSE. This paper demonstrates that the speed of court execution of cases has a
significant impact on the rate of lending of banks in India on the financing of firms.

\textsuperscript{93} Johnson, McMillan and Woodruff (2002) see note 5
distant trade.\textsuperscript{92} Perceptions of Russian courts seem to not diverge very far from actual performance.

Russian courts require 37 steps before recovery of disputed debt, it takes 281 days to get the debt, and the price is on average 13.4 percent of the debt. In comparison to Sweden, where there are 30 steps before recovery of disputed debt, and the average time period of 508 days, at a cost of 31.3 percent of the debt. In the US there are 32 steps, and an average of 300 days at a cost of 9.4 percent of the debt.\textsuperscript{93} The comparison divulges that the Russian court system is not far behind Western countries when it comes to the formalities of debt recovery through courts. In sum, Russian courts function, however there are serious flaws that deter private and weak firms from using them. It could be the case that it is the mistrust of businessmen of courts that deters them from using them.

Figure 2. Lawyers vs. Judges: Efficiency in Solving Commercial Conflicts.

Scale from (0 to 10)

<table>
<thead>
<tr>
<th>Lawyers</th>
<th>6.5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Judges</td>
<td>4.8</td>
</tr>
</tbody>
</table>

\textbf{1.6 Law enforcement in Russia}

Law enforcement agencies in post-Soviet Russia suffers from severe shortages. They have been reported to be underpaid and outnumbered.\textsuperscript{94} Their place is taken by private armies and protection rackets. There are five recognized powers in Russia today, the executive, legislative, judicial, the mass media and the bandits. The police are reported to have problems confronting a \textit{krysha}, which literally means “roof.” As a slang word, krysha refers to a criminal protection racket, such as a gang that extorts money from a store owner. Many businessmen report that the use of \textit{krysha} as the only way to enforce a contract. Shopkeepers view private protection organizations primarily as a substitute for state-provided police protection and state-provided courts.\textsuperscript{95} The research on law enforcement in Russia has been focused on the general picture, researchers often painting a sad picture of the law enforcement agencies. Corruption is usually mentioned as one of the reasons to this. In a situation of debt recovery, law enforcement acts upon a court order only, and not preventively. Survey studies that measure the impact of law enforcement is in short supply. Law enforcement agencies in Russia leave much to be desired.

\textsuperscript{92} McMillan and Woodruff (2000) see note 1.


\textsuperscript{94}Hoffman D., Washington Post , May 12th 1997 p. A01

Data Collection and the Survey

The survey was completed by the author and his Russian students among 246 enterprises between March and May 2005 in St. Petersburg, Pskov and Kaliningrad in northwest Russia. St. Petersburg embodies three fifths of the enterprises and Pskov and Kaliningrad one fifth apiece. Enterprises were represented from ten diverse industrial categories. Enterprises were of sizes 5, up to 7,000 employees, with average firm size of 44 employees. The average time span of firm activity at the point of the survey was 9.5 years. 72 percent of the respondents were male, 28 percent female. 7 percent of firms were registered on a stock exchange. 8.3 percent were at least state-owned to some degree. 18.1 percent of the enterprises were open stock companies (OAO), and 30.3 percent were closed companies (ZAO), the remaining 51.9 percent were of other legal affiliation or unrevealed. The blend between industry and services in this survey, is 60 - 40, reflecting the Russian economy as a whole. The survey instrument contained 200 queries on topics ranging from firm legal strategy to methods of financing the firm to client structure and trade credit. We approached CEOs and top managers in each firm at trade fairs and directly in offices. The total response rate was 50 percent or above. The internal response rate within the questionnaires themselves was 80 percent or above.

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96 My gratitude to Vyacheslav Eropkin in Pskov, and Olga Belova and Elena Osipova in Kaliningrad for assistance with collecting and the surveys. I would also like to thank the Inga-Lill Norlin at the Visby Programme with the Swedish Institute and for two generous grants supporting the data collection in Russia.
Results and Discussion

In this section the hypotheses are tested controlling for enterprise size and court use. The results are examined in light of previous research. In the ensuing discussion the implications for theory

Trade Credit provision, controlling for enterprise size and court use

Private order institutions    Public order institutions

<table>
<thead>
<tr>
<th></th>
<th>Legal self-efficacy</th>
<th>Perception on lawyers ability to solve commercial conflicts</th>
<th>Membership in trade association</th>
<th>Perception on courts' ability to solve commercial conflicts</th>
<th>Perception on law enforcement ability to solve commercial conflicts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-0.001 (0.993)</td>
<td>0.182** (0.013)</td>
<td>-0.076 (0.308)</td>
<td>0.045 (0.548)</td>
<td>0.027 (0.717)</td>
</tr>
<tr>
<td></td>
<td>Df 184</td>
<td>Df 185</td>
<td>Df 185</td>
<td>Df 180</td>
<td>Df 182</td>
</tr>
<tr>
<td>Business clients</td>
<td>0.150** (0.041)</td>
<td>0.231*** (0.002)</td>
<td>0.053 (0.478)</td>
<td>-0.065 (0.384)</td>
<td>0.090 (0.225)</td>
</tr>
<tr>
<td></td>
<td>Df 184</td>
<td>Df 185</td>
<td>Df 185</td>
<td>Df 180</td>
<td>Df 182</td>
</tr>
<tr>
<td>Clients in the same town</td>
<td>0.151** (0.040)</td>
<td>0.193** * (0.008)</td>
<td>0.096 (0.193)</td>
<td>-0.021 (0.784)</td>
<td>0.138 * (0.063)</td>
</tr>
<tr>
<td></td>
<td>Df 184</td>
<td>Df 185</td>
<td>Df 185</td>
<td>Df 180</td>
<td>Df 182</td>
</tr>
<tr>
<td>Clients in other towns and</td>
<td>0.165** (0.025)</td>
<td>0.175** (0.017)</td>
<td>0.012 (0.867)</td>
<td>0.010 (0.896)</td>
<td>0.064 (0.388)</td>
</tr>
<tr>
<td></td>
<td>Df 184</td>
<td>Df 185</td>
<td>Df 185</td>
<td>Df 180</td>
<td>Df 182</td>
</tr>
</tbody>
</table>

* Significance at the 10 percent level
** Significance at the 5 percent level
*** Significance at the 1 percent level
Private order institutions; Legal self-efficacy, lawyers and trade associations

Proposition one: Legal self-efficacy correlates more strongly with the granting of trade credit than do the perceptions of public order institutions such as courts and law enforcement is affirmed, legal self-efficacy has an equal impact on the granting of trade credit as courts and superior to that of law enforcement. Legal self-efficacy can be interpreted as a way of trust in one’s own capacity to use law. This capacity enables managers to grant trade credit to three out of four groups, all except friends and clients. The most distinctive characteristic of this measure is that it is based in managers’ beliefs in their legal capacity, as “citizens in the world of law”. The mere knowledge that one can apply law to certain situations is significant, only that one may not know which law to apply. Legal self-efficacy as a measure of distributed legal efficacy in the population is affirmed as having as significant impact as courts. In business, the lawyer plays an essential part in communicating legal norms between parties. It is no coincidence that internalization of legal norms and the use of legal terminology when doing business and belief in lawyers’ ability to solve commercial conflicts concur. An individual’s belief in law as a means of communication is significantly correlated to the confidence in lawyers to solve commercial conflicts. Legal self-efficacy as a measure of distributed legal efficacy in the population is affirmed as having as significant impact as courts.

In business, the lawyer plays an essential part in communicating legal norms between parties. It is no coincidence that internalization of legal norms and the use of legal terminology when doing business and belief in lawyers’ ability to solve commercial conflicts concur. An individual’s belief in law as a means of communication is significantly correlated to the confidence in lawyers to solve commercial conflicts. Legal self-efficacy as a measure of distributed legal efficacy in the population is affirmed as having as significant impact as courts.

Proposition two: Belief in lawyers’ efficiency in solving commercial conflicts correlates more strongly with the granting of trade credit than do the perceptions of public institutions such as courts and law enforcement is affirmed; lawyers have a stronger impact on the granting of trade credit than do courts and law enforcement. The significance of impact is impressively high, in particular among business clients. This result supports the view of lawyers as transaction cost engineers. The need for lawyers has increased since the fall of the Soviet Union. The findings about the role of lawyers as a significant factor for the contractual assurance for Russian firms is partial response Hendley et al. (1999), who questions of what the role of lawyers in post-Soviet Russia play. Lawyers help structure deals between firms, and to recuperate unpaid trade credit. The perception of lawyers’ ability to solve commercial conflicts has a medium impact on almost all Russian firms granting trade credit.

Proposition three: Membership in trade associations correlates more strongly with the granting of trade credit than do the perceptions of public institutions such a courts and law enforcement is not affirmed; trade associations play an inferior role to that of public order institutions when firms grant trade credit in Russia. The findings of Fafchamps and Minten (2000), that trade associations have a strong positive effect on trade are not supported. McMillan and Woodruff (2000) find no evidence that trade associations do not support long distance trade. This study supports that observation. Pyle’s (2005) observation that the marginal value of trade associations increases when the parties are in different cities is not supported. The study supports Hendley, Murrell and Ryeterman’s (2001) observation that trade associations only play a marginal role in helping

97 This theory is validated in a 0.161 correlation with 1.4% significance.
98 More than in 998 out of 1000 trade credit decisions, the perceived efficiency of lawyers’ ability to solve commercial conflicts has a 23 percent impact.
99 See note 61, p. 860
enforce contracts is supported. Trade associations have a weak effect only on local trade and no effect on other groups of clients.

Legal self-efficacy and perception of lawyers’ ability to solve commercial conflicts have a strong impact on the trade credit decision in Russian enterprises in comparison to the impact of courts and law enforcement. The human legal capital of businessmen and lawyers are a strong and significant factor in the provision trade credit for Russian enterprises.

**Public order institutions: courts and law enforcement**

Courts have no impact on the granting of trade credit for any group. Courts are local, just like law enforcement and would be expected to have a stronger impact on local clients than on distant ones. This may depend on the fact that the firm that puts up trade credit usually writes a condition of use of local courts in case of default of payment.\(^\text{100}\) Law enforcement is local, which the results reflect; the only significant impact is on local clients. Courts must first order law enforcement agencies to collect an overdue debt, and are not allowed to act on their own.\(^\text{101}\) The view of law enforcement agencies as having difficulties supporting contract enforcement gets support in this study.

**Discussion and theoretical implications**

Legal human capital has a significant impact on transactional behaviour. La Porta et al. (1997 and 1998) explain the external legal determinants of finance in terms of legal origin and legal rules covering protection of corporate shareholders and creditors.\(^\text{102}\) This paper takes the opposite approach and uses managers’ perception of their ability to use legal terminology as a determinant of granting trade credit to client enterprises. The results of this paper are that external legal determinants of finance have no impact on external financing of firms, but that legal self-efficacy as an *internal* legal determinant of finance does. These results add to the theories of external legal determinants of finance and contradicts them in that they say that human perception of law is a stronger determinant of behaviour than the innate characteristics of legal institutions. Financing of firms do not hinge entirely on the characteristics of the legal system, but also on the degree that entrepreneurs are *law businessmen*.

This paper demonstrates the importance of the individual and the degree of internalization of legal norms and reliance on legal means of communication. It has demonstrated that the more confident a person is with using legal terminology for defining and communicating about matters the more prone a person will be to take the risk of granting trade credit to a customer. The assumption derives from Hirschman’s classical work on loyalty, which has formed the basis for significant amount of theory on customer loyalty and service quality.\(^\text{103}\) According to Hirschman’s original idea customers are loyal not by repetitive trading with a supplier, but by feeling confident

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\(^\text{100}\) The logic behind this reasoning is that the provider of trade credit runs the higher risk, and is therefore compensated by use of a local court in case of dispute.

\(^\text{101}\) An exception to this may be the Russian tax police, but they are usually not involved in collecting trade credit debt.

\(^\text{102}\) See note 7

\(^\text{103}\) See note Hirschman 55
in their ability to correspond with a supplier. Thus, what people believe about their abilities to correspond through a channel or a set of concepts, constitutes loyalty towards the supplier, but notably in this respect, loyalty also to the communication channel and the set of concepts they use. In the same fashion, the legal efficacy concept developed by Torpman & Jörgensen assumed that law is effective when it is the basis for social expectations. One implication of the finding that manager’s legal self-efficacy has a larger impact on the granting of trade credit than the perception of courts and law enforcement is that policy makers can find more efficient ways of improving contractual assurance.

In light of current theory on trade credit, which explains the trade credit decision in terms of enterprise dependent factors the findings of this paper add a new dimension – legal human capital legal self efficacy and the belief in lawyers’ ability to solve commercial conflicts. All other things equal, human capital has a significant impact on the granting of trade credit. The implications for trade are that human legal capital boosts growth. In Russia for example, trade credit is by far the largest source of external capital and improves the chances of growth of the enterprise. Legal human capital helps enterprises guard their private property rights and cut transaction costs. In transition economies, where bank financing is even harder to find, trade credit plays a larger role for firm growth than in developed economies. Typically, private property rights are more challenged and less well established in transition economies. Improvement of human legal capital can be a key for advancing growth in transition economies.

Legal self-efficacy can be considered a means of risk reduction. Risk reduction occurs before the management decision with involving risk, as well as after. The way in which a problem is framed affects the perception of and attitudes towards risk. As Karl Llewellyn (1941) put it “Law purposes to channel behavior in such a manner as to prevent or avoid conflict; and law does in important degree so channel behavior. Without the purposive attitude, law is unthinkable: without the effect attribute, law cannot be said to “prevail” in a culture, to have “being” in it.” As a result managers who appreciate that their ability to communicate with legal terminology will be accepted by their counterpart experience a high degree of legal efficacy. In the case when both parts of a business agreement accept law as communication law can be said to be a focal point. Law has an expressive effect in that it coordinates expectation of behaviour of business partners and can serve as a point of equilibrium. Law is thus expected to be a norm in the coordination of an economic exchange. A legal rule may guide behaviour merely by influencing the expectations on how others will behave.

The internalization of law and the acceptance of law as a means of communication, both captured in the concept of individual legal efficacy, provide economic actors the means to rely on law as a way of coordinating expected behaviour. Individuals who display a high degree of internalization of law are more likely to be able to frame a problem in legal terms and communicate it in legal terminology, as in the case of i.e. default in the payment of trade credit. The communication with the client will be more permeated by legal language. It is only through

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104 See Torpman & Jörgensen (note 2)
107 See Torpman & Jörgensen 2005 note 2
the application of law in a population that law can be said to be effective. It is also the single occasion when law can have an effect on society.\textsuperscript{109}

The confidence in lawyers’ ability to solve commercial conflicts correlates significantly with legal self-efficacy. Managers’ belief in their ability to use legal terminology facilitates communication with lawyers. The coincidence of these two observations is not unexpected as lawyers are visible representatives of the legal system that communicate with legal terminology. Lawyers function as the link between laymen and the legal system in their role as representatives of the legal system. Laymen who feel like law businessmen can communicate with a lawyer without strenuous effort. This study demonstrated that the impact of the perception of lawyers’ ability to solve commercial conflicts on transactional behaviour is not insignificant. The affirmation of lawyers as necessary, useful and trusted supporters of enterprise transactions is a sign of the Russian market that moves towards an economy of private property rights.

Membership in trade associations means being part of a group of enterprises. This group has a certain identity, or \textit{social network capital}. The identity of this group forms a part of the individual’s self concept. The self-concept is a merged view of oneself that is presumed to be formed through direct experience and assessments adopted from significant others.\textsuperscript{110} It is a knowledge organization that helps people organize and give meaning to memory and actions.\textsuperscript{111} As such it mostly includes direct self-descriptions and such elements as institutional legal structure can be self-descriptive for an individual only as a result of collective classification at the societal or national level. It is typically not an important aspect of an individual’s self. Thus, a person may describe him/herself as a good painter, a poor tennis player, and a good brother, but only to a much lesser extent as a citizen of a state with inefficient law enforcement. These descriptions serve both as guides for (automatic) behaviour choice and as motivators. Other information which is not self-descriptive of the individual is also motivating, but only if it has importance for the self either through perceivable consequences for the individual or through values that the individual hold. Thus, the individual is motivated to use law if “being lawful, or legal “ gives rise to positive effects for the self-concept, for example by making positive interpretations of the self possible through self-verification. The individual is motivated to avoid law if it has connotations that are unfavourable or unsuitable for the self in a situation. There is solid confirmation in psychology that support the primacy of the self-concept as motivator, for instance information may be stored better in memory when it is self-relevant and self-relevant information may be more systematically linked to other information.\textsuperscript{112} This study demonstrates that the self-concept of the individual does not have a momentous impact on trade credit behaviour of Russian enterprises. This suggests that the characteristics of the individual, such as legal self-efficacy are a more suitable for analysis of trade credit behaviour of Russian enterprises than group identity or social network capital.

This study demonstrates the strength of the human legal capital of the individual manager in terms of legal self-efficacy and also of the human legal capital of lawyers in the transactions of

\textsuperscript{109} Torpman and Jörgensen 2005 see note 2 p. 29, 14
\textsuperscript{110} See Bandura note 44.
Russian enterprises. The results underscore the importance of individual characteristics of legal self-efficacy and the importance of lawyers for granting of trade credit. Individuals are more important for contractual assuredness in the Russian economy than collective organizations, such as trade associations. When comparing the private and public order institutions, the public order comes out weaker than the private order in this study. The policy implications are that programmes for improving individuals trust in their own ability to use law can be at least as purposeful as efforts to improve formal legal institutions. The role of lawyers as mediators of transactions and interpreters between legal language and laymen’s communication is evident. It is therefore easy to agree with Jeffrey Sachs in that Russia needs more lawyers. It also needs more law businessmen who have a high level of legal self-efficacy. The findings in this paper warrant future research on the impact on legal self-efficacy and lawyers on other economic transactions, such as money lending and borrowing between firms and banks in various comparative country contexts.
Appendix

Table 1

Participants responded to the following seven items:113

According to the law, must the following types of agreement be in writing?

Agreement to sell goods:

A. Written form is *always* required by law.
B. Written form is *sometimes* required by law.
C. Written form is *never* required.
D. I don’t know.

2. According to the law, must the following types of agreement be done in writing?

Agreement on collateral:

A. Written form is *always* required by law.
B. Written form is *sometimes* required by law.
C. Written form is *never* required.
D. I don’t know.

According to the law, which of the following types of pledges must be notarised?

Pledges of buildings:

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113 These questions are identical to the those in Jörgensen & Svanberg (forthcoming)
According to the law, which of the following types of pledges must be notarised?

Pledges of vehicles:

Yes
No
Don’t know

5. According to the law, which of the following types of pledges must be notarised?

Pledges of inventory:

A. Yes
B. No
C. Don’t know

6. Suppose an enterprise is in the process of liquidation because the enterprise was seriously overdue in its payments of taxes to the government and on a loan to a bank. The loan was legally secured with collateral. According to the law, which of the creditors – the government or the bank – should be paid first from the proceeds of the liquidation?

The government should be paid in full first.
The bank should be paid in full first.
Both must be paid, if not in full, then in proportion to the size of the two debts.
The court must decide which should be paid first.
I don’t know.
7. When litigation occurs in court, is it necessary for the plaintiff and defendant involved to pay salaries of the judges and clerks as compensation for their time?

Yes

No

TABLE 2
Answers to questions regarding use of law enforcement methods

<table>
<thead>
<tr>
<th>Sanction</th>
<th>Percentage of enterprises having applied or threatened to apply the sanction (of those reporting)</th>
<th>Mean value of perceived effectiveness of sanction on a scale between 0 and 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>S1. Telling other enterprises about the behaviour of an enterprise that did not honour its agreement</td>
<td>54</td>
<td>5.3</td>
</tr>
<tr>
<td>S2. Forcing the enterprise to pay a financial penalty</td>
<td>47.1</td>
<td>5.5</td>
</tr>
<tr>
<td>S3. Stopping trade with the enterprise</td>
<td>76.0</td>
<td>6.9</td>
</tr>
<tr>
<td>S4. Filing a complaint against the enterprise with an antimonopoly committee</td>
<td>8.4</td>
<td>3.4</td>
</tr>
<tr>
<td>S5. Sending protesja or other notices suggesting a possible court action</td>
<td>57.4</td>
<td>5.8</td>
</tr>
<tr>
<td>S6. Filing a claim in court</td>
<td>42.5</td>
<td>6.0</td>
</tr>
<tr>
<td>S7. Reporting the enterprise to a local government organ</td>
<td>13.3</td>
<td>3.5</td>
</tr>
<tr>
<td>S8. Reporting the enterprise to a federal government organ</td>
<td>11.0</td>
<td>3.8</td>
</tr>
<tr>
<td>S9. Report the enterprise to a business association or a financial-industrial group</td>
<td>7.3</td>
<td>3.3</td>
</tr>
</tbody>
</table>

114 Ibid.
<p>| | | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>10. Reporting the enterprise to social, religious, or civic organizations</td>
<td>1.2</td>
<td>1.5</td>
</tr>
<tr>
<td>11. Reporting to a private security organization or other physical persons or group of persons in order to extract unpaid debt</td>
<td>26.1</td>
<td>5.9</td>
</tr>
</tbody>
</table>