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Legal Self-efficacy and its Latent Causes: Human Legal Capital, and Access to Information.

This study reveals that legal self-efficacy as well as access to and search for internal and external information concerning business risks each bring a significant reduction of business risk in two separate but interrelated channels. The direct channel of risk mediation is that of legal self-efficacy, while the indirect channel of risk mediation is that of information acquisition from texts, media and human sources. Both channels confirm previous findings by Jörgensen (2008) and Cho and Lee (2006). The results indicate that risk reduction can be achieved not only through legal human capital but also through behaviour related to the search for and finding of information. Previous research on contractual assurance and risk reduction has focused on the improvement of legal institutions such as courts and legal texts to address the problem of contractual assurance. This study takes an opposite approach of addressing the legal consciousness and behaviours of the end users of law. The policy implications are that managers can be taught to improve their legal self-efficacy or they can use risk-reducing behaviour to mitigate business risks.

An ongoing concern for enterprises is the reduction of business risk. Businesses face a multitude of risks and uncertain outcomes. One role of the legal system is to reduce business risk. Previous research in law and economics and particularly law and finance has pinpointed the institutions of the legal systems and found that their characteristics play a significant role for business risk in terms of, for instance, capital structure. This study turns this narrow approach around and focuses on the role of the human psyche – legal self-efficacy and the access to and search for information both internally from previous experience, as well as beyond the individual such as books, magazines, and films with legal information for the reduction of business risk. The legal consciousness of businesspeople has a more significant impact on economic transactions than has been previously recognized. Prior research on the interaction between law and business has failed to systematically study the interrelationship between legal consciousness and business risk. As a result, there has been no standardized concept for measuring legal consciousness among individuals. This study devises the concept of legal self-efficacy and demonstrates two channels through which this self-efficacy mediates business risk.
One reason to undertake this study, which suggests how businesspeople can use both attitude and behaviour to reduce risk perception and as a result take more risks, is Schumpeter’s observation that society will enjoy more innovation if managers are more optimistic and take more risks (Schumpeter, 1950). New innovations will create more jobs and provide for growth in countries that suffer lower growth due in part to poor legal systems. Risk reduction is well received in developing countries where businesspeople face higher business risk than in similar countries with better legal systems and higher access to external capital.

Legal self-efficacy as a phenomenon can be a supplement to the Coase theorem in the prediction of transactional behavior of businesspeople because of the endowment effect and transaction costs in real life, among other things. The aim of this study is to show that legal self-efficacy can serve as a foundation for the reduction of business risk using two channels. Another aim is to present self-efficacy as a concept that can be used for systematic research to discern how legal self-efficacy and specific behaviors can aid businesspeople to reduce business risks. Although the concept of legal self-efficacy is tested only in relation to two business risks in this study, it may be applicable to various risks in future studies. Much of the research in law and economics and law and finance concerns the reduction of transaction costs. The risk reduction as described by legal self-efficacy can help businesspeople reduce transaction costs, such as enforcement costs and legal fees. The efficiency of private contracting might be a function of legal self-efficacy and risk-reducing behaviours which this and previous studies (Jørgensen, 2008) demonstrate.

Legal self-efficacy is both a concept and a tool that can help develop models that better explain the interaction between economic actors and legal norms. For many years, law and economics scholars have worked with norms but not taken advantage of systematic research by social psychologists who have gone far further than LEN (Law and Economics) scholars in conducting and devising rigorous tests (Feldman & MacCoun, 2003, p. 360). This is perplexing, since the uses of cognitive psychology are quite evident in economics (Kahneman & Tversky, 1984; Tversky & Kahneman, 1981). The challenge for LEN scholars is to exploit social psychology in a manner that improves validity and realism in models while at the same time maintaining formal tractability and heuristic value (Feldman & MacCoun, 2003, p. 381).

When a legal system cannot provide adequate risk attenuation in terms of contractual assurance and protection against government nationalization, businesspeople are left with few options to attenuate business risk. One of them is to involve a lawyer to protect the interests of the enterprise; another is to acquire legal self-efficacy (Jørgensen, 2008). This study tests if there is yet another way to achieve a reduction of risk perception: to search for internal and external information about a particular decision that involves business risk. It also tests if legal self-efficacy has a direct effect on the reduction of risk perception in relation to business risk. Businesspeople need to take risks, as society will benefit from their endeavors.

1. Business risk and risk perception

A business risk is a condition or issue that may have a negative impact on the operation or prosperity of a given business. Sometimes referred to as company risk, a business risk can be the
result of internal conditions, as well as some external factors that may exist in the wider business community. For the purposes of this study business risk is related to the protection of private property rights. Client risk means that the further the distance to the client, the higher the risk of default on payment, as the availability of effective sanctions diminishes for a client in a remote location, as in a foreign country. The risk of government nationalisation of a business, for instance, is a sort of property risk.

Business risks are either actual or subjective. Actual risks can be assessed by objective analysis, perhaps by a team of experts. Subjective risks are those, which individuals distinguish in, given situations affected by bounded rationality, lack of total information, and possible errors of calculation. Subjective risk consists of two distinctive elements, uncertainty and significance of consequence (Cox, 1967; Taylor, 1974). “Uncertainty about the outcome can be reduced by acquiring and handling information. Uncertainty about the consequences can be dealt with by reducing the consequences through reducing the amount at stake” (Taylor, 1974, p. 54).

Every decision maker has his or her own set of frames of problem perception in risk calculation. This study brings to attention the legal frame of legal self-efficacy. Self-efficacy has a significant effect on the individual’s risk assessment (Krueger & Dickson, 1994; Locander & Hermann, 1979). A person equipped with legal self-efficacy is more likely to frame a decision of risk with legal terminology. This individual calculation is the foundation of the individual’s decision as to whether or not to engage in a certain behavioural pattern (Dowling & Staelin, 1994). Legal self-efficacy has been demonstrated to have a significant effect on the protection of private property rights and legal activism (Jörgensen, 2008; Jörgensen & Svanberg, 2009). Self-efficacy in an individual’s attitude has been demonstrated to have a reducing effect on individuals’ risk perception as well as an enabling effect in relation to specific tasks.

This study goes one step further than previous studies in finding mechanisms of risk reduction in relation to business risks by establishing two separate channels of risk mediation from a combination of two models (Conchar et al., 2004; Cho & Lee, 2006). The relationship prescribes that two separate searches of information, internal and external, be employed to reduce risk perception in relation to a specific decision. The study also seeks to test if legal self-efficacy is correlated to these two risk reduction behaviours to find out if there is any causality between them. If there is a correlation, there is a dual causality between the two risk-reducing behaviours and legal self-efficacy, implying that risk reduction can not only be achieved by two separate channels – the direct legal self-efficacy channel and the indirect channel over the two risk-reducing behaviours – but that they reinforce each other.

The findings of this study have both theoretical and practical implications in the research fields of law and economics and law and behavioral economics, as well as law and finance. The Coase theorem, the centerpiece of law and economics, is used as a starting point for a critical discussion that among other things reviews the concept of legal effectiveness which in the literature is defined only in terms of external legal institutions. Legal self-efficacy is introduced as a concept of individual legal effectiveness. Section one includes a brief review of the research findings of these four areas. Section two introduces legal self-efficacy. In section three, previous research on risk, business risk, and the two channels of business risk mediation are introduced. Section four
includes methodology and results. The paper closes with the final and fifth section presenting a discussion and the possible theoretical implications.

1.1 Previous research in law and economics

Law and economics scholarship has created a portal for psychology to access legal doctrines in a way never before considered relevant (Feldman & MacCoun, 2003, p. 361). This study uses this portal to find two channels that connect legal consciousness to the reduction of business risk. The study is a response to previous work in law and economics that has excluded the legal consciousness as an independent variable. An example of the neoclassical approach is the recent research on law and finance (LLSV, 1997, 1998; Levine, 1996, 1997, 1998) which has been able to establish that investor protection aids investment in minority positions in companies, and that the quality of established law has high explanatory power for financial market development across countries. Another finding is that legal family has an impact on investor protection. It is also a response to Feldman and MacCoun (2003) who call for research on how and when norms operate in relation to economic behaviour, as well as how internalisation of norms occurs.

The Coase theorem is a nucleus of law and economics modelling (Jolls, 2004). It has had an enormous impact on economics scholarship. The theorem states that when trade in an externality is possible and there are no transaction costs, bargaining will lead to an efficient outcome regardless of the initial allocation of private property rights. Bargaining between parties will achieve allocative efficiency by minimising transaction costs. This can only occur in a world of zero transaction costs and perfect contractual commitment. The allocative efficiency therefore hinges on a theoretical assumption that cannot be achieved in the real world. The work of Allais (1952) and Ellsberg (1961) points out that the fundamental assumptions of neoclassical economics are unrealistic and cannot in themselves provide the models that predict human behaviour in relation to law and economics. The Coase theorem is correct in theory but the conditions of reality make it invalid (Hoffman & Spitzer, 1993; Jolls, Sunstein, & Thaler, 1998). Coase admitted that the world of zero transaction costs is only hypothetical and thus unrealistic. Kahneman, Knetsch and Thaler (1990) empirically assess the Coase theorem and find that its theoretical prediction is hampered by what is known as the endowment effect (Thaler, 1980, p. 44), so that the theorem loses its validity in this context. Korobkin (1998) concludes that the endowment effect better describes contract law default rights than does the Coase theorem. The knowledge about the endowment effect is helpful when understanding the limits of the conventional normative analysis of law (Jolls, 2004, p. 10).

Previous studies partially describe businesspeople’s use of law. The individual can decide to engage, avoid, or resist law in communication with other people (Ewick & Silbey, 1998). The decision to do so is a function of legal self-efficacy and the expected utility of applying a legal perspective to the problem at hand. A sample of the studies that capture businesspeople’s relation to law in various settings include Macaulay (1963), Ellickson (1991), Hendley (1999), Hendley and Ryterman (2000), and Cooter (1994). Empirical evidence suggests that business is not structured via law but through social relations. Macaulay and Ellickson’s studies describe how businesspeople avoid the use of law, preferring the usual handshake to the involvement of lawyers. Bernstein (1992) and Axelrod (1984) both describe how reciprocity and reputation
function as mechanisms of efficient trade, norms that can only work in close-knit groups or in situations where reputations can be monitored.

The legal practice in the diamond industry is described by Bernstein (1992). Disputes are resolved using an elaborate set of rules understood by the chosen participants, complete with characteristic institutions and sanctions to handle disagreements among industry members. Cooter (2000) goes so far as to state that only when norms are internalised do they ensure a self-enforcing mechanism. Macneil (1985) demonstrates the value of relational trading, for instance, to trade without litigating, as continuous trade and interdependence is an effective means of avoiding litigation. The cornerstone of relational trading is that it is repetitive and is, as such, similar to the tit-for-tat strategy. Long-term relationships are more conducive for business than court adjudication. Hendley et al. (2000) describes the transactional strategies of Russian businesses, which include all three in relation to the exercise of law.

Bounded rationality describes the limitations of human beings in assessing all information relevant to making rational contract decisions. Opportunism refers to the human motivations that seek to exploit vulnerabilities created by the contract by not fulfilling contractual obligations. Bounded rationality can be divided into two categories: judgement errors (such as discrimination) and heuristics bias (the departure from maximum utility). Bounded rationality derives from cognitive errors that arise from biases in judgement and from efforts to economise on decision costs (“heuristics”). Bounded rationality derives from “framing effects”; that is, a person’s reaction to choice may depend on how that choice is framed or envisioned. Loss aversion and endowment effects are examples of bounded rationality. Loss aversion is a departure from expected utility theory. People are loss averse when they dislike losses more than corresponding gains. Other factors affecting individual transactions are utility maximisation, opportunism, and bounded rationality of the actors. These realities surrounding transactions need to be taken into account to achieve a realistic view of the transaction.

The goal of behavioural law and economics is to account for the imperfections of the human mind, which psychology in many ways is more successful in systematically researching. Behavioural law and economics involves both the expansion and the assimilation within law and economics of behavioural insights drawn from various fields of sociology and psychology. There have been several interesting attempts by scholars in behavioural law and economics to present the effects of bounded rationality on human interaction with law (see e.g., Parisi & Smith, 2005). Yet the field is extremely fragmented and there are hardly any common definitions of psychological terms and concepts, making systematic research more difficult.

1.2 Legal self-efficacy

Self-efficacy is the faith in one’s ability to do something in a specific field. There is significant support for a positive correspondence between self-efficacy and performance (Stajkovic & Luthans, 1998). Persons with a high level of self-efficacy view circumstances as presenting

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1Tit for tat means "equivalent retaliation". If player A rats on player B, then player B will retaliate with the same or maybe another measure to hurt player A. In game theory it is a highly effective iterative strategy in e.g. the prisoner’s dilemma. In business a tit for tat strategy can be considered buyer A purchases sub-quality products from seller B. Buyer A retaliates by not paying, or delaying payment for the product from B.
achievable scenarios. They envisage success scenarios that provide guides for winning performance. Those who judge themselves as having low self-efficacy conversely view situations as perilous and cannot seem to visualise affirmative prospects (Krueger & Dickson, 1994).

Self-efficacy has been demonstrated to be a strong predictor of behaviour in various fields. Self-efficacy is a mechanism of personal agency that mediates between the sources of its creation and subsequent outcomes (Maddux et al., 1986). The foretelling and mediational role of self-efficacy has received support from a growing body of findings from diverse fields and applications (Barragan et al., 2007). Self-efficacy has been proven to be effective in exercise (Lee et al., 2007), personal and social development of youth (Johnson et al., 2007), knowledge sharing (Lin, 2007), and computer use at work (Ng, 2006).

Intellectual capacity and self-efficacy are found to have a significant correlation (Bosma & Boxtel, 2007). Students’ self-efficacy is found to be a useful predictor of perceived competence in science (Beghetto, 2007). Self-efficacy reflects beliefs about one’s ability to organise and execute courses of action necessary for attainment of a goal (Maddux & Gosselin, 2003). 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, be persistent in their goal-directed behaviour, and be successful in their pursuit of these goals (Judge & Bono, 2001).

Bandura posits that there are four sources of self-efficacy: experience, modelling, social persuasion, and physiological factors. ‘Mastery experience’ is the most significant factor deciding a person’s self-efficacy. Simply put, success augments self-efficacy, while failure lessens it. Modelling, or vicarious experience, is founded on the comparison between the individual and someone else. When one sees someone achieve something, one’s self-efficacy will be augmented; when one sees another not succeeding, self-efficacy will decrease. Social persuasion concerns the encouragement or discouragement from peers. People in an individual’s surroundings can boost or lower self-efficacy by persuasion. In terms of physiology, people tend to exhibit symptoms of distress in stressful situations. These symptoms can be interpreted negatively by persons with low self-efficacy and as normal to people with high self-efficacy. A sound body helps a person feel more self-efficacious whereas an unhealthy body can deter a person from having high self-efficacy (Bandura, 1977).

The theoretical foundations of legal self-efficacy as a concept of distributed legal effectiveness are laid out by Torpman and Jörgensen (2005). According to their definition, the effectiveness of law is a direct consequence of businesspeople’s ability to use legal terms and in their acceptance of law as a means of communication. Legal effectiveness is thus a function of the distributed acceptance of law as a way to structure business transactions. Two subsequent studies have empirically validated the concept (Jörgensen & Svanberg, 2009; Jörgensen, 2008).

A layman’s understanding of legal concepts such as rights, debt, obligation, and contracts may not always be in line with the textbook definitions. A precondition of the use of legal terminology is familiarity with legal terms. It is reasonable to assume that self-efficacy (and therefore familiarity with basic legal concepts) is relevant to the choice to apply a legal perspective to a situation. Prior practice and performance help create self-efficacy perceptions, which are strong predictors of subsequent performance (Pajares & Kranzler, 1995).
2.1 Legal self-efficacy as a frame and heuristic

Legal self-efficacy is an attitude that can be seen as a “standard decision procedure” or heuristic. The reasons why some people have legal self-efficacy and others do not can depend on previous experience with law and the four ways in which one achieves self-efficacy: performance accomplishments, vicarious experience (modelling), verbal persuasion, and physiological states (Bandura, 1977). The cognitive theory of choice under uncertainty offers two sorts of insights of some relevance to analysts interested in the regulation of risk. The first is that people take shortcuts (use heuristics). This can lead to mistakes about variables. The second is that people approach risk in ways that depart from the norms and assumptions of conventional decision analysis (Noll & Krier, 1990). Legal self-efficacy is facilitative 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. Law shapes the individual’s expectations, calculations of action, and understandings (McCann & March, 1995).

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 in behaviour than do the inherent qualities of institutions themselves (Opp, 1985; Denzau & North, 1994). Legal self-efficacy is also a measure of how much an individual has internalised legal norms. Internalised legal norms are closely related to emotions, that is, non-legal sanctions of the individual on himself, such as shame, guilt, and remorse (Frank, 1987; Huang & Wu, 1994). Emotions are the sanctions that internal norms impose on the individual. This is helpful in enforcing second- and third-party sanctions as well.

2.2 Legal self-efficacy as risk-reducing belief

Legal self-efficacy is an attitude that diminishes the perceived risk in a situation of economic transactions under hazard. The reduction is that of subjective perceived risk, not of objective (absolute) risk. Risk perception is the subjective judgement that people make about the probability of an event and the ability to handle that event. Objective risk differs from subjective risk in that objective risk is \textit{actual} probability of an occurrence and \textit{actual} probability that the consequences can be handled. Self-efficacy in general is a risk-reducing belief related to a specific area, but the mechanism of this reduction is seldom related to the field of risk research, which offers its own explicit models of mechanisms of risk reduction.

This paper connects the two strands of research and tests how two risk-reducing mechanisms relate to legal self-efficacy. The reduction occurs through two different channels. The first channel links legal self-efficacy directly to risk behaviour. The second channel – the framing model of risk reduction – operates through two risk-reducing behaviours, the searches for internal and external information in a process called framing. The two channels are separate but
interrelated. The hypotheses of this paper test both channels separately and examine how legal self-efficacy is related to framing.

2.3 Legal self-efficacy as individual legal effectiveness

This paper is in part a response to current research on legal effectiveness as an external phenomenon. Previous research on external legal effectiveness by economists and, in a few cases, legal scholars have one-sidedly treated legal effectiveness as an external phenomenon, as though it emanates solely from formal legal institutions. This section briefly presents previous research on external legal effectiveness and explains the benefits of legal self-efficacy as a measure of internal legal effectiveness.

The rationale of the legal effectiveness concept is, with few exceptions, that law is effective when the professional and institutional services provided by lawyers, courts, and authorities can be acquired rapidly, accurately, and at low cost. The formal legal system is here associated with the transaction costs to businesses. The concept is a reaction to previous studies of legal effectiveness based on the characteristics of external institutions such as creditor rights, speed of court rulings, and effectiveness of law enforcement agencies (see e.g., Pistor, 2000; LLSV, 1997, 1998; Botero et al., 2003; Buscaglia & Uhlen, 1997; Church et al., 1978; Mahoney et al., 1985). According to the definition used in these studies, law is effective when behaviour is in compliance with law, and compliance is described as if it is achieved mostly through the model of Austinian command backed by threat.

Legal self-efficacy is an individual’s own assessment of how comfortable he/she is with the use of legal terminology in communication with other people. The concept is an application of the legal effectiveness concept developed by Torpman and Jörgensen (2005). Legal self-efficacy is the distributed legal effectiveness assuming laymen as end-users of law. A layman’s application of law demands some basic knowledge of what law is, the boundary of law, and the ability to assess the result of its application. This requires some fundamental cognitive ability and familiarity with law as well as trust in the use of the legal system, not dissimilar from the Hirschman concept of exit-voice-loyalty, which shows that consumers are loyal to a product if they feel that they can communicate with the product (Hirschman, 1970). The most valid estimation of legal effectiveness in a population ought to be closely related to legal self-efficacy, as law has effect in society only if legal communication is accepted as law with its inherent meanings and expectations (Torpman & Jörgensen, 2005).

As a result of the development of the concept of legal self-efficacy as a form of internal legal effectiveness, it becomes clear that the concept also has useful applications in understanding the impact of legal transplants in a general population with a particular focus on legal application (Jörgensen & Svanberg, forthcoming). Foreign law has been transplanted throughout history. The previous concepts of external legal effectiveness, including adherence to established law, fit
poorly with the transplanted law, especially when it derives from another legal family and was imposed’ a short time before. This is one of the reasons for the resilience of legal systems.

In legal environments that cannot provide contractual assurance, legal self-efficacy might act as a substitute where the individual businessman can reap benefits from trade despite a poorly functioning legal system. The inconsistent rule of law in Russia is a perfect case in point to test the theory of legal self-efficacy. Russia has a history of controversial attitudes to private property and the matter is still far from settled. There is extensive dissatisfaction in wide swaths of the population in Russia regarding the distribution of private property, in the wake of the privatisation carried out in the 1990s.

3. Business risk and the channels of risk reduction

The introduction above notes that a business risk is a condition or issue that may have a negative impact on the operation or prosperity of a given business. The two risks chosen for this study are property risk and client risk. The client risk increases with the distance between the producer and client. The property risk cannot be eliminated in Russia, a factor which we clarify below. This section begins with a brief review of these two business risks.

3.1 Private property rights in Russia and the CIS

Russia has a distrust of private property that can be traced back to medieval times. Whereas in Western Europe private property rights are considered indisputable civil rights and a natural part of the constitution of each country, without any serious political challenge, Russia has never viewed private property rights as an elementary civil right. Property rights have instead existed at the caprice of the government, Czarist or Communist, which could grant individual ownership rights to private property. Ownership rights could easily be revoked by the Czar or the Party, with only a restricted right of appeal (Pomeranz, 2004).

After the fall of Communism, Russia has been a leading country in terms of the absolute size of privatisation. This process has been controversial, since the process of privatisation was the most rapid and perhaps worst planned of all of the former planned economies. The discontent among the general population with the results of privatisation cannot be underestimated. Denisova et al. (2007) analyse an EBRD 2007 survey on the support for revision of privatisation in 28 post-communist countries. Eighty percent of the respondents favoured some kind of revision, but one third of the respondents supported total nationalisation. The main conclusions of this analysis were that endowed individuals are the most against revision and those who have negative personal experiences of privatisation are most in favour of revision, owing to a belief in lack of fairness. Lack of higher education was also a predictor for support for revision. An earlier survey of Russia’s population in 2006 found that 52 percent of respondents concurred with the statement “the majority of private assets in the country should be nationalised”.

“In your opinion, what should be done with most privatised companies? They should be…”
Renationalised and kept in state hands | Renationalised and then re-privatised again using a more transparent process | Left in the hands of current owners provided that they pay privatised assets’ worth | Left in the hands of current owners with no change

| 36.7 | 13.3 | 31.5 | 18.5 |

As reported in Denisova et al. (2007) p. 28.

Re-nationalisation is not only confined to the energy and media sector. Many privatisation reversals have occurred in the financial sectors as with PromStroyBank and Guta Bank, in manufacturing, such as the OMZ (United Machine Factory), Siloviye Mashiny (Power Machines), and the largest car factory, AvtoVAZ (Denisova et al., 2007), as well as YUKOS, Sibneft, the Industrial Construction Bank of St. Petersburg, and Irkut. In all, there are approximately 20 firms anticipating the results of pending court cases. The trend of nationalisation began in Russia in 2004. The tendency is that infrastructural companies such as Russian Railways and in the energy sector consolidate their suppliers to the point where it becomes unclear whether Russia is truly a market economy (Kommersant, 2007).

Putin, on the one hand, adamantly promised that there would be no nationalisation of companies, while on the other hand he actively pursued nationalisation policies. The Land Code of 2001 gave businesses an opportunity to buy the land on which they are located, or lease it from the local government. There is, therefore, a double policy of nationalisation and expanding the importance of ownership for businesses. The average businessman cannot expect to be confident of his rights to his business and the land that it sits on (Sonin, 2003).

Legal self-efficacy can be expected to have an impact on the perception of such property rights, an immediate relationship that can be called the direct channel of legal self-efficacy. The following hypothesis captures this relationship:

H1: There is a positive and significant relationship between legal self-efficacy and the protection of property rights.
### 3.2 Customer risk: Credit risk and effectiveness of sanctions

Two major components of customer risks are credit risk and effectiveness of sanctions for a defaulting customer. Customer risk in terms of credit risk can be mitigated by information about a customer prior to and during a trade relationship. When a customer is in default, the effectiveness of various methods of sanctions to recover trade credit also mitigates customer risk. Both risks vary, depending on the physical distance to the customer.

The role of information in customer risk assessment has increased with the growth of the complexity of risk factors that can have an impact on the extension of trade credit. Currently speed, accuracy, and cost are the primary factors in the decision to ‘buy vs. make’. This makes the customer risk assessment an issue for the whole development of the economy. In the emerging economies, as in the CIS countries, public records and general information structures are underdeveloped and access to data is difficult. This lack of information significantly increases credit risk, making personal visits and physical proximity to a potential customer all the more important in Russia as contrasted with more developed economies (Bartels & Hirt, 2001, p. 71).

In countries with a poorly functioning legal system, the role of direct sanctions to recover debt from defaulting customers takes on added importance. There are at least eleven types of sanctions against customers in default (Jørgensen & Svanberg, 2009, Table 3). Physical distance has a direct negative impact on the instigation and perhaps effectiveness of these sanctions. Filing a claim in court, or sending a *pretenzia* (a written warning about court adjudication if conditions are not met) is not affected by distance to the customer, given that the contract stipulates adjudication in the town of the supplier, as is common practice to compensate for the credit risk that the supplier takes. The effectiveness of sanctions such as telling other enterprises, reporting the enterprise to a local or federal government organisation, reporting the enterprise to a business association or a financial-industrial group, or reporting the enterprise to a private security organisation or individuals or groups who can collect debts are all affected by the physical distance to the customer. Businesses may not consider it worthwhile to report a defaulting customer to a local government department on the other side of the globe.

The importance of physical proximity to a customer to acquire information and be able to efficiently apply sanctions effectively limits the range in which companies do business. As this study shows, this effect can be partially compensated for by legal self-efficacy. Businesspeople with legal self-efficacy are more likely to apply sanctions to clients in default (Jørgensen & Svanberg, forthcoming). Legal self-efficacy can also be expected to have an impact on the perception of customer risk, a relationship that is another direct channel of legal self-efficacy. The following hypothesis captures this relationship:

H2: There is a positive and significant relationship between legal self-efficacy and customer risk.
3.3 Previous research on risk

This section presents the two major theories on risk, the psychometric model and cultural theory.

Risk has been researched with the focus on either the source of the risk or the individuals subject to it. The psychometric model, based on psychology and decision research, states that perceived risk is a function of the risk attributes, such as old versus new risk, voluntariness, etc. (Sjöberg, 2002). Both large-scale societal risks, such as nuclear power, and personal risks, such as being a victim of a car accident, have been studied (Fromm, 2005). With the aid of the psychometric model and factor analysis, the number of factors that explain variance in how different risks are perceived is narrowed to three: unknown risk, dread, and a factor related to the number of people exposed to the risk (Slovic, 1987). (For an in-depth review of the research results and methods of the psychometric model, see Boholm, 1998). This model also differentiates between laypeople and experts. There is no clear definition of an expert, and many of those named as experts make judgements outside their own area of expertise (Fromm, 2005).

Cultural theory, on the other hand, has its roots in social anthropology and sociology. It posits that risk is socially constructed. It further holds that there exist four categories of people with their own biases and world-views (Wildawsky & Dake, 1990): egalitarians, individualists, hierarchists, and fatalists, and, as a consequence, each social group may have its own sets of risks. Cultural theory has received significant criticism from Löfstedt and Frewer (1998), among others. The measurement of risk should be done from an inclusive perspective, using the characteristics of the individual in relation to a defined risk or set of risks. This is a more realistic and credible method as it mimics real-life situations and the dependent variables are more limited. The present study is an example of this inclusive perspective.

Previous research has identified several other factors, both individual and organisational, that affect risk behaviour. Individual characteristics include the individual’s labelling of situations (Douglas, 1985; Dutton & Jackson, 1987). 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 (Felstiner & Sarat, 1980-81; Engel, 1980, 1984). Claims, during both formation and processing, may be framed or transformed in ways that reject law or include it (Merry, 1990). The probabilistic estimates of the extent and controllability of risk and the confidence in the risk estimates (Baird & Thomas, 1985; Duncan, 1972), knowledge (Monroe, 1976; Rao & Monroe, 1988), and the ability to perform under risky conditions are also documented individual effects (Allman, 1985; March & Shapira, 1987). Risk or loss aversion is another individual characteristic (Kahneman & Tversky, 1979; Zinkhan, Joachimsthaler, and Kinnear, 1987), as is intolerance of uncertainty (Kahn & Sarin, 1988; Raju, 1980), and uncertainty evasion (Hofstede, 1980).

In addition to research on individual traits affecting risk behaviour, there is research on organisational traits and their role in risk behaviour. Organisational traits include the role of leaders in modelling risk-related behaviour in organisations and in lending their personal authority to the relation to risks (Jacofsky, Slocum, & McQuaid, 1988; MacCrimmon & Wehrung, 1986; Nutt, 1986; Schein, 1985).
3.4 Models of risk

Modelling risk in business decisions is a long-overdue project. The two predominant models, psychometric and cultural theory, have not produced very good results for decisions in businesses. This is part due to the fact that they were designed for the prediction of other types of risk. Little empirical research has been done on entrepreneurs’ decision-making, risk perception, and risk propensity among potentially risky entrepreneurial ventures (Forlani & Mullins, 2000), yet risk is a central element of decision contexts, including entry into new ventures or markets (Dickson, 1992; Timmons, 1994).

Risk is a characteristic of decisions, defined here as the degree to which there is insecurity about whether potentially considerable and/or disappointing outcomes of decisions will be realised. Sitkin and Pablo (1992) propose a model of risk propensity and risk perception as the determinants of risk behaviour. They posit that risk propensity dominates both the actual and perceived characteristics of the situation as a determinant of risk behaviour. They derive their conclusions from a comprehensive review of previous research, which suffered from fragmented and overly simplified models of individuals, organisations, and problem-related characteristics. This research also produced contradictory results. These characteristics of inadequate models only indirectly influence risk behaviour, which are mediated by risk propensity and risk perception. Self-efficacy and greater wealth position has been demonstrated to have a risk-reducing effect using the Sitkin and Pablo model (Cho & Lee, 2006).

An attempt using previous research to explain risk behaviour relevant to business decisions is made by Conchar et al. (2004). Conchar et al. (2004) reviews the current literature on risk behaviour in order to formulate an integrated framework for the conceptualisation of perceived-risk processing in three steps – framing, assessment, and evaluation – explained below.

3.4.1 Framing

This initial step involves searching for internal and external sources of information related to the risk and the decision about risk, as well as the choice of alternatives. Each situation of a decision about risk can contain a number of alternatives; each alternative produced is the result of the twin search for internal and external information. The result of this search is a set of alternatives from which to choose. An individual's attitude to the use of legal terminology is related to the framing of a decision of risk about a larger decision involving the protection of private property. An individual who has internalised legal self-efficacy will be more likely to frame alternatives in a legal context. The first source of information is previous experience of similar situations. When a prior situation has been successfully encountered using a certain heuristic, more likely than not, that heuristic will be used again, for good or ill, depending on the similarity of the situations.
Table 1.

<table>
<thead>
<tr>
<th></th>
<th>My knowledge about the legal system derive mostly from</th>
<th>My impressions about the how the legal system works derive mostly from</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>yes</td>
<td>percentage</td>
</tr>
<tr>
<td>My practical experience</td>
<td>165</td>
<td>68.2</td>
</tr>
<tr>
<td>Foreign movies</td>
<td>6</td>
<td>2.5</td>
</tr>
<tr>
<td>Domestic movies</td>
<td>2</td>
<td>0.8</td>
</tr>
<tr>
<td>Soap operas on TV</td>
<td>3</td>
<td>1.2</td>
</tr>
<tr>
<td>Newspapers</td>
<td>86</td>
<td>35.5</td>
</tr>
<tr>
<td>Books</td>
<td>45</td>
<td>18.6</td>
</tr>
<tr>
<td>My friends</td>
<td>38</td>
<td>15.7</td>
</tr>
<tr>
<td>My colleagues</td>
<td>75</td>
<td>31</td>
</tr>
<tr>
<td>Other</td>
<td>11</td>
<td>5.3</td>
</tr>
</tbody>
</table>

3.4.2 Internal information search

This behaviour includes information stored in memory on risk learning and previous experience with risk pertaining to the current situation (Punj & Staelin, 1983; Brucks, 1985). Product loyalty as demonstrated in Roselius (1971) is closely associated with Hirschman’s (1970) study about exit-voice-loyalty, which finds that brand loyalty depends on customers’ impression that they can communicate with the product. Prospect theory posits that people assign value to gains and losses relative to some individual reference point (Tversky & Kahneman, 1992). Reference points serve as a benchmark with which to weigh risk in a situation of similar nature in previous experience. Relevant experiences can serve as benchmarks and help inform individuals when making a decision about risk. Cox (1967) writes that past experience, habits, and reference to similar situations influence perceived risk. An individual’s comfort with the use of law can be the result of previous successful uses of law. The individual can be satisfied with this internal search for information and may not need to consult external sources. If this consultation is made, the sources tend to be those most accessible.

3.4.3 External information search

The external sources of information include social references (Miniard & Cohen, 1983; Bearden & Etzel, 1982) or market information such as company web sites, advertising, salespersons, or
product brochures (Beatty & Smith, 1987; Agarwal & Teas, 2001). There may be several references of both external and internal natures, including target references or aspirations, regret references, average experienced outcomes, social expectation references, and best-possible references (Yates & Stone, 1992). Social expectations such as peer pressure are examples of common external pressures, which can occur in an external information search. Cho (2006) empirically validates that both external and internal sources of information are related to framing in a choice about risk.

Incidentally, Bandura’s (1977) model of sources of self-efficacy coincides with Conchar’s (2004) theory on risk-reducing behaviour, except for physiological factors. The search for information in this model coincides with three of the four sources of self-efficacy mentioned above. Internal information search has much in common with mastery experience in that previous experience is a benchmark for future performance. Modelling and social persuasion coincide with the external information search.

3.4.4 Risk assessment

In the risk assessment stage, the information collected in the previous stage is assessed in individual and situational contexts. This is the subjective estimation of the probability of various events. It is necessary to assess the individual’s subjective evaluation of risk (Von Neumann & Morgenstern, 1947). Risk is subjective, multidimensional, and contextual in nature (Bauer, 1967; Vann, 1983). Perceived risk is the result of a combination of context-dependent importance weights, the inherent risk in a specific situation, and the influence of individual factors (Conchar, 2004, p. 430).

This phase includes both personality traits and situational related variables (Dowling, 1986; Hansen, 1976). The individual assigns a probability to each explicit risk situation. It is the subjective probability of a certain event, as opposed to objective probability, which is the probability of an occurrence based on either computation or by actual observations of a large number of similar events taking place in similar conditions. Subjective probability often differs significantly from objective probability, either because the person cannot compute the actual probability, because the person feels lucky or ill-fated, or because they think they can control the game.

3.4.5 Risk evaluation

At this step the information on the set of alternatives from the previous two steps is weighed and compared. The subjective probability of the set of events is multiplied with the subjective perceptions of loss or gain and this calculation is combined with the current status of available assets. Individuals engage in mental accounting – perceived risk evaluation (Thaler, 1991). A good metaphor for this is when a poker player is willing to risk more when he/she is ahead because incurred losses will be less damaging (Thaler, 1991). Risk evaluation occurs relative to an evaluation standard, financial, social, physical, or convenience. Initial entitlements matter in the risk situation, and are not dissimilar to the endowment effect (Tversky & Kahneman, 1991, p. 1039).
3.5 Conceptual framework

The relationship that this study proposes rests on the following propositions:

1. Legal self-efficacy affects individuals’ perception of risk in a context related to the protection of property rights using a direct channel. Legal self-efficacy is mediated via an indirect channel by framing, applying risk-reducing behaviour in the form of searches for internal and external information relevant to the situation of risk. Perceived risk is indirectly mediated in three separate but interrelated phases: framing, risk assessment, and risk evaluation.

The relationship builds on the findings of Sitkin and Pablo (1992), which risk behaviour hinges on two factors: risk perception and risk propensity. The two channels of risk mediation presented in this paper omit risk propensity for several reasons, the main one being that the causality of risk propensity has not been clearly established. It also further develops channels of risk perception beyond Sitkin and Pablo (1992) in that it includes framing in terms of risk-reducing behaviours and the subsequent steps of risk assessment and risk evaluation.

3.6 Hypotheses

The combined risk model of Conchar et al. (2004) and Cho (2006) posit that risk-reducing behaviour occurs in the form of searches for internal and external information. The behavioural origins of legal self-efficacy and this risk model coincide in terms of previous experience, including internal information, vicarious experience\(^2\), and social experience, and external information. Self-efficacy also includes physiological factors, which are not included in this study. The purpose here is to see how well self-efficacy and risk-reducing behaviour coincide. We test the indirect model in the following four hypotheses. The first two test the two-directional causality between legal self-efficacy and framing.

3.7 The indirect channel of risk behaviour – the framing model

The significance of the relation between legal self-efficacy and the two search behaviours is tested in these two hypotheses:

\[ H3: \text{There is a positive and significant relationship between the search for internal information and legal self-efficacy.} \]

\(^2\)observed experience of others.
H4: There is a positive and significant relationship between the search for external information and legal self-efficacy.

The following two hypotheses test the relationship between framing and client risk:

H5.1 There is a positive and significant relationship between the search for internal information and client risk.

H5.2 There is a positive and significant relationship between the search for external information and property risk.

These next two hypotheses test the relationship between framing and the protection of property rights:

H6.1: There is a positive and significant relationship between the search for internal information and the protection of property rights.

H6.2: There is a positive and significant relationship between the search for external information and the protection of property rights.
Figure 1. The relationship between Legal Self-efficacy and Business Risk

Legal Self-efficacy

Indirect channel

Risk Framing

Internal Information Search

External Information Search

Risk Assessment

Risk Evaluation

Direct channel

Business Risk

Customer Risk

Protection of Property Rights
4. Method and Results

The survey was carried out by the author and two Russian students between March and May 2005, canvassing 246 enterprises in St. Petersburg, Pskov, and Kaliningrad in Northwest Russia. The respondents from random samples of 146 businesspeople attending several trade fairs at Lenekspo in the Petersburg Sports and Concert Complex in St. Petersburg, and a random sampling of businesspeople in Kaliningrad (50) and Pskov (50). We approached CEOs and top managers in each firm at the trade fairs and directly in their offices. The response rate was 50 percent or better. The internal response rate in the questionnaires themselves was 80 percent or better. The whole sample is a mixture of a convenience sample and a random sample; it was random in terms of choice of respondents within the groups of businesspeople, but the quantity is not quite sufficient for it to be considered a pure random sample. The aim was to get a sample large enough to draw some valid conclusions with regard to businesspeople in Northwest Russia.

Enterprises from ten different industrial categories were represented. Firms had from 5 to 7,000 employees, with an average firm size of 44 employees. The average timespan of firm activity at the date of the survey was 9.5 years. Twenty-eight percent of the respondents was female, and 72 percent male. Seven percent of firms were registered on a stock exchange, and 8.3 percent were at least partially state-owned, while 18.1 percent were open stock companies (OAO), and 30.3 percent were closed (ZAO). The remaining 51.9 percent were of another legal structure or undisclosed. The mix between industry and services was 60-40, representative of the Russian economy as a whole. The survey instrument contained questions on topics ranging from firm legal strategy to methods of financing the firm, client structure, and trade credit.

The constructs of legal self-efficacy included “I am confident in using legal terminology” (the standard measure of legal self-efficacy) and “I know the legal system very well”. The answers were provided via Likert scales from 0 “I do not agree at all” to 10 “I fully agree”.

I am confident in using legal terminology

<table>
<thead>
<tr>
<th>I do not agree at all</th>
<th>I fully agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3My gratitude is expressed to Vyacheslav Eropkin in Pskov, and Olga Belova and Elena Osipova in Kaliningrad for assistance with collecting the surveys. I would also like to thank the Swedish Institute and Inga-Lill Norlin for two generous grants supporting the data collection in Russia.
The literature consists of four publications issued in Russia.

Rossiskaya gazeta, the official Russian daily newspaper issued by the government of the Russian Federation, publishing most new laws, making it a favourite among those who need to keep up with current legislation. RG is a key source of information about politics, economics, and law, rather like Izvestiya and Kommersant.

Ekonomika i zhizn’ (Economy and Life) is a weekly journal focusing on the economy with articles by specialists.

Sobranye zakonodatel’stva RF (Legislation of the Russian Federation) is issued by the Office of the President of the Russian Federation, and contains federal laws, decrees from the president, government decrees, and news from the constitutional court.

Vestnik Vyshego Arbitrazhnogo Suda (Bulletin of the Supreme Court of Arbitration) is the official gazette of the Russian Supreme Court of Arbitration.

The last three are not publications the ordinary citizen subscribes to; rather they are relevant for those who have a special interest in the official publication of the latest laws and decrees.

4.1 Tests of hypotheses

The testing of hypotheses begins with the direct channel between legal self-efficacy and risk behaviour, followed by the testing of the second channel: legal self-efficacy and external and internal sources of information. The final hypotheses concern the relationship between framing and risk behaviour.

A Friedman test of all variables included in calculations in this paper shows that variables are normally distributed at the 1 percent level of significance.
**Legal self-efficacy and customer risk**

**H1:** Legal self-efficacy and the share of remote customers in a company’s set of clients are positively and significantly correlated with internal and external information.

Legal self-efficacy and the correlation to the share of customers out of town/same town contribute with this portion of present customers.

0.167 *** (0.010) Df: 191 when controlling for size.

**Legal self-efficacy and the protection of private property rights**

**H2:** Legal self-efficacy and the attitude to the protection of private property rights are positively and significantly correlated.

The question was: What is the likelihood that your firm will be nationalised within the next few years?

Legal self-efficacy and attitude to the protection from nationalisation of own enterprise,

0.226*** (0.001) Df: 187 when controlling for size.

The following tests the indirect channel of legal self-efficacy and risk behaviour.

**The indirect channel**

The hypotheses set out below test the dual causality between legal self-efficacy and the risk-reducing behaviours of internal and external search. By demonstrating that legal self-efficacy and risk-reducing behaviour correlate, we find two things. First, legal self-efficacy is connected to behaviour that reduces risk. The two-way causality reinforces the belief that legal self-efficacy has impact on indirect behaviour that reduces risk, and the behaviours in their turn reduce risk perception. Second, we demonstrate that risk behaviour such as client risk and protection of private property is mediated to legal self-efficacy via risk-reducing behaviours such as searches for internal and external information. Legal self-efficacy as a reduction of risk perception is mediated by risk-reducing behaviours.

**H3:** There is a positive and significant relationship between the search for internal information and legal self-efficacy.

Filing a complaint against the enterprise with an antimonopoly committee and legal self-efficacy:

0.220*** (0.004) Df=165.

Forcing the enterprise to pay a financial penalty:

0.194** (0.012) Df=168.
The last two hypotheses test the relationship between framing via the search for internal and external information and risk behaviour.

H4: Legal self-efficacy is positively correlated to access to external information and therefore facilitated search for information in legal sources.

This concerns the correlation between legal self-efficacy and the sum of the consulted legal sources (Rossiskaya gazeta, Ekonomika i zhizn', Sobranye zakonodatel'stva RF, Vestnik Vyshego Arbitrazhnogo suda), as well as other sources.

Legal self-efficacy and access to text legal sources: 0.206*** (0.001) Df =138.

H5.1 There is a positive and significant relationship between the search for internal information and client risk.

Stopping trade and client risk: 0.164** (0.037) Df = 137.

H5.2: There is a positive and significant relationship between the search for external information and attitude to the protection of property rights.

The search for external information is a combination of three sources: the available legal literature, as noted above, various impressions, and knowledge of the legal system. The other sources in terms of impressions and knowledge are foreign movies, domestic movies, and soap operas on TV, newspapers, books, friends, and colleagues: 0.159** (0.025) Df : 195.

H6.1: There is a positive and significant relationship between the search for internal information and the protection of property rights.

Stopping trade with a customer: 0.169** (0.037) Df : 153.

H6.2: There is a positive and significant relationship between the search for external information and the protection of property rights.

The search for external information comprises a total of three sources identical to the one above: available legal literature as noted above, other sources of impressions, and knowledge of the legal system. The second and third sources in terms of impressions and knowledge respectively of external information are foreign movies, domestic movies, soap operas on TV, newspapers, books, friends, and colleagues. 0.149** (0.038) Df : 194

5. Discussion and theoretical implications

The study demonstrates both the significance and usefulness of legal self-efficacy and the significant risk reduction resulting from access to and search of legal information. Legal self-efficacy has a significant impact on the reduction of business risks; the two first hypotheses are confirmed as positive and significant direct effects on customer risk and attitude to the protection of private property. The indirect channel – the framing of risk – is also confirmed. Search behaviours are positively and significantly correlated to both legal self-efficacy and risk
behaviours of customer risk and protection of private property. The internal information search shows that legal self-efficacy positively correlates with two types of sanctions: filing a complaint against the enterprise with an antimonopoly committee, and forcing the enterprise to pay a financial penalty.

The indirect channel is confirmed for client risk as well as the protection of property rights by the same types of searches for information. The internal information search demonstrated that the relational, or tit-for-tat strategy, of stopping trade with a client was most effective. The external information is a combination of elements: legal texts, personal impressions, and knowledge. Sources of external information are foreign movies, domestic movies, television soap operas, newspapers, books, friends, and colleagues. These identical results for two risk behaviours suggest that the relational option – stopping trade with a customer – has a particular impact on risk behaviour. Stopping trade is the preferred strategy when dealing with business risk. This is in line with the results discussed by Macneil (1985) concerning relational trade as noted in the introduction. The best sources for external information when dealing with business risk are other people, movies, media, and legal texts.

The role of the media for informing people depends on the level of the confrontational presence of law in some one’s life. The role of media for legal consciousness depends on the recipient (Gies, 2003, p. 49). Furthermore, the role of media in moderating legal consciousness is a subtle process. The legal consciousness may, in the interview situations of Gies (2003), have had a subtle presence. However, in my survey the subscription to five specific legal journals, in addition to impressions and knowledge from many sources, are proven to have a significant impact on risk perception. Mass media has in itself no serious impact in the external search for information that can provide risk reduction.

The indirect mediation of risk reduction via risk-reducing behaviours has a weaker impact on the reduction of risk perception than does the direct channel of legal self-efficacy. The indirect channel is mediated by external information – the combination of legal texts, movies, etc. – since it correlates both with legal self-efficacy and the risk behaviour. Stopping trade was demonstrated to directly reduce risk. It did not correlate with legal self-efficacy. Instead, filing a complaint against the enterprise with an anti-monopoly committee and forcing the enterprise to pay a financial penalty correlate positively and significantly with legal self-efficacy. This does not invalidate the indirect channel; instead it shows the strong value of access to external legal information to both boost legal self-efficacy and reduce risk perception when engaging in risky business behaviour.

This study confirms the two channels of risk concept which can be used for systematic research to discern how legal self-efficacy and specific behaviours can aid businesspeople to reduce business risks, thereby shrinking transaction costs and increasing business opportunities. The study is a response to previous scholarly work in law and economics that ignored the legal consciousness as an independent variable. It is also a response to Feldman and MacCoun (2003), who call for research on how and when norms operate in relation to economic behaviour, as well as how internalisation of norms occurs. My response is that norm internalisation in terms of legal self-efficacy has a double effect on risk reduction. Risk reduction occurs through two separate but interrelated channels. There is a direct channel through legal self-efficacy that directly
diminishes business risk. The indirect channel reduces business risk by behaviours such as access to written legal sources and human and relational trading. One result of this response was the creation of a concept that addresses the need for measuring individual legal effectiveness. Another finding is that these two channels of risk reduction could improve the research fields of law and economics and law and finance by using the current theory of self-efficacy provided by cognitive psychology to explain transactional behaviour. Previous theories produced by the neoclassical school of economics have mostly failed to produce models with predictive value (Rostain, 2000).

Legal self-efficacy and the two channels presented in this study present one solution to the problem of poor creditor protection in the less favorable legal families such as Eurasian and French, as presented by La Porta et al. in several studies. Analysing the legal consciousness of the end users of law has the distinct advantage over a one-sided analysis of the institutions of law, both in that individual effects can be measured more exactly, and the relationships with other individual effects can be assessed. To measure legal self-efficacy and compare it to investor protection in the various legal families, similar studies in the common law, German, French, and Scandinavian legal families to assess legal self-efficacies can better explain business risk behaviour.

The hypotheses on risk-reducing behaviour and legal self-efficacy were affirmed and we can therefore assume that the attitude of legal self-efficacy can be substituted or complemented by risk-reducing behaviours to achieve a similar risk-reducing result. The two channels of risk reduction can be used by scholars to identify risk-reducing behaviours that mitigate risk perception. The specific behaviour of searching for information about law among friends, media, and texts had applicability on both business risks, as did the strategic behaviour in relational trading of stopping trade with a customer. This behaviour mitigates risk as it eliminates further contact with a possible source of risk. One curious result is that legal proficiency is not correlated to risk reduction or legal self-efficacy. A common misperception is that legal proficiency per se is a sort of risk reducing quality for businesspeople. Knowing the law doesn’t automatically imply a reduction of perception of business risk. The individual perception of one’s own knowledge of the law however, does.

The two channels of risk devised in this study can be used to explain behaviours that involve decisions of risk in relation to matters like property rights. Although the channels are tested only in relation to two business risks in this study, such testing may be applicable to other risks. Much research in law and economics and law and finance concerns the reduction of transaction costs. The risk reduction as described by the two channels used here can help businesspeople reduce transaction costs in terms of lower enforcement costs and legal fees. The channels may help to explain the effect of legal self-efficacy on the individual’s interpretation of the rules of investor protection when investigating the problem of investor protection from the receiver end. The efficiency of private contracting might be a function of legal self-efficacy and risk-reducing behaviours, which this and other studies (e.g., Jörgensen, 2008) demonstrate. The behaviour of stock traders and buyers and sellers of property includes strategic moves, for instance, into a new market.
The policy implications of this study are that legal self-efficacy and risk-reducing behaviour can be taught to businesspeople and used as a complement to the employment of lawyers when transacting. A common reduction of risk perception among businesspeople can lead to increased innovation and hopefully an improvement in the standard of living. Legal self-efficacy and risk-reducing behaviours are not substitutes for, but complements to an improved legal system in terms of better functioning courts and effective laws that are accepted and used by the population.

The theoretical implications of these two channels are that legal self-efficacy and risk-reducing behaviours can reduce the perceptions of business risk. This should be taken into account when designing programs to improve business conditions in a country. The channels are based on empirical research that demonstrates the heretofore unvalued significance of the legal consciousness in relation to business risks and property rights. Risk reduction can be achieved by employing the two most efficient risk-reducing behaviours and improving legal self-efficacy. This study shows that they are likely to strengthen each other. The two channels can be tested on a variety of business risks and behaviours; the relation is a complement to previous models in law and economics and law and finance, as well as in legal sociology such as prospect theory, the endowment effect, the expected utility hypotheses, and bounded rationality.

There are limitations to this study both in terms of the generalizability of the results – the sample was from one country only – as well as the risk-reducing behaviours. Such behaviours can differ as risk perceptions and strategies may differ between legal systems. It should also be noted that legal self-efficacy does not significantly reduce risk perception on all possible risky transactions. One possible affecting variable could be the efficacy of abstract reasoning. The proposed channels do not purport to be a model as such. The results presented in this study are findings from a single empirical study and therefore do not aspire to present a full model. There can be hidden variables, which could provide the same results as those of legal self-efficacy, perhaps psychological traits of the individual, such as locus of control, intelligence, and the ability to think in abstract terms. The latter two may likely have an impact on legal self-efficacy.

Future research on legal self-efficacy could focus on decisions that involve business risk. A comparative study between different legal systems could demonstrate the importance of legal self-efficacy in different legal systems and families. Every contractual environment has its own unique features. The same should hold true for risk-reducing behaviours. Finally, this study did not delve into the four sources of self-efficacy, another investigation that could be of value.
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