Make it or Break it: Corporate Bankruptcy and Management Careers*

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Abstract: The extent to which a corporate bankruptcy can shift the career trajectory of managers has important implications for high-skilled labor markets but has proven difficult to measure. By combining an instrumental variable approach with the random assignment of judges who differ in their propensity to liquidate firms, this paper offers novel evidence for small and medium-sized business CEOs' careers. We show that these CEOs, when displaced in bankruptcy, are 30 pp less likely to remain in the executive labor market, experience a temporary fall in labor earnings, and a persistent, near elimination of capital income. However, displaced CEOs are quickly re-employed and move to better-paying firms, although often in lower-ranked positions. Taken together, our evidence shows that CEOs can make or break their executive careers due to bankruptcy events that are beyond their control. We explore heterogeneity in effects and find that bankruptcy is most detrimental for longer-tenured CEOs and when a case is petitioned during times at which bankruptcy rates are low. Our findings are consistent with models of firm-specific human capital and statistical discrimination, where the labor market uses bankruptcy as a (negative) signal of managerial ability.

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