

## **Enforcing Covenants Not to Compete: The Life-Cycle Impact on New Firms**

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### **Abstract**

We examine the impact of enforcing non-compete covenants (CNC) on the formation and performance of new firms using matched employer-employee data on 30 US states. To identify the impact of CNC, we exploit the inter-state variation in CNC enforcement along with the fact that courts do not enforce such covenants between law firms and departing lawyers in any state. Using a difference-in-difference-in-difference specification with law firms and firms that are not within-industry spinouts as the baseline, we find states with stricter CNC enforcement have fewer, but larger within-industry spinouts that are more likely to survive their nascent years, and conditional on survival, grow faster during those years. These results are consistent with CNC enforcement having a selection effect on within-industry spinouts. Particularly, with stricter enforcement, only founders with higher-quality ideas and resources choose to overcome CNC-related barriers, which reduces entry rate but increases observed short-term performance of these spinouts.

### **Speaker Profile**

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