DOES IDIOSYCRATIC BUSINESS RISK MATTER FOR GROWTH?

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Abstract
Several imperfections can prevent entrepreneurs from diversifying away the idiosyncratic risk of their business. As a result idiosyncratic risk discourages entrepreneurial activity and hinders growth, with the effects being stronger in economies with lower risk diversification opportunities. In accordance with this prediction, we find that OECD countries with low levels of risk diversification opportunities (as measured by the relevance of family firms or of widely held companies) perform relatively worse (in terms of productivity, investment, and business creation) in sectors characterized by high idiosyncratic risk. Differently from previous literature, we allow risk to be country specific. Since risk is endogenous to risk diversification opportunities, we instrument its value using sectoral risk in the US, a country where idiosyncratic business risk can be more easily diversified away. Tackling the endogeneity of risk and recognizing that it varies by country magnifies the estimated effects of risk on growth. (JEL: F3, G1, O4)