

Investor Protection and the Coasian View*

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Abstract

Some legal regimes leave gaps in the protection provided by the law to firm investors. This paper considers the decision by a firm to opt out of the law and bridge those gaps using contracts. Examining the charters of a sample of Mexican firms, we find that private firms often enhance significantly the protection offered by the law to their investors, but public firms rarely do so. To explain our findings, we construct a model that endogenizes the degree of investor protection that firms provide, using as springboard the assumption that legal regimes differ in their ability to enforce *precisely filtering contracts*, namely, contracts that provide protection only in those cases where expropriation can occur. Our model generates predictions about the types of contracts that would be employed and the levels of investor protection that they would provide across different legal regimes in both private and in public firms.

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