“Enforcing Covenants Not to Compete: The Life-Cycle Impact on New Firms” by Evan Starr, Natarajan Balasubramanian, Mariko Sakakibara

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 variation in the enforcement of CNC by state 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 new firms that are not within-industry spinouts as the baseline, we find states with stricter enforcement of CNC tend to have fewer, but larger, and faster-growing within-industry spinouts. These results are consistent with the view that CNC enforcement has a selection effect on within-industry spinouts: while CNC reduces the rate of within-industry spinout formation, the spinout founders who have higher-quality idea choose to overcome the barrier of CNC.