

Why do Rates of New Firm Formation Differ across Countries?

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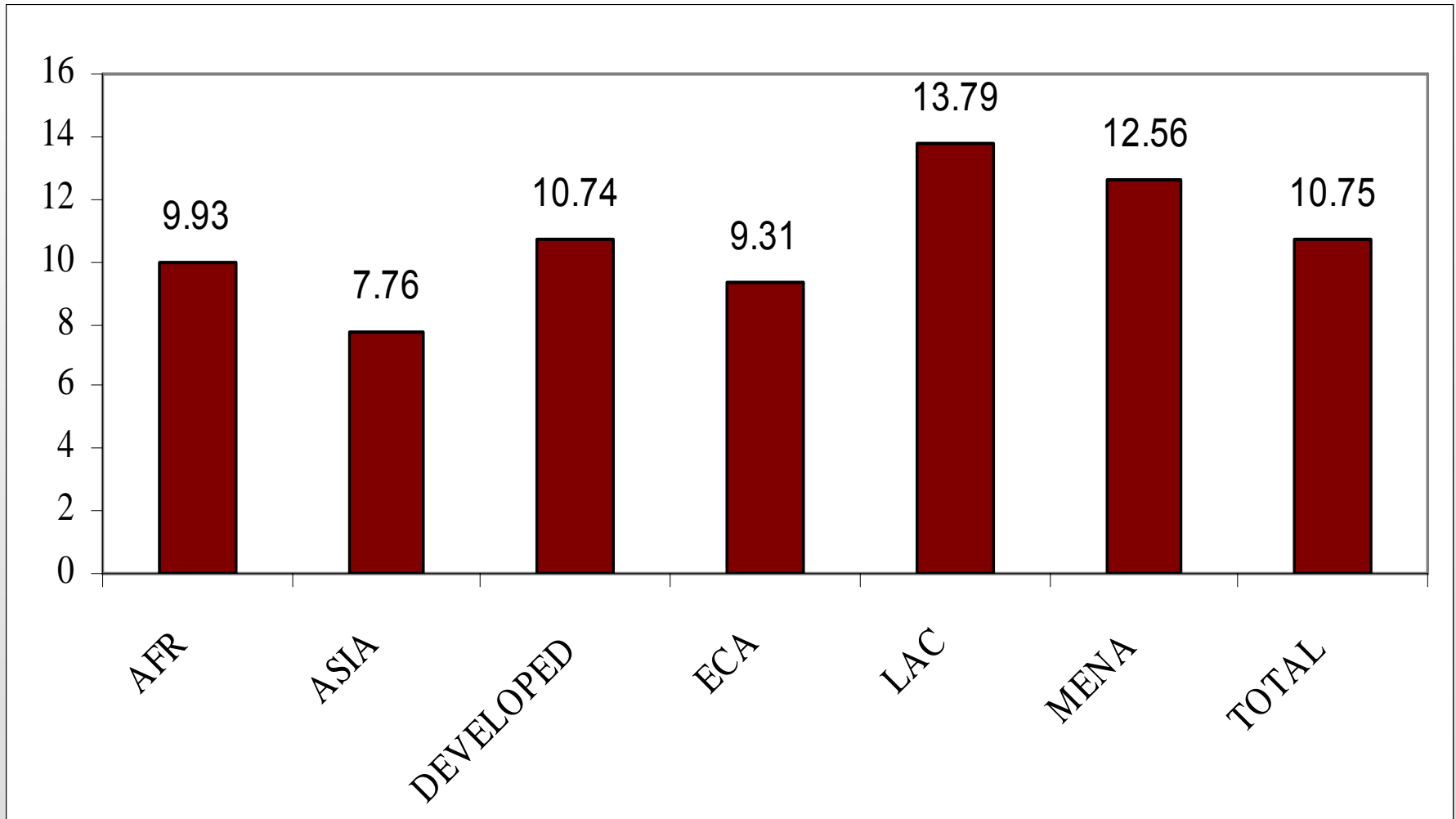
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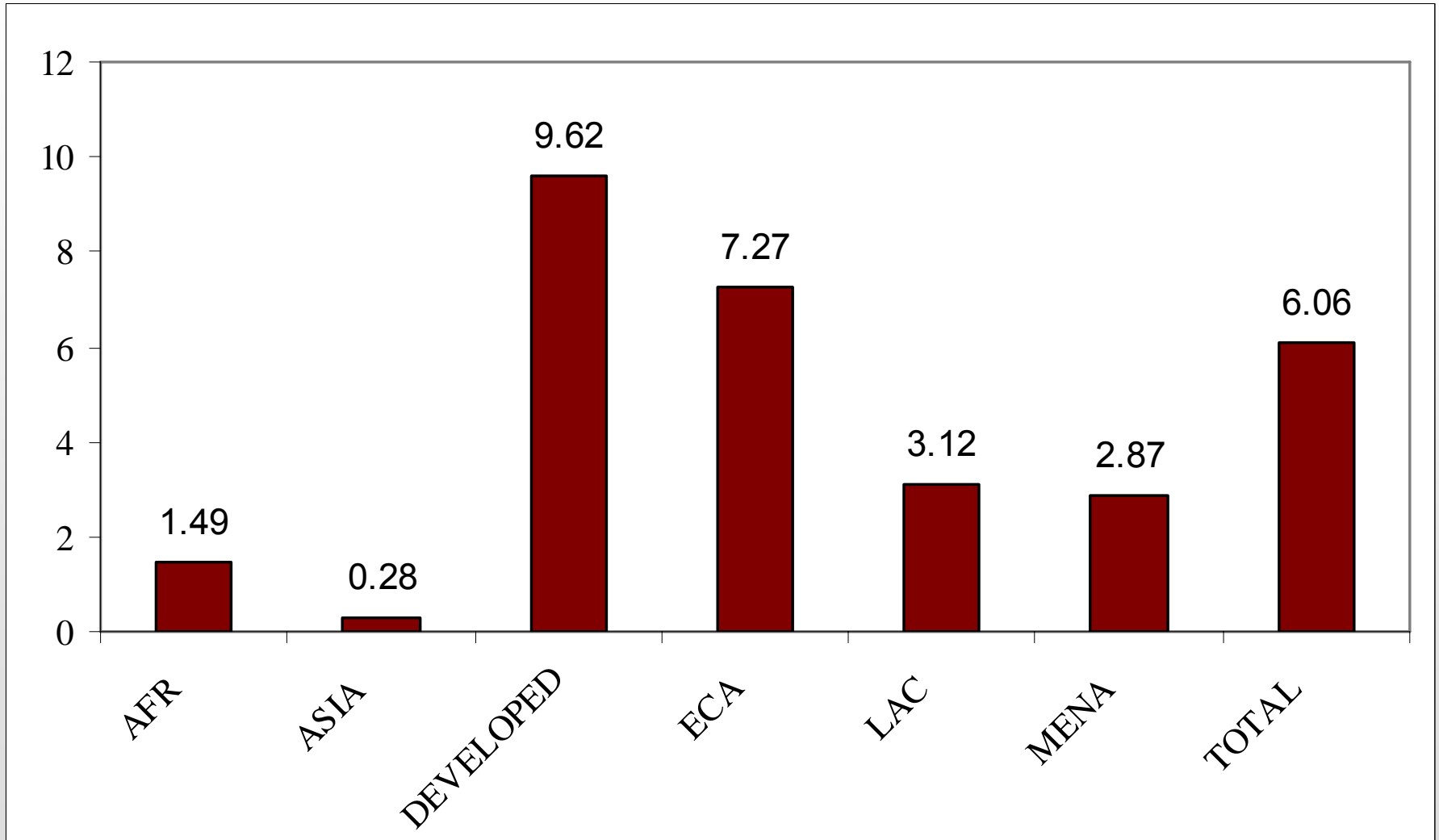
Research Question

- Why do rates of new firm formation differ from country to country?
- Literature has explored:
 - Barriers to new firm creation (e.g. Klapper et al. 2006).
 - Schumpeter's creative destruction: interplay between entry and exit rates.
 - Frictions in capital and labor markets (Gompers, Kovner, Lerner, and Scharfstein, 2005, Gompers and Lerner, 2001; Kaplan, and Strömberg, 2001; Silveira and Amit, 2006).

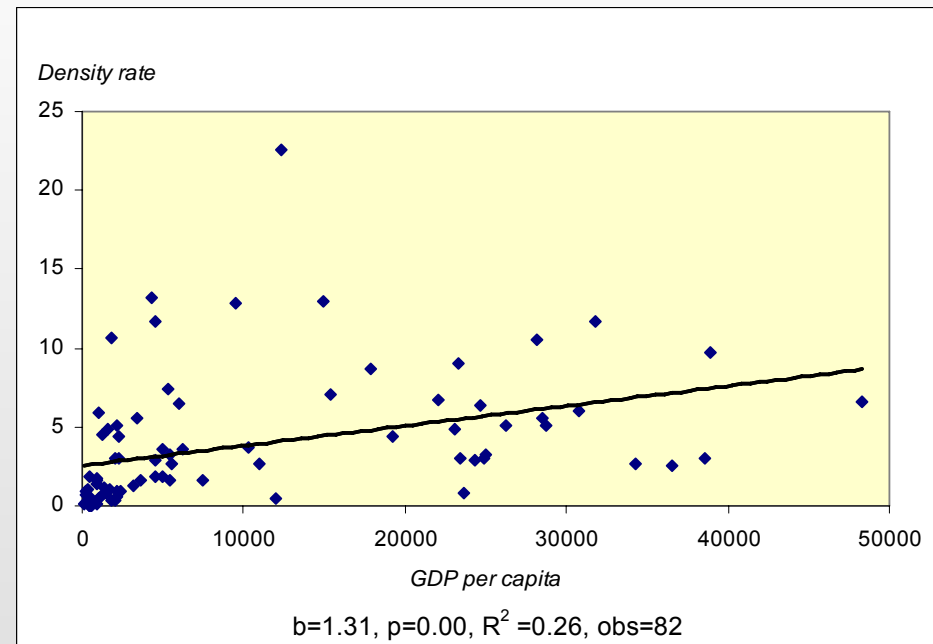
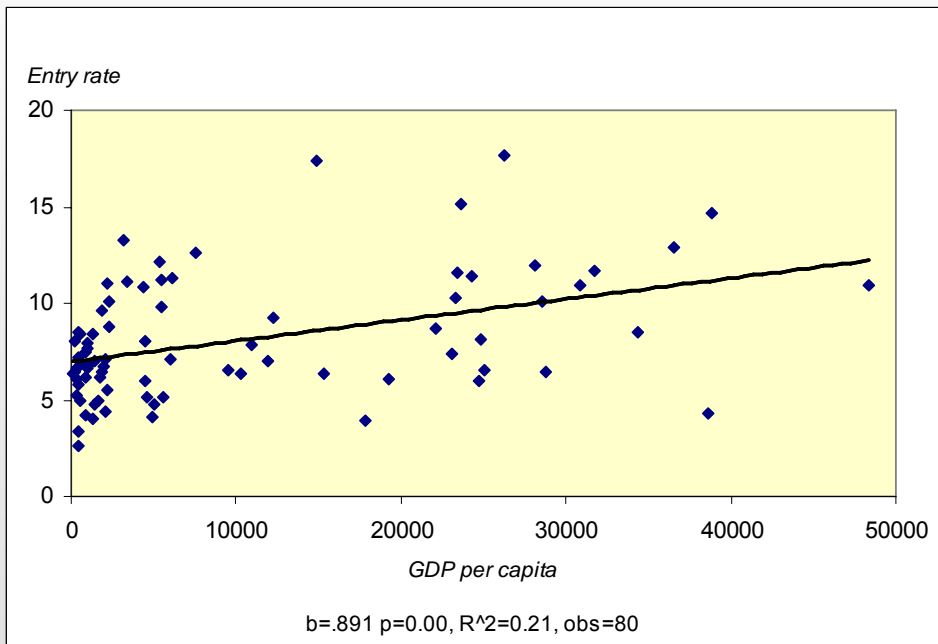
Rate of New Registrations



New Registrations (per 1,000 population)

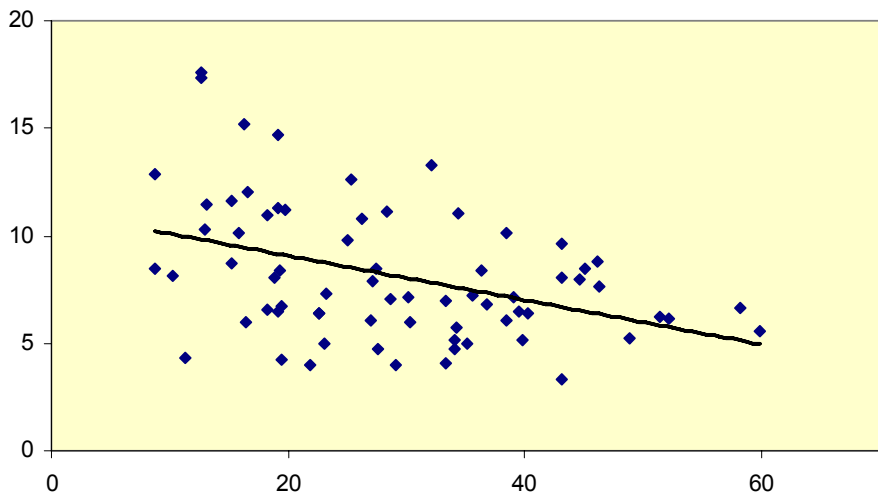


Correlation with GDP per capita



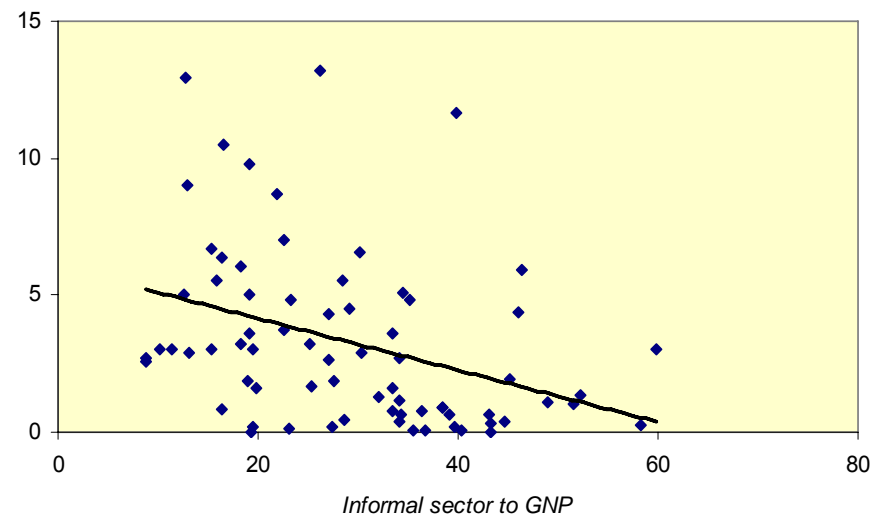
Correlation with Informal Sector

Entry rate



Informal sector to GNP
 $b=-.103$, $p=0.00$, $R^2=0.17$, $obs=70$

Density rate



Informal sector to GNP
 $b=-.09$, $p=0.00$, $R^2=0.13$, $obs=72$

Theoretical Model

- Countries are heterogeneous in terms of:
 - Inputs that can be mobilized by entrepreneurs to create new firms.
 - Efficiency with which inputs are allocated to specific entrepreneurial initiatives (Jovanovic 1982).

Relevant Inputs

- Labor:
 - Abundance.
 - Skill level.
- Capital:
 - Equity, including PE and VC.
 - Debt.
- Knowledge not embedded in labor:
 - Scientific and technical knowledge.

Efficiency

- Our argument is that the efficient allocation of inputs to entrepreneurial activities is shaped by process/institutional variables:
 - Incorporation costs.
 - Labor regulations (Botero et al. 2004).
 - Financial regulations (Rajan & Zingales 1998).
 - Taxation (Gordon & MacKie-Mason 1997).
 - Policy stability (Henisz & Williamson 1999).

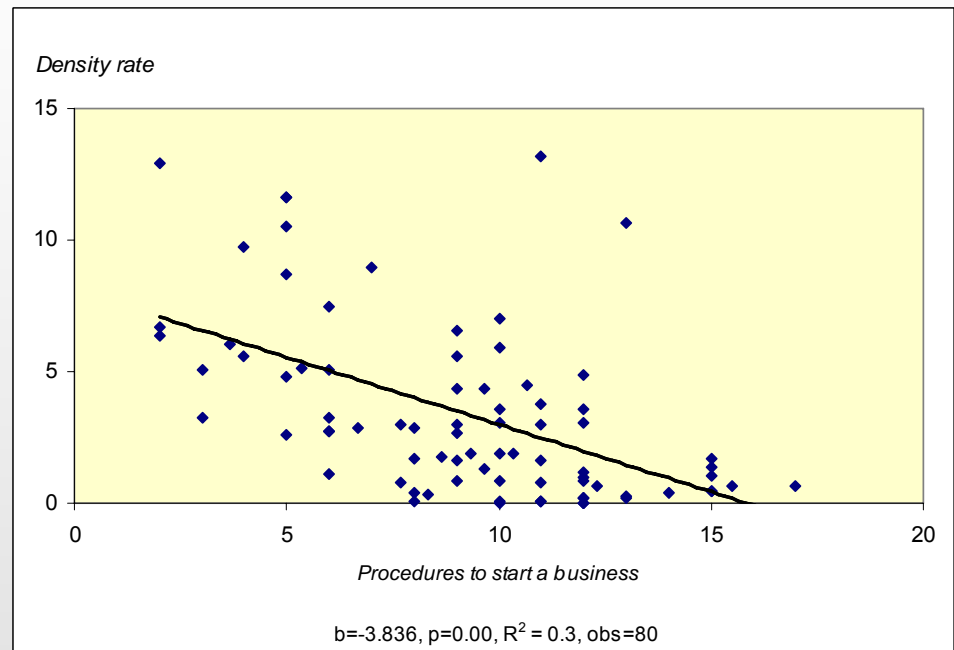
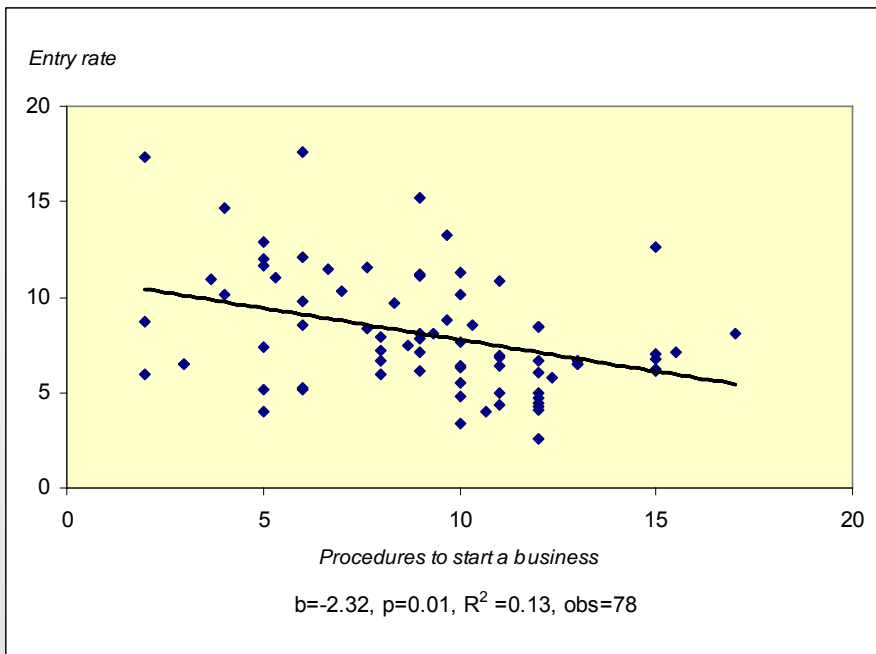
Inter-Industry Heterogeneity

- Dunne et al. (1988) found entry and exit patterns to be heterogeneous across industries.
- Evans (1987) established that industry growth depends on firms' age and size.
- This poses a challenge to studies of new firm formation which use aggregate data at the country level because countries have different industry distributions.
- Need to control for industrial (sectorial) heterogeneity and/or to model cumulative stocks of firms explicitly (they are the result of entry & exit patterns).

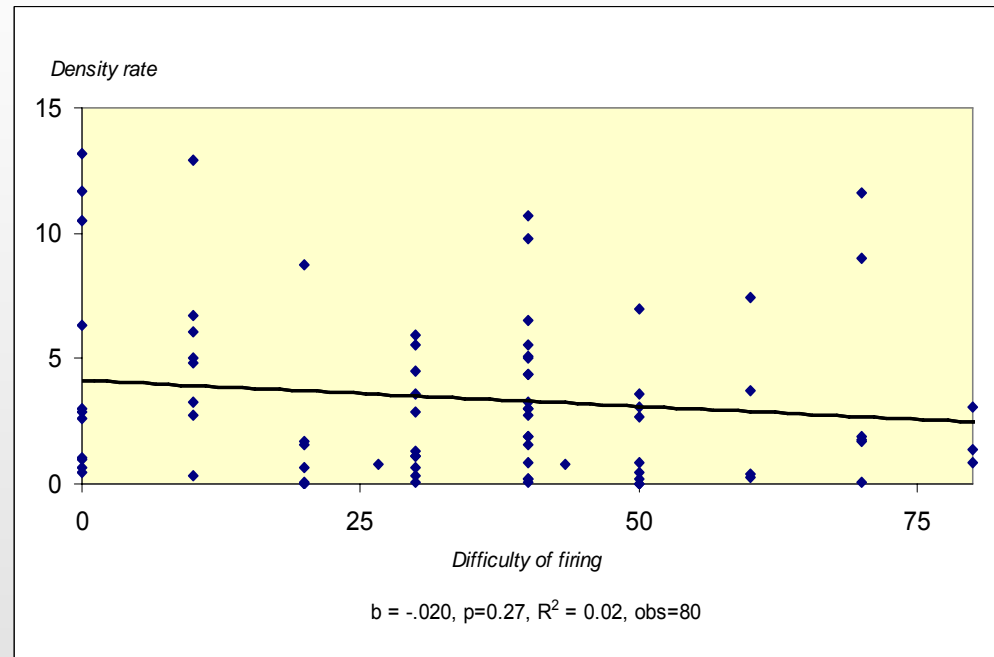
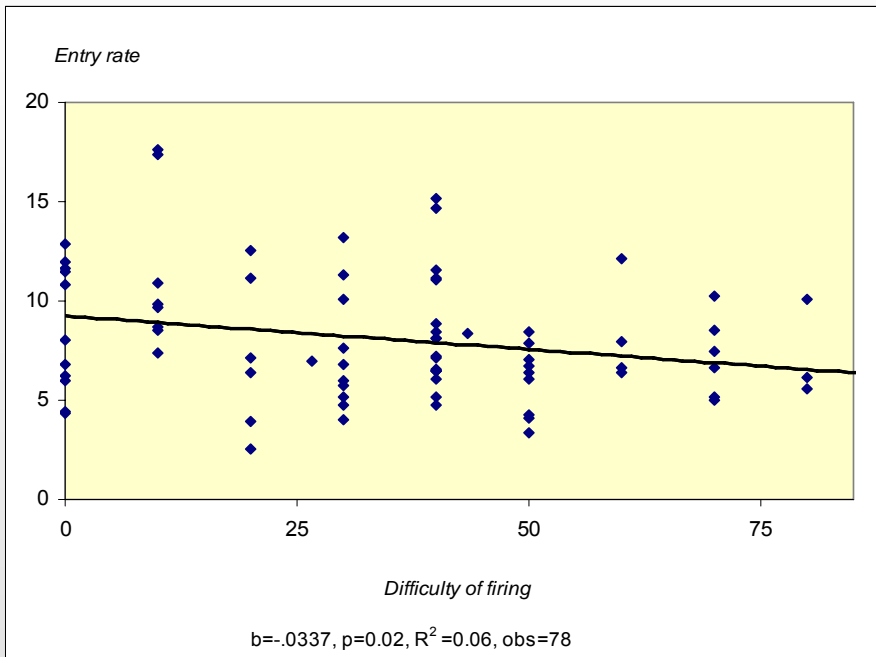
Empirical Approach

- Dependent variable [rate of entry, entry/pop, firm density]=
- Process/institutional variables:
 - + β_1 Incorporation cost
 - + β_2 Labor regulation index
 - + β_3 Financial market regulation indicator
 - + β_4 Corporate tax rate
 - + β_5 Policy stability index
- Input variables:
 - + β_6 Abundance of Labor
 - + β_7 Quality of Labor
 - + β_8 Abundance of Capital
 - + β_9 Knowledge
- Heterogeneity controls:
 - + β_{10} Industry composition

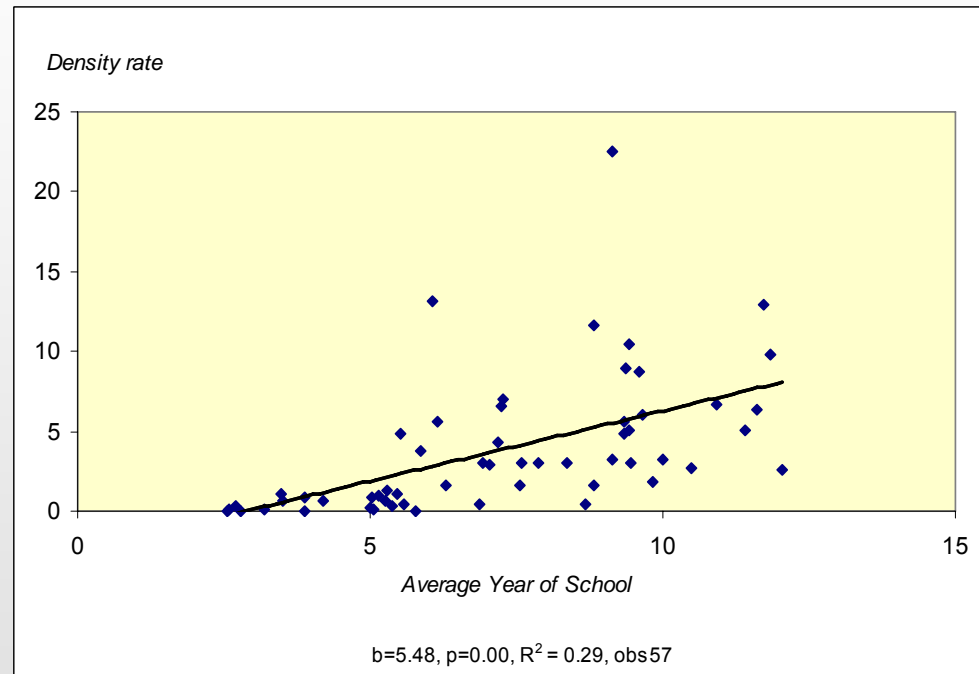
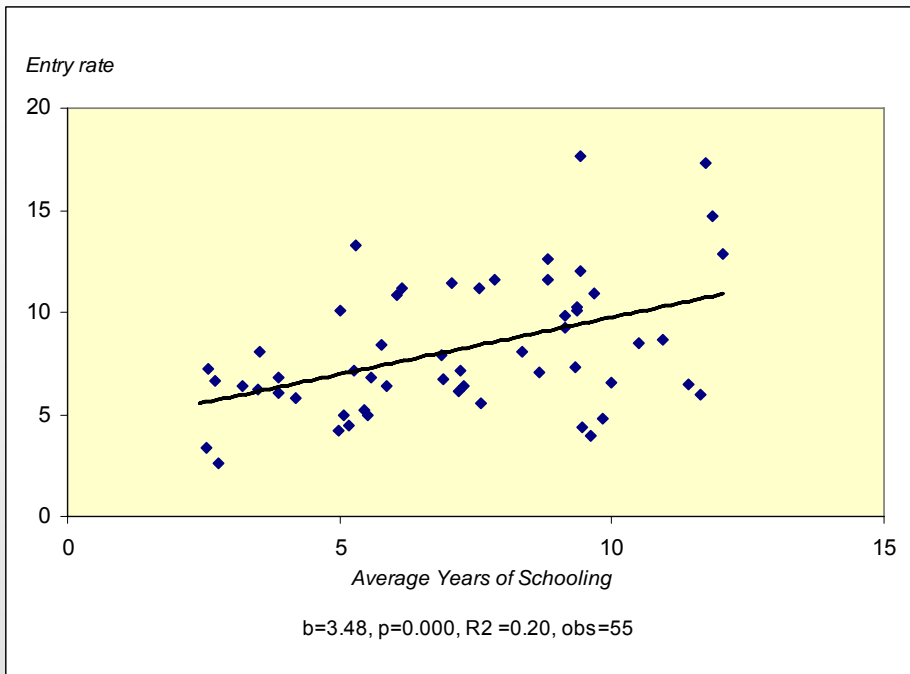
β_1 : Incorporation Cost



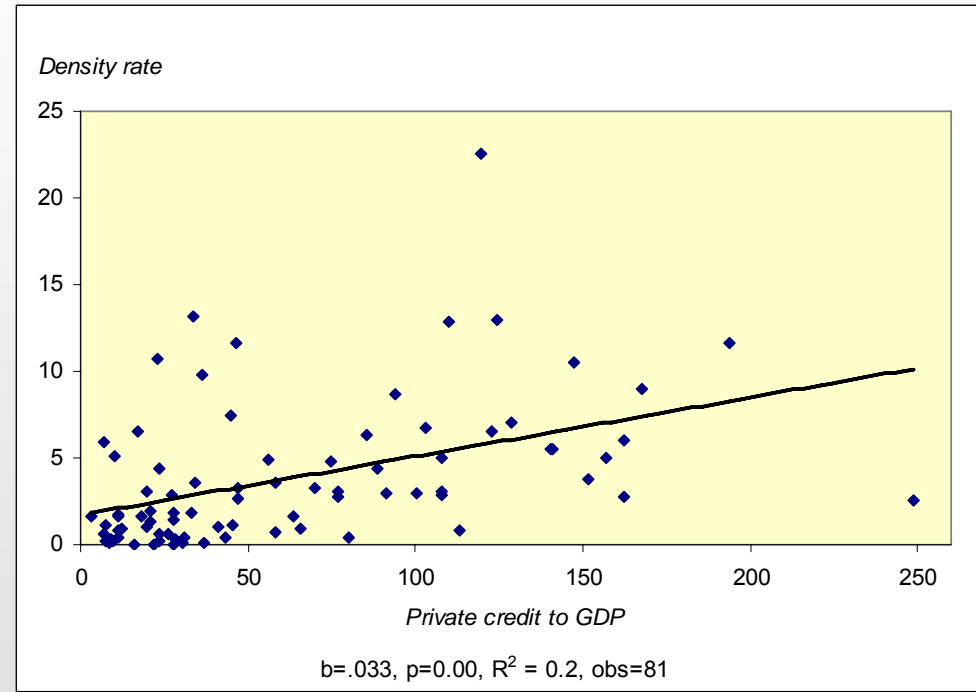
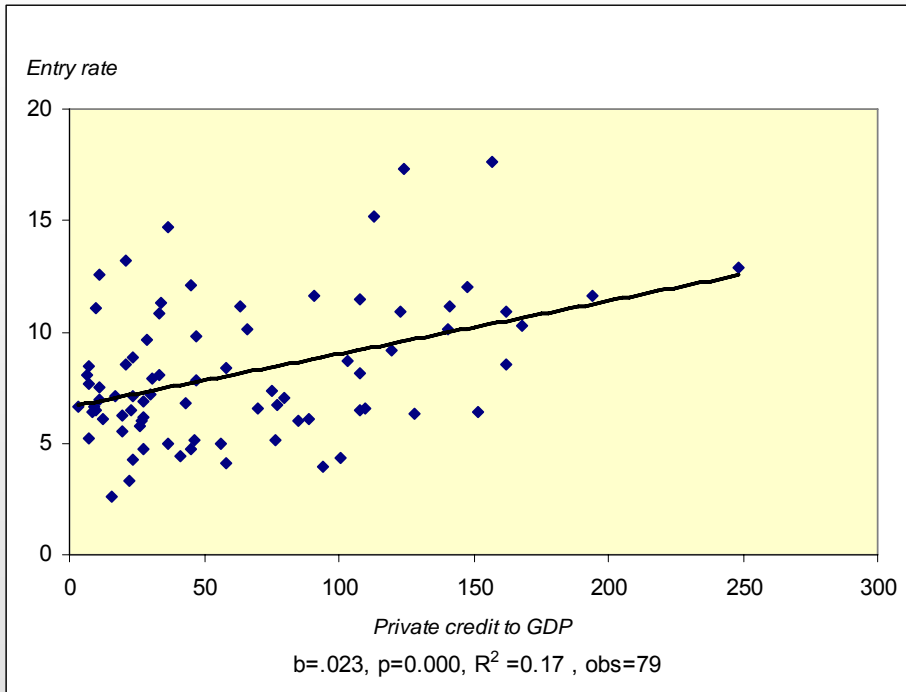
β_2 : Labor Regulations



β_7 : Quality of Labor



β_8 : Abundance of Capital



Index

- We would also like to create an index ranking countries in terms of their entrepreneurial performance.
- Two options:
 - A (simple) synthetic index calculated using weights for key variables.
 - An index comparing entrepreneurial performance with entrepreneurial potential of countries, based on the regression model.

Policy Uses of the Index

- Benchmarking.
- Diffusion of “best practice.”
- Criteria for the allocation of funds to foster entrepreneurship around the world.

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