
**New Business
Formation and Regional
Development: A Survey
and Assessment of the
Evidence**

New Business Formation and Regional Development: A Survey and Assessment of the Evidence

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Abstract

This monograph reviews the current state of knowledge about the effects of new business formation on regional development. These effects are diverse and include the creation and destruction of employment, introduction of innovations, structural change, and increasing productivity, among others. Theory particularly emphasizes the role that some new businesses play in the diffusion of knowledge and innovation as drivers of economic growth. I provide an explanatory approach that highlights the competitive challenge that start-ups pose to incumbent firms and discuss important implications. The overview of empirical research particularly deals with the development of start-up cohorts, identification of different types of indirect effects and their magnitude, differences based on characteristics of entry, and regional variation. A general conclusion is that the diverse indirect effects of new business formation on development are much more important than the growth effects created by newcomers. The diverse indirect effects of entry on

development are currently less than fully understood. Finally, I draw conclusions for policy and put forward a number of important questions for further research.

Keywords: Entrepreneurship, new business formation, employment, regional development

JEL Codes: L26, M13, O1, O18, R11

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1

The Link Between New Business Formation and Growth

The belief that new business formation is a source of economic growth has been a strong motivation for a great deal of research in entrepreneurship. It has also motivated politicians in many countries to devise strategies aimed at stimulating the formation of new firms.¹ However, the theoretical and the empirical foundation for this belief are remarkably weak. Empirical research on the issue started late and only recently have researchers begun to assess the effects of new businesses on economic development in detail. The effect of new business formation on regional development is an important field of research. This type of research can provide insight into the relationship between business dynamics and the different aspects of development, such as the growth and decline of employment, structural change, innovation, productivity increases, well-being, and the like. A proper understanding of these relationships may provide important input for policies aimed at stimulating growth.

¹See, for example, Wennekers and Thurik (1999), OECD (2003), Commission of the European Communities (2003, 2010), Reynolds et al. (2005), and the contributions in Audretsch et al. (2007) and Leitao and Baptista (2009).

2 *The Link Between New Business Formation and Growth*

This monograph provides an overview on the current state of knowledge about the effects that new businesses have on regional development. The focus is on regions because geographical units of observation are much better suited for such an analysis than are industries (see Section 4.1). The reasoning behind this statement is that if industries follow a life cycle (Klepper, 1997), then the number of entries and the start-up rate will be relatively high in the early stages of the life cycle when the industry is growing, and comparatively low in later stages when the industry is in decline. In such a setting, the positive correlation between the start-up rate and the development of the industry in subsequent periods can hardly be regarded as evidence for a positive causal effect of entry on growth but it may be appropriate to view entry as a symptom of industry development. Accordingly, the results of empirical analyses at the regional level can be considerably different from those found in an analysis at the industry level (see Fritsch, 1996).

Regional growth is a complex process that involves large numbers of start-ups in diverse industries, firm exit, and growing and declining incumbent firms. The determinants of the effects that new business formation has in this complex process may be rather different from those factors that make individual start-ups either a success or a failure. Hence, this survey does not concern itself with the determinants of individual firms' success or failure. It begins with a brief sketch of the extant research on this topic (Section 2). Section 3 reviews the main theoretical approaches that may provide insights and explanations and combines them "more eclectically" in an attempt to explain the effects of start-ups on development. This eclectic approach particularly highlights the competitive challenge that start-ups pose to incumbent firms and the important role played by the regional environment. Section 4 reports the available empirical evidence on the different effects that new business formation might have on regional development. Policy implications are discussed in Sections 5 and 6 outlines important questions for further research. Section 7 concludes.

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