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**Communication proposal**

**Firm Entry and Exit in Local Retailing and Consumer Services:  
Market Pull and Unemployment Push**

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Firm entry and exit flows may be regarded as a convincing evidence of the Schumpeterian creative destruction. The new innovative firms, by introducing new products or new industrial processes, compete with the incumbent firms. Entrepreneurs can fail in their business or, occasionally, be successful and lead to the obsolescence of the incumbents. In both cases, entries of new entrepreneurial firms are followed by some exits. That is, the Schumpeterian creative destruction process or the “seedbed” function of the new firms has been closely linked with a turbulent industrial environment characterized by both high entry and exit rates (Beesley and Hamilton, 1984; Acs and Audretsch, 1992; Audretsch, 1995).

Innovation is not so important however to understand firm dynamics and evolution in retailing when compared to manufacturing (Pakes and Ericson, 1998) and linking firm entry and exit flows to some innovation process only would miss the bulk of these entrepreneurial events, particularly if we refer to common industries like shoe stores, flower shops or restaurants. Here, the explanation for the business dynamics is probably not Schumpeterian in essence but more close to what Schultz (1975, 1980) and, more particularly, Kirzner (1973, 1979) have proposed to be the specific function of the entrepreneur in economic analysis. What accounts for entry in these ordinary sectors would be much more a situation of ignorance and market disequilibrium (or market inefficiencies) and the entrepreneurial discovery of profit opportunities, i.e. the “market pull” effect. Notice, by the way, that three main reasons of business failure and exit can be distinguished in addition: 1) (exogenous) adverse shocks affecting market demand; 2) the entrepreneur’s own mistake, entering the market whereas (s)he should not do so because there is no actual business opportunity; 3) (collectively erroneous) entry decisions made by entrepreneurs (or overshooting).

The creation of new firms is not just a matter of profit opportunities as the Kirznerian-type analytical framework would suggest and not all people are equally likely to start up. As the occupational choice of the individual enters the discussion, entrepreneurial profit has to be put in balance with other job-related revenues like the wage that is earned as an employee. The relative pay-off depends on the individual abilities and skills. It is also noticeable that the occupational choice decision is not independent from an economic environment. In some circumstances, i.e. an economic area facing a high unemployment rate, the probability for an individual to find a job in accordance with his individual capacities will be low and entrepreneurship can prove to be more or less a second choice. We describe this as the “unemployment push” effect. Examined from a more positive point of view, a high number of

unemployed people engaging in entrepreneurship would allow a faster equilibrating process whenever the market would be inefficient. The survival of the new entrepreneurial activity will then depend closely on the situation and structure of the market. An important question becomes to know if the market is able to support new firms and therefore an additional supply, or if it is already saturated (equilibrated).

The equilibrium number of firms in local retailing and consumer services markets is primarily dependent upon local demand. Bresnahan and Reiss (1991) derive and estimate their so-called entry threshold, a measure of the market size required to support a given number of firms. Markets that have fewer firms than the threshold would show (net) entry of firms in the subsequent period and markets that have more firms than the threshold are expected to show (net) exit.

In brief, does a correction process for market disequilibrium exist that is to be associated with the entrepreneurial dynamics as measured through entry and exit flows? Are these dynamics completely determined by market (dis-)equilibrium or are they shaped as well by other factors? In particular, does unemployment, as affecting the individual occupational choice parameters, play any role?

The present article addresses these issues with regard to the local markets for retailing and consumer services. We have compiled a dataset for a range of carefully selected industries in the 455 local regions (municipalities) of Belgium with less than 20,000 inhabitants. These data include number of firms, entry, exit, factors determining market size and local unemployment statistics.

The assessment is conducted according a two-step procedure. In the first step, the expected (equilibrium) number of firms is obtained for each selected industry. The computation is based on an ordered probit regression analysis, the number of active local firms being put into relation with a multivariate assessment of the market size. In the second step, we explain entry, exit and net entry patterns from 1) a 'market room' (or market disequilibrium) indicator defined as the difference between the expected (equilibrium) number of firms and the actually observed one, 2) unemployment and 3) the number of firms as scale variable.

Current results suggest significant differences as entry, exit or net entry are considered. It has been shown that, over a three-year period, (net) entry is positively affected by the presence of local 'market room'. This is not true as regard with the exit rate. The analysis suggests that firm entry is more flexible and more important in the adjustment process towards local market

equilibrium than exit. Unemployment, as affecting the individual occupational choice parameters, could have an impact on the firm dynamics. And, in fact, a significant ‘unemployment push’ effect on firm entry has been estimated for some industries (with no effect in the other industries). An appealing result, that deserves complementary studies, which will be conducted as part of the communication proposal, is however the almost pervasive positive effect of the unemployment level on firm exits. The corollary of the ‘unemployment push’ would predict a negative effect.

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