7. On Factors Promoting and Hindering Entry and Exit

1. INTRODUCTION

The importance of new entry for market competition, efficiency and economic development is largely undisputed. Alfred Marshall (1961) used the parable of the young trees of the forest replacing large old trees that gradually lose their vitality. The deteriorating economic performance of centrally planned economies showed the consequences of frustrating entrepreneurial initiatives. The lack of new entry may also have been a problem for the Japanese economy in the past decade (see Kawai and Urata, 2002). New entrants can bring innovative business solutions to the market, sometimes even leading to the foundation of completely new industries (for a recent example of a software industry, see Giarratana, 2004). They may notice profit opportunities that are overlooked by incumbent firms and increase market efficiency. Industries with low birth and death rates are likely to be more vulnerable to an inadequate allocation of resources, limited innovativeness and some form of formal or tacit collusion (Geroski and Jacquemin, 1985). Therefore, high barriers to entry and exit may be serious impediments to dynamic market efficiency.

The aim of this chapter is to discuss and evaluate the empirical evidence on the processes of entry and exit that has accumulated since the early contribution of Mansfield (1962). There is relatively little empirical work on entry and exit compared to the huge amount of theoretical work in the Industrial Organization literature (Disney et al., 2003). Firm entry and exit rates vary widely across industries (industrial dimension); see, for example, Dunne et al. (1988). There are more barriers to starting up or closing down an airplane manufacturing company than a restaurant. But barriers also differ strongly over time (temporal dimension) within an industry following the industry life cycle;
see, for example, Gort and Klepper (1982). And entry and exit rates (aggregated or within an industry) may differ from one region (regional dimension) to another; see, for example, Audretsch and Fritsch (1999) and Carree (2002). As a specific case of the latter category, there may be differences in entry and exit rates between countries, for example, due to cultural factors; see, for example, Mueller and Thomas (2000) and Reynolds et al. (2002). Finally, the probability of entry or exit can differ across individuals (individual dimension) within the same region. Persons with high financial, human and social capital may be more likely to start a venture and make it successful compared to persons who lack such resources. This chapter seeks to provide an overview of the factors behind these differences in entry and exit rates and on their interrelationship. Specific attention will be paid to the factors promoting, and the factors hindering, entry and exit in regions and industries.

2. ENTREPRENEURSHIP AND ENTRY

New venture creation is traditionally regarded as being at the heart of the research field of entrepreneurship (Gartner, 1985, 1990; Low and McMillan, 1988). However, more recently, studies of entrepreneurial behavior have been extended to include corporate entrepreneurship (or intrapreneurship). Lumpkin and Dess (1996) argued that the essential act of entrepreneurship is new entry. New entry, in their opinion, is defined as entering new or established markets with new or existing products. Hence, this may be achieved by starting a business, but also through an existing business (intrapreneurship). Nevertheless, founding a firm is widely regarded as a prime example of entrepreneurial activity (Verheul et al., 2005). The extent of new venture creation differs vastly across countries. This can be derived from data collected through the Global Entrepreneurship Monitor (GEM); see, for example, Reynolds et al. (2002).

The Adult Population Survey of the GEM measures the total entrepreneurial activity rate (TEA), defined as the percentage of adult population (18–64 years old) that is either actively involved in starting a new venture or the owner/manager of a business that is less than 42 months old. This percentage ranges from close to 20% for Thailand and India to less than 3% for Japan and Russia (see Table 7-1). There are various reasons for the differences in entrepreneurial activity rates across countries. In developing countries micro-enterprises (in the informal sector) can be set up and dissolved with very limited means. There is a lot of entrepreneurial activity in these countries, but the vast majority of these “enterprises” remains very small. In some former communist countries, like Poland, Slovenia, Croatia and Russia, entrepreneurial activity may be low since the population did not grow up in a society in which entrepreneurship played a role.