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THE BEHAVIOUR OF FIRM ENTRY AND EXIT IN DISEQUILIBRIUM THE ENTREPRENEURIAL ECONOMY IN THE USA, 1998-2003 (SUMMARY)

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SUMMARY

THE BEHAVIOUR OF FIRM ENTRY AND EXIT IN DISEQUILIBRIUM
THE ENTREPRENEURIAL ECONOMY IN THE USA, 1998-2003

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Principal Topic

The strategic management literature on entrepreneurship supports the notion of a sustainable number of firms implying a balance between available profit opportunities and the number of firms trying to exploit them. Likewise, the economics literature claims that a sustainable number of firms not only exists, but acts as a point of gravity in equilibrium based models of industry. Both schools speculate about the behaviour of business start-ups and deaths when the industry is in disequilibrium. Remarkably, there is little empirical analysis of these processes. This paper aims to rectify this shortcoming.

Method

Using a rich panel dataset of American firm entry and exit for 4-digit NAICS industries between 1998 and 2003 (the period of the dot.com boom/bust cycle), we first model the long run sustainable number of firms and then, investigate the role of new ventures and exits when the industry deviates from the sustainable level.

Results and Implications

Our findings support an equilibrium process, with evidence of the number of firms adjusting downwards if the actual number is above the sustainable level and vice versa. However the force of this adjustment, although statistically robust, is relatively weak. We observe a herd effect among entrants which is disequilibrating and where entrants appear unaware that a market is either over or undershooting. In fact, we find that over the period covered, it is entirely through exits that the industry comes closer to equilibrium, with exit rates accelerating in an overshoot and declining in an undershoot.

The results have major policy implications. The identification of periods when markets over and undershoot, raises the issue of whether, as in macroeconomic policy, government policy to promote start-ups also ought to have a counter cyclical dimension? In other words, should business start-ups be promoted more strongly in an undershoot than in an overshoot? Our findings suggest the equilibrating mechanism to be rather costly – being driven by expensive firm failure rather than by deterring entry and saving the start up costs. Therefore, any policy which either better communicates or guides entrepreneurs about the current state of the entrepreneurial economy would enhance its performance.

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