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**The Persistence of Regional New Business Formation-
Activity over Time – Assessing the Potential of Policy
Promotion Programs**

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Abstract

We investigate regional differences in the level and the development of regional new business formation activity. There is pronounced variance of start-up rates across regions. The level of regional new firm formation activity is rather path-dependent so that changes are relatively small. The main factors determining the level of regional start-up activity are innovation and entrepreneurship. In addition unemployment seems to play a role. These factors also appear to be responsible for changes in the level of regional new business formation activity and could be an appropriate starting point for policy measures trying to promote start-ups. Our empirical evidence strongly suggests that such measures may have significant effect only in the long run.

JEL-classification: M13, O1, O18, R11

Keywords: New businesses, entrepreneurship, growth regimes, time lags

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Extended Abstract

There can be little doubt that new business formation is of key importance for economic development (Fritsch & Mueller, 2004, b; Van Stel & Storey, 2004; Scarpetta, 2003). But it is much less clear in how far is it also suited as a target variable for a policy that wants to promote economic growth. The paper wants to assess the potential for public policy measures that are aiming at influencing the level of regional new business formation activity. What are the appropriate starting points of such a policy? What measures would be appropriate and how long will be the time period until first results will become visible?

In a first step we analyze the development of new business formation activity for West German planning regions between 1983 and 2002. Our analyses show a pronounced level of persistence and path dependency. Regions with relatively high new business formation rates in the past are very likely to experience a correspondingly high level of start-ups in the future and regions with a low level of new businesses can be expected to have only relatively few start-ups in the future. Changes in regional start-up rates are small and, if they occur, they tend to emerge over quite a long period of time. This high degree of persistence suggests that there are only weak prospects for rapid change with regard to regional new business formation activity. Economic policy targeting the stimulation of entrepreneurship seems to need a long-term perspective.

In a second step we investigate the determinants of new firm formation, particularly of changes of the level of new firm formation activity. It is a key hypothesis in the literature that entrepreneurship is closely linked to innovation activity and structural change. In particular qualification of the regional workforce and the intensity of entrepreneurial “spirit” in a region may have a pronounced effect on the level of new business start-ups (see Fritsch & Falck, 2002, Armington & Acs, 2002, Reynolds, Storey & Westhead, 1994 for an overview). Being unemployed may make the setting up of an own business relatively attractive and can, therefore, also constitute

a main source of entrepreneurship. Our estimations of the determinants of new business formation activity largely confirm the expectations. The main determinants of regional new business formation found are regional innovation activity, the regional level of entrepreneurship, the sector structure and the number of employees in small and medium size enterprises. In addition to these factors the regional unemployment rate, population density as well as gross value added per employee play a role. Many of the variables that influence the level of new business formation activity in a region also have an effect on the change of start-up rates. The main factors that lead to increasing start-up rates are regional innovativeness, entrepreneurship and unemployment.

Our analyses of the factors that determine the level and the development of regional new business formation clearly indicate a strong influence of innovation and entrepreneurship. These two issues should be the main starting points of a policy that aims at stimulating new firm formation and regional development. However, if policy succeeds in increasing new business formation rates, the expected positive effects on employment will need another five to ten years to become effective (Fritsch & Mueller, 2004). Clearly, a policy that is trying to stimulate economic development by promoting entrepreneurship is not likely to provide a quick solution.

References

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