Literature Review about Determinants of New Firm Formation

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Abstract:
This paper aims to overview about the determinants of new firm. The results highlight that the factors including population growth, population density, urbanization, income level, exit rate and mean establishment firm size (MES) have a positive correlation with new firm formation, whereas unemployment rate, Foreign Direct Investment (FDI) and Provincial Competitiveness Index (PCI) fail to emerge as significant influences on new firm formation.

Key words: New firm formation, Vietnam.

1. Introduction

The theory of the firm is one of the cornerstones of economics. In the past, the positive contribution of new enterprises to economic development has mostly been discussed under the heading of “competition”. Since the days of Adam Smith, economists have learned to expect that the entry of new competitors plays a decisive role in driving prices towards the competitive level, thus promoting technical and allocation efficiency. Several studies can, at least from a long-term perspective, establish a positive relationship between new firm formation, productivity and economic growth (Van Praag and Versloot, 2007; Karlsson and Nystrom, 2008). How do these improvements in productivity and growth through the creation of new businesses? One frequent explanation is that many new firms are established based on innovations, thus they are the main source of the motivating power for technical progress as they rely on innovation to secure market share. Resultantly, new firms are claimed to be a crucial link to commercialization of innovations (Acs, et al., 2004). In addition, it is argued that the establishment of new firms play an integral role in the structural change process since it represents reallocation of resources, which may result in a more efficient utilization of resources (Schumpeter 1934 and 1942).

During recent decades, the importance of new firm formation has received increased attention from both researchers and policy makers because of the strong belief that new firm formation is an important driver of economic growth and development (Baumol, 1968). A healthy economy is characterized by an appropriate level of existing business activity (stock of businesses) but also by a continuous process of new business creation (flow of businesses). Indeed, several studies found that low levels of business ownership hurt economic growth (Carree et al. 2007), while others showed that new businesses are more likely to innovate (Colombelli and Quatraro 2018; Wennekers and Thurik 1999). Moreover, new businesses are also responsible for a large part of job creations (Carree et al. 2015; Decker et al. 2014). Entrepreneurship is a key element of evolutionary economics (Schumpeter 1934; Witt 1998; Grebel et al. 2003; Metcalfe 2004; Grebel 2007) and has been recognized as an important element in explaining regional economic development (Acs and Armington 2004; Audretsch et al. 2006; Fritsch 2008). This means that the explanation of regional variations in new firm formation has also become an important issue. Even more so because there are pronounced differences within and between nations in rates of entrepreneurship and in their determinants (Bosma and Schutjens, 2008).

Nevertheless, most studies analyzing the process of transition from a command to a market economy have focused on the privatization of existing firms rather than on the creation of new firms, which is also an integral channel for growth and development. New firms challenge existing firms, forcing incumbents to constantly improve their products and production techniques. Firms that cannot live up to these challenges will eventually disappear. As a result, the fittest firms remain, governing economic growth. These reasons are behind the
continuous interest researchers show for this topic. Only after the seminal work by Birch (1979), who recognised the importance of small firm formation in employment generation, did new firm formation become a relevant topic for both researchers and policy makers. After that, researchers have started to evaluate the determinants of entrepreneurship, including the impact of the business environment, institutions, and the role of the government.

2. Literature review

2.1. Definition of new firm formation

Enterprise creation is the organizing of new organizations (Gartner, 1985) by assembling on-going interdependent actions into sensible sequences that generate sensible outcomes (Weick, 1979; Vesper, 1980). These actions generally take place in five stages, namely: identification of business opportunity, business concept definition, resource mobilization, enterprise formation, and launch of business (Delmar & Shane, 2002; Reynolds et al., 2005). As the enterprise creation process is dynamic and case-specific, these stages do not necessarily occur in sequence (Bhave, 1994; Bruyat & Julien, 2001) and entrepreneurs may give up their efforts in the middle of the process when they realize that the business ideas are not fruitful or feasible (Carter et al., 1996).

Steps for firm formation

Enterprise creation is the organizing of new organizations (Gartner, 1985) by assembling on-going interdependent actions into sensible sequences that generate sensible outcomes (Weick, 1979; Vesper, 1980). These actions generally take place in five stages as follow:

- **Stage 1:** Bhave (1994) argued that opportunity recognition may precede the decision to start a new venture. It occurs when the prospective entrepreneurs experience, or are introduced to, needs that cannot be easily fulfilled through available vendors or means. In finding solutions to satisfy the needs, the entrepreneurs realize that the need was widespread and recognize it as an opportunity to create a new venture. The author also argued that opportunity recognition may be preceded by the decision to start a new venture. This occurs as a result of interruptions in prospective entrepreneurs’ personal and environmental circumstances. In this case, the entrepreneurs see vastly more opportunities than they seriously chose to pursue and thus the decision to start a business is followed by a search to align the prospective entrepreneurs’ knowledge, experience, skills and other resources with market needs.

- **Stage 2:** Having identified business opportunities, the entrepreneurs need to clarify business concepts in order to achieve a good fit between customer needs and the entrepreneurs’ perceptions of those needs (Bhave, 1994). At this stage, the entrepreneurs build their business model when setting objectives for the firm, deciding the firm size, drafting a vision for the firm, calculating risks, and defining success criteria, etc. (Ardichvilia et al., 2003; Morris et al., 2005). These may be written down in a business plan because entrepreneurs want to do it or it is required, say, by financial institutions (Honig & Karlsson, 2001). Having that said, it is unclear if the business plan influences the realization of the project (Gasse et al., 2004) although researchers tend to advocate several advantages for making business plans (Filion et al., 2009).

- **Stage 3:** To realize the business, the entrepreneurs must be able to mobilize sufficient required resources. They are typically organizational, technological, human, social, financial, and physical resources (Brush et al., 2001). The literature gives ample evidence that entrepreneurs need to work in teams to assure success and team members are usually family members, friends or colleagues (Brush et al., 2001; Ruef et al., 2003; Aldrich et al., 2004; etc.). Ruef et al. (2003) found that the teams tend to be people with similar characteristics as they make decisions together and share with each other the ups and downs of the business.

- **Stage 4:** The next step is to create the organization. The entrepreneurs often set it up in an area close to where they live or even at their homes (Gasse et al., 2002; Borges et al., 2005). The most important
considerations for choosing a premise for their start-up business are quality of life, proximity to home, and availability of space rather than advantages of the region or access to R&D (Filion et al., 2006). Besides choosing a location, the founders have to build an organizational structure for the business (Gartner, 1985). Once the organization is set up, they may let the business run in the informal sector or register it as an enterprise (Schneider & Enste, 2000; Bennett, 2010).

Stage 5: When the organization is in place, it is time to launch the business. The activities carried out during this phase are critical determinants of the future of the firm (McMullan & Long, 1990). Studies by Duquette-Labrecque et al. (2005) and Filion et al. (Filion et al., 2006) show that the time between when the decision is made to the time the activity is carried out is longest for the development of the first product, then for the first sales, and then for hiring the first employee. Such variance in gestation periods implies how these activities are important for the entrepreneurs.

As the enterprise creation process is dynamic and case-specific, the previous stages do not necessarily occur in sequence (Bhave, 1994; Bruyat & Julien, 2001).

Measurement of new firm formation

There is little contention that measuring the absolute numbers of new entrants and then comparing them across markets would be as misleading as revealing. This can be explained by the fact that markets, either along a product or a regional dimension, are not homogeneous with respect to size. For example, if the number of new entrants was twice as great in one market as in another, but the first market was also twice as large, it would not be correct to infer that entry activity was greater in the first market than in the second. That is, the absolute number of entrants must be standardized somehow to render a meaningful comparison across markets of different sizes. Two approaches have generally been set out in attempting to measure and compare entry activity across markets, including ecological approach and labor market approach (Audretsch and Fritsch, 1994b). Similarly, Storey (1991) also divided the literature into two categories as follow.

Ecological approach

The first category emphasizes traditional industrial organization theory, examining the impact of the industrial structure on new enterprises establishment ability. In particular, the industrial organization method is used to verify whether the market structure impedes or speeds up the process of new firm formation. This method calculates entry rates based on the stock of existing firms, in specific, it standardizes the number of entrants relative to the number of firms in existence at the beginning of the period. Therefore, it can be termed as the ecological approach because it considers the amount of entry activity relative to the size of the existing population of businesses. The ecological approach is particularly prevalent in the industrial organization literature, where empirical studies have attempted to explain why the degree of entry varies so much across product markets.

Labor market approach

The second research category takes labor market theory as its starting point, in which annual firm formation is related to the number of employees (in the same region, sector and year). Integrated data is used to gain an understanding of the factors influencing new firm formation and lead an individual to decide to become an entrepreneur. The main consideration here includes the changes in the status of the individual within the labor market. This method’s aim is to standardize the number of entrants with respect to the size of the work force. It reflects the assumption that new entrepreneurs originate from the existing pool of labour. The labor market approach has a particular theoretical appeal, in that it is based on the theory of entrepreneurial choice proposed by Evans and Jovanovic (1989), among others. That is, each new firm is started by someone. The labor market approach implicitly assumes that the entrepreneur starting a new business is in the same labor market within which that new firm operates. It should be pointed out that the labor market approach does not assume away the
phenomenon of cross-market worker mobility. This approach recognizes that labor is mobile, both in terms of spatial and product markets. However, it is assumed that some experience as an employee in the market has been gained before starting a new business.

In most empirical studies investigating determinants or economic consequences of regional entry rates, the labour market approach is applied (Van Stel and Storey, 2004). The difference between these two approaches mirrors the conceptual argumentation to separate independent start-ups from start-ups originating from incumbent firms. In which, independent entry is related to the workforce in the same region, while the number of new subsidiaries is related to the number of existing firms. In other words, independent entry stems from the existing pool of labor while new subsidiaries stem from the stock of existing firms.

In summary, this thesis employed the second method since the author believes that the labor market approach is the best way to study a country’s attitude towards entrepreneurship as it is based on the theory of entrepreneurial choice. An important implicit assumption made by the labour market approach is that the entrepreneur is in the same labour market within which that new firm operates. Considering the fact that most new firms are initially established at home or in close proximity to it (Stam, 2009), and that most new entrepreneurs will have some work experience in the region, the implications of this assumption were acceptable.

The importance of new firm formation

When new businesses enter an industry, they may have both direct and indirect effects on industry-wide economic performance. The direct effect relates to the new jobs that are created in the new units at the start of business operations while the indirect effects relate to the effects that the new businesses create on the incumbent firms in the market.

Direct impacts of new firm formation on economic development

The importance of new businesses and their role in the wider context of economic development and well-being cannot be over emphasized. A major factor in uneven regional economic performance is low rates of new firm formation and low stocks of regionally based businesses. New firms provide choice, dynamism, competition, employment, are locally owned and committed to the local area and act as the seedbed function, a vital contribution to the long run health of the economy. High rates of new business creation have been linked to innovation, new product development, new sources of employment and additionally, have been shown to provide a causal link to economic well-being.

New business formation creates new competitors that feed the process of innovation, a clear determinant of wider economic well-being, domestic rivalry and the demand generated for goods and services by large numbers of individual firms is central to competitiveness and consequent economic growth. However, the activity and sector of the new firms is also important in driving competitiveness and this is of fundamental importance.

Firm formation and economic prosperity are closely related and work through several underlying mechanisms. Firstly, new firms are often entrepreneurial and have a high proportion of innovative activities. They therefore act as bearers of change leading to industrial renewal and creation of new jobs, emphasized in several studies (Acs and Audretsch, 1990; Acs, 1992; Acs et al., 1994; Audretsch, 1995; Tang and Koveos, 2004; Koellinger, 2008). Secondly, new firms influence the industrial dynamics in a location but the impact differs among industries and over time (Audretsch, 1995). New firms per definition change the industrial dynamics by entering the market and increasing the competition level. New firms also tend to have a faster and more diverse growth and are more prone to exiting the market, factors influencing industrial change (Evans and Leighton, 1989). Jovanovic (1982) models the industry evolution of heterogeneous firms that learn about their abilities over time. Efficient firms survive, while inefficient firms are forced to exit the market. The advantages of
having a larger proportion of small firms are emphasized in Audretsch et al. (2002) and Carree and Thurik (1998). They find that countries experiencing a faster restructuring of their industry, made possible by the entry and exit of firms, experienced faster economic growth, which measured in GNP. Thirdly, new firms work as a counterforce to market imperfections such as monopolies and monopolistic behavior. Fourthly, small firms are more flexible giving them a competitive advantage and making them more able to handle and adapt to external shocks (Wennekers and Thurik, 1999). Last but not least, new firms increase the consumption bundle satisfying consumers’ love of variety (Rothwell, 1989).

a) New firm formation and regional productivity growth

Most of the recent empirical studies show a positive relationship between new firm formation and regional productivity growth. The direct effect of new firm formation on productivity seems limited, however. New firms have a competitive advantage in radical product innovations (Audretsch and Keilbach, 2004) rather than in productivity enhancing process innovations. This is in line with life-cycle theory which states that entry will become more difficult in later stages of the life-cycle, because scale in combination with high productivity, are then more important (Suarez and Utterback, 1995; Klepper, 1996). And indeed new firms have been shown to be built around product knowledge mostly (Koster, 2006). Still, a positive effect on productivity can be expected as new firm formation has indirect influences. Firstly, the threat of entry forces incumbent firms to increase productivity. Secondly, new firms play a role in the dissemination of knowledge which can be important in general productivity growth. This idea has been elaborated in the knowledge spillover theory of entrepreneurship (Acs et al, 2006).

The knowledge spillover theory of entrepreneurship contends that entrepreneurs act upon knowledge that is created within existing firms, for example as a result of R&D activities. If incumbents do not commercialize this newly created knowledge, possibilities arise for entrepreneurs to base firms on this knowledge. In the process, knowledge is distributed to another organizational and spatial context. By starting new firms on the basis of existing knowledge, knowledge and routines are propagated to other places. There are two basic implications of this theory. First, in knowledge rich environments the start-up rate should be high (Audretsch and Lehman, 2005). Second, start-ups disseminate knowledge and, as such, indirectly contribute to regional productivity (Audretsch and Keilbach, 2004). The process of knowledge distribution through firm start-up can be affected by globalization through an increasing international knowledge base. This process has two sides.

Firstly, domestic firms may become more international by increased foreign trade, alliances with foreign firms and international supplier relationships. As a result, the knowledge base of domestic firms may become more diverse and more international. Employees can use this knowledge for the benefit of their own firms, hereby disseminating global knowledge in a local context. This process has been summarised as ‘Local buzz, global pipelines’ (Bathelt et al, 2005). It is interesting to note that internationalising firms are also the firms that are most innovative (Suddle and Hessels, 2007). In that sense, international firms do not only partly drive globalization, they are also necessary for regions to tap into “global knowledge pools”.

Secondly, as mentioned before, subsidiaries of foreign firms can increasingly serve as sources of local knowledge. This offers opportunities to tap into knowledge pools of other countries. Importantly, institutions and an entrepreneurial culture should be in place in order to reap the benefits from the access to new knowledge. Following the knowledge spillover theory of entrepreneurship, a lack of entrepreneurship can either be the result of too low an intensity of knowledge availability or of too few entrepreneurs that recognize and act upon entrepreneurial opportunities. In order to gain from FDI in a structural way, suitable institutions for recognizing and using imported knowledge appear crucial. Acs et al (2007a) indeed find support that Ireland has benefited from FDI more than Wales because of its receptive and entrepreneurial climate.

b) New firm formation and employment growth
Although theoretically new firm formation has an intrinsic link with increased productivity and economic growth in general terms, empirically new firm formation is often regarded in relationship with employment generation. A large body of empirical research on this issue has, however, not generated consensus. There are regional and temporal differences in the job generation capabilities of new firm formation. In the USA, positive relationships are normally found (Acs and Armington, 2004), but in Europe the evidence is less convincing. Particularly for the 1980s, studies have found negative impacts of new firm formation on regional employment change such as Audretsch and Fritsch, 2002 for Germany and Van Stel and Storey, 2004 for the UK). In order to come to a more comprehensive idea of the impact on new firm formation on employment generation, Fritsch and Mueller (2004) take an explicit longitudinal approach. They describe a four stage model that is based on the idea that the effect of new firm formation has a temporal dimension. Initially, new firms have a direct employment generating effect. Even small firms offer employment to, at least, the founder of the firm. Assuming that part of the jobs previously occupied by the founders will be taken over by others, a direct increase of employment can be expected. After this initial stage, however, there may be negative effects on employment. Employment in incumbent firms may be threatened by increased competition. This phase mimics the phase of creative destruction, which involves the replacement of existing, less efficient firms. In addition, many new firms will not survive the first years of operation. Entry and exit rates are strongly correlated over time (Karlsson and Nyström, 2002). These effects combined explain decreasing employment in this stage. After this stage, the effect becomes positive again because of the overall positive effect on the regional economy. This is in line with the Schumpeterian idea of development through entrepreneurship; the overall efficiency of a region may be increased, leading to employment growth. Finally, the effect of start-up in the base period fades away. Empirical evidence for this wave-shaped relationship has been found for the UK (Mueller et al, 2007), Germany (Fritsch and Mueller, 2004), Portugal (Baptista et al, 2007) and the Netherlands (Van Stel and Suddle, 2007). The evidence suggests that in order to assess the relationship between new firm formation and employment generation, a longitudinal setting is pivotal. Apart from the role of new firm formation in reshaping the types of jobs that arise from new industries related to the global economy (Beyers, 2000), globalization can have an impact on the temporal dimension in job creation. If product life cycles become shorter on average, it can be expected that firm churning per time period may increase. In terms of the longitudinal model described in the above, it can be expected that the effects of new firm formation on employment generation may be much quicker. Overall, it could be expected that total employment in new firms may increase as it offers a flexible way of creating regional scale efficiencies that is necessary in an environment of shorter product life cycles. This remains an empirical question.

c) New firm formation and innovation

Entrepreneurship, expressed in new firm formation, has a theoretical connotation with innovation. If entrepreneurship is the creation of new combinations by individuals (Schumpeter, 1912), it has an inherent link to newness and progress. This works in several distinct ways. Not only does the entry of new firms push other, less efficient firms out, even the threat of entry may stimulate existing firms to produce more efficiently (Fritsch and Mueller, 2004). Apart from these effects, Fritsch and Mueller observe that new firms can play an important role in driving structural change by exploring new markets and that new firms can increase the number of product solutions through innovative entry. All these effects eventually contribute to increased innovation and economic rejuvenation. In the light of globalization, conceptualised as the enlargement of markets, the mechanism of these effects may change.

The enlargement of markets works towards a decreasing length of product life- cycles. Knowledge and information about products is disseminated more quickly, which reduces the period in which entrepreneurs can capitalise on a competitive advantage. Imitation and further development of products and services by competitors can be imminent. In addition, rapid dissemination of a product decreases the turnaround time of market information. In other words, the new product can be scrutinized by consumers quickly, which helps a
dominant design to be installed quickly. In order to translate this effect of globalization into new firm formation, the distinction between exploitation and exploration is important (Breschi and Lissoni, 2001). New firm formation based on exploitation is strongly rooted in existing practices and may even involve the direct imitation of an existing business idea (Schmitz, 1989). Exploration, in contrast, stresses the newness and trial-and-error function of new firm formation. If indeed rapid dissemination of knowledge restrains the possibilities of ensuring a long term competitive advantage then entrepreneurship aimed at exploring new technologies and products is crucial for continuously establishing short term advantages. This would imply that innovative new firm formation is becoming more important for economic growth in a globalizing world. Recently, studies have distinguished between types of entrepreneurship in order to capture the impact of innovative new firm formation. Both Mueller (2007) and Audretsch and Keilbach (2004) find for the German case that particularly high-tech and knowledge intensive start-up contribute to economic growth. Wong et al. (2005) corroborate this finding using GEM data at the country level: new firms based on the recognition of business opportunities govern economic growth. Based on these studies, it can be concluded that particularly new firm formation that is explorative in nature has a beneficial effect on economic development. Still, although innovative new firm formation may guide the direction of economic development, a quick exploitation of a short term competitive advantage may also be important, particularly for establishing a regional competitive advantage based on spatially confined knowledge advantages (Schmitz, 1989). Shorter product life cycles may prevent single firms to achieve scale efficiencies easily. New firm formation based on the exploitation of locally available knowledge may create a complex of smaller firms that together establish regional scale-benefits in production.

These ideas are again subject to the question to what extent the changes related to globalization (such as shorter product life-cycles) apply to distinct product categories and distinct regions. In addition, it can be argued that by the same token the notion of “locally confined knowledge” may be less applicable, taking away incentives for clustering. Nevertheless, the argument shows that the interplay between innovation and replication can be an important feature of understanding the role of new firm formation in regional economic development and that globalization may indeed impact on this interplay.

Indirect effects of new firm formation on economic development

There are several types of indirect effects of new business formation on economic growth which may be positive or negative. Negative effects happen due to an increase in competition among incumbent firms and new firms, while positive effects appear when incumbents imitate innovations made by new firms and stimulate to innovate themselves after that. Furthermore, in order to resist the threat of start-ups, incumbents lower their prices, which, in turn, increases demand for products and services (Verhoeven, 2004).

New firms represent introduce new capacities into the market and therefore are an essential element of the market process. The evolution of the newcomers, e.g., as measured by how many employees they have or their market share, may be termed the direct effect of new capacities. Due to competition and market selection, only a fraction of start-ups survive for a longer period of time, and those that do succeed in establishing themselves in the market may displace incumbents. Two types of market exit may result from the entry of new businesses. First, a considerable number of new businesses fail to be sufficiently competitive and thus are forced to exit the market. Second, displacement of incumbents by new competitors leads to declining market shares or market exit. Such crowding-out effects may occur in the output market because the entrants gain market share, as well as in the input market due to the additional demand for resources made by new businesses that can lead to scarcity of inputs and increasing factor prices.

These crowding-out effects are somewhat indirect. Given that market selection works according to a survival of the fittest scenario, firms with relatively high productivity will remain in the market, whereas those with low productivity with either have to reduce their output or exit. At a constant output level, this market selection process should lead to a decline in employment, instead of the creation of jobs, because fewer resources are needed to produce the given amount of goods and services at a higher productivity level. Hence, although
starting a new business means creating additional capacities that require personnel to operate them, the effect of new business formation on the number of jobs in the economy will not necessarily be positive but could just as well be negative.

2.2. Unemployment rate

It is suggested that there is a relationship between new firm formation and unemployment. While unemployment rate is the most common factor affecting firm formation, the literature on this subject shows contradictory results. Interest in the question of whether unemployment leads to an increase or a reduction in new firm formation has led to the development of the recession-push and prosperity-pull hypotheses, which are two conflicting perspectives regarding the effect of unemployment on new firm formation. The first one assumes that a higher level of unemployment may reduce aggregate disposable income, effectively reducing local aggregate demand for goods and services, thereby putting downward pressure on its rate of new firm formation (Mocnik, 2010) and cause less business entry (Delfmann, Koster, McCann and Van Dijk, 2014; Sutaria and Hicks, 2004; Fotopoulos, 2014; Audretsch and Fritsch, 1994). Some evidence found that regional firm formation is negatively related to the level of unemployment, such as Tervo and Nittykangas (1994), Sutaria (2001), Sutaria and Hicks (2004).

The second view argues the higher the unemployment rate, the unemployed tend to start up their own businesses so as to secure employment. The basic logic here is unemployed people can be an important source of potential entrepreneurs because their expected payoff from self-employment is likely to be higher than social allowances. Resultantly, rising unemployment may cause more people to establish their own business, for reasons of necessity. Furthermore, it is easy for start-up enterprises to hire labor, hence the incentive to start a new business increases (Okamuro & Kobayashi, 2005). For instance, Reynolds et al. (1995) suggested that as individuals cannot find jobs, they start new businesses in an act of desperation. Storey (1991) discussed that high unemployment ratio can lead to higher entry rates, because they force unemployed workers to start their own companies as an alternative to unemployment. Hamilton (1989) suggested that the relationship between unemployment and new firm formation might not be a simple linear relationship. He posited that the relationship is different depending on whether or not a given "borderline" level of unemployment has been reached. Most literature in which interviews or questionnaire surveys were used supports the view that there is a positive correlation between unemployment and new firm formation (Binks and Jennings, 1986; Vivarelli, 1991). Storey (1991) and Audretsch and Fritsch (1994) found both positive and negative associations while Fritsch and Falck (2002) found no relationship between firm formation and unemployment.

2.3. Population growth

On the one hand, population change can influence new firm formation by providing opportunities for new economic activity as new and bigger consumer markets emerge because of the growing population (Armington and Acs, 2002; Wennekers et al., 2005). Goods and services sought by individuals, in particular, should create new prospects for new firms and lead to start-up activity (Reynolds et al., 1995). Population growth may also be a push factor to engage in new economic activity in order to make a living: the expanding population places additional strain on salaries and thereby lowers the opportunity costs for self-employment (Verheul et al., 2001). Even though some studies have not found a significant effect (Audretsch and Fritsch, 1994; Garofoli, 1994), there are several studies which found that population growth is positively related to start-up rates (Armington and Acs, 2002; Bosma et al., 2008; Reynolds et al., 1995; Wennekers et al., 2005). According to the research of Ian Hathaway, Robert E. Litan (2014), there is a strong positive correlation between population growth in the 1970s and a region and the firm formation rate at the end of that decade. In other words, the firm formation rate tended to be higher in regions that experienced greater population growth, the opposite was true for regions with lower firm formation rates. Sutaria and Hicks (2004), on the other hand, found that population growth was not positively significant in explaining firm formation. However, they accepted the modeling limitations that could not capture the expected positive relationship between new firm formation and population growth.
2.4. Population density

Population density is an important determinant of new firm births. According to Reynolds et al. (1994), urbanization and agglomeration are closely associated with population density and new firm formation rates are often positively associated with population density. Audretsch, Fritsch (1994) also found a positive relationship between population density (agglomeration) and new firm births. The percentage of entrepreneurial activity is higher in urban regions that are characterized by high population density (Bosma, Schutjens 2011). However, if a region has already maximized the benefits of urbanization, high population density can have negative impacts as well (Delfmann et al. 2014).

The literature of other scholars (Audretsch and Fritsch, 1994; Guesnier, 1994; Reynolds, 1997; Armington and Acs, 2002; Bishop, 2012; Fotopoulos, 2014) had also pointed out positive impact of population density on new business formation that an increase in population is expected to drive rising demand for goods and services, which in turn can lead to rising rates of new firm formation. This can be explained by the fact that regions with a high density of population and economic activity will spawn more entrants into a region thanks to better access to large and differentiated markets for input factors such as capital, labor and services (Fritsch and Mueller, 2006). In most studies, a positive impact of population density on entry is observed. Gaygisiz and Koksal (2003) state the results on cross-section and panel data analyses and show that population density is the most significant variable in explaining regional variation in new firm formation in the manufacturing sector in Turkey. Additionally, Guesnier (1994) noted that in France, higher new firm formation rates are also associated with higher population densities, which was also experienced in the study of Audretsch and Fritsch (1994) on spatial variations on firm births in Germany. However, there is only one exception, which belongs to Garofoli (1994), who concluded that population density has no significant impact in the case of Italy.

2.5. Urbanization

Degree of urbanization is defined as the percentage of the population living in urban areas and measured by the number of inhabitants living in a highly urbanized or urbanized area over total population of that region. It captures general benefits of locating in dense regions which contributes to new firm formation through provision of the labor market opportunity, information flows and a higher variety in goods and services. Those benefits are indeed important considerations for entrepreneurs when they choose a location to establish a new enterprise. This can be explained by the fact that urban regions are often characterized by a more diversified population, leading to more variety in demand. Higher diversity also stimulates new firm start-ups; more diversified cities have a higher chance of fostering innovation than less diversified cities (Bosma et al., 2008; Frenken and Boschma, 2007). Conditions for entering a market are thought to be more favourable in more densely populated regions (Audretsch and Fritsch, 1994; Sternberg, 2011), as the consumer market is in closer proximity and the more developed business infrastructure (Bruderl and Preisendorfer, 1998; Fritsch and Mueller, 2008).

In addition, agglomeration effects can positively affect new firm formation through increased local market opportunities relating to the consumer market and necessary inputs (Reynolds et al., 1995). Locating in a dense area, firms may experience positive external effects, for instance, lower transportation costs and closeness to suppliers and customers can help them to reduce cost and improve the quality of goods or services produced (Nystrom, 2005). Urbanization also improves the likelihood of the presence of a more skilled workforce and enables ideas and knowledge to flow faster. Moreover, the risk of starting a business in urban areas is considered relatively low due to the rich employment opportunities which function as a safety net in case the new firm fails (Stam, 2009).

However, the positive influence of urbanization on new firm formation is not univocally agreed upon because higher degree of urbanization can lead to the pursuit of economies of scale, which enables firms to serve their clients more efficiently and leaves fewer opportunities for small firms (Verheul et al., 2001). Other negative effects of agglomeration include excessive competition, possibly resulting in increased wages and elevated
input prices, thus discouraging entry (Nyström, 2007). Van Stel and Suddle (2008) also found a negative effect for start-ups in the Netherlands shown by the number of service start-ups, as they are less dependent on the agglomeration benefits mentioned.

2.6. Income level

Income can be seen as both a demand and supply factor. Income growth increases demand but also facilitates access to capital for aspirant entrepreneurs. Verheul et al. (2001) discussed conflicting hypotheses explaining the impact of one particular form of income, wages, on start-up rates. The first hypothesis argues that high wages lead to high opportunity costs of being self-employed, and therefore relate to a lower level of new firm formation. It is expected that income is associated with the propensity of firms to start an enterprise due to the fact that the opportunity cost of start-up decision is their salaries. The higher the salaries workers receive, the less likely they will split off to set up their own establishments. In addition, the income level constitutes labor costs for the companies. A high-income level might therefore deter entry in markets that are sensitive to high labor costs (Nyström, 2007). Santarelli et al. (2009), Audretsch and Fritsch (1999), Fotopoulos and Spence (1999) found that there is a negative relationship between wage and new firm formation in developed countries. In addition, Bosma et al. (2008) mention the potential negative influence on self-employment due to the high costs of hiring employees.

The second hypothesis argues that high wages are positively correlated to start-up rates, as higher income is a sign of a prosperous economy with above average survival rates. This can be explained by the fact that higher levels of income in a region can determine an increased demand for a wide range of goods and services that would stimulate entrepreneurial activity, especially new business start-ups. Gaygisiz and Koksal (2003), Cala and Arauzo-Carod (2010) affirmed that markets with a low level of income reduce the rise in demand and discourage the entry of new firms. Butler and Herring (1991) also noted that individuals who have access to a higher family income are likely to have higher employment opportunities. Armington and Acs (2002) and Lee et al. (2004) observed a positive association between income growth and new firm births, and Reynolds et al. (1995) found that the presence of greater personal wealth and firm formation are positively related to each other.

2.7. Exit rate

Johnson and Parker (1996) found no relationship between exit rate and entry rate. Once again, however, we find a statistically significant positive influence of prior-year’s exit rate on current-year rate of new firm formation. This suggests that as firms leave the market place – voluntarily or involuntarily – they create a kind of ‘vacuum’ pulling in new firms better able to satisfy existing market demand with innovative new products and services and to meet competitiveness criteria. At the same time, however, with the exit of firms from a region’s market, the degree of competitiveness within the market may subside, thus offering a less hostile environment for new entrants. The results involving both entry and exit rate influences taken together would appear to support the conclusion that the previous year’s entry rate is a stronger predictor of the current year’s entry rate than is the previous year’s exit rate. Once again, this may reflect the “momentum” argument, whereby the continuation of a trend, rather than its cessation, is ultimately more conducive to new firm formation. While it may follow that a region experiencing new business entry in a prior year can expect to respond by experiencing even more this year, it does not follow that a region’s most likely endogenous response to firm exit the previous year would be a process to compensate through new firm formation the following year.

2.8. FDI inflows

The studies of new firm formation in the transition economies will be incomplete without considering the impact of FDI, which has been shown to play a critical role in fostering growth, technology transfer, new market development and enterprise restructuring. Given the fact that most new firms are started by persons who
were previously employed (Garvin, 1983 and Acs et al., 2006), a large share of FDI in a regional economy may influence the nature of new firm formation efforts.

On the one hand, the presence of foreign-invested enterprises in an industry can generate demand for local products and services, bring new or higher quality inputs, and generate new business opportunities in the local market, thus encouraging the entry of domestic firms, which is called demand creation effect. For instance, Görg & Strobl (2002) find a positive effect of the FDI on the entry of new domestic firms in Ireland. On the other hand, foreign-invested enterprises’ presence in an industry can have a negative impact on the entry of domestic firms by raising the technological barriers to entry, which is called the entry barrier effect. Some research has found a negative effect or no effect of FDI on the entry of new domestic firms, especially in developing economies. Negative effects can appear when foreign-owned firms compete for the same customers and affect domestic firms. The presence of foreign firms in an industry can have a negative impact on the entry of domestic firms by raising the technological barriers to entry. The contradictory results obtained in the specialized literature can be associated with the lack of distinction between opportunity and necessity-driven entrepreneurs. The necessity driven entrepreneurs are the persons that are involved in entrepreneurial activities because they do not have other options for work and seek to secure an income necessary for living. By comparison, the opportunity driven entrepreneurs are those people who want to start a business from the desire to be independent in their work or to increase their income. Foreign investment brings new products and services into the host economy, generating demand for these products. There are several implications of this positive spillover (Javorcik, 2004). First, the new products lead to the creation of new markets and entrepreneurial opportunities (horizontal effects). New domestic firms can offer comparable products by imitating their foreign competitors. Secondly, new firms may seek to exploit niche opportunities within sectors neglected by foreign-owned firms. Thirdly, new firms can learn from the failed attempts of foreign-owned firms to satisfy customers through the introduction of more appealing alternatives, being aware of the cultural features of their customers – demonstration effect (Caves, 1996; Pitelis & Teece, 2010). Next, FDI provides managerial skills for the host country firms. The diffusion can occur directly through mobility of managers and workers when they are hired into the foreign-owned firms and subsequently move on to other local firms (Fu, 2012). Additionally, FDI provide support for trade flows, boosts export competitiveness and stimulates import-competing production (Christiansen & Ogotcu, 2002). They bring technical and informational externalities (Rodriguez-Clare, 1996; Meyer, 2004). Moreover, FDI permit access to financial resources (Urata & Kawai, 2000; De Maeseneire & Claey’s, 2012). Finally, FDI can help new firm extend their activities by subcontracting activities or by developing collaborations for different activities (vertical effects).

On the contrary, foreign presence can also discourage domestic entrepreneurs either by raising entry barriers or exit costs. This entry barrier effect could arise due to several reasons: Foreign firms are often more technologically advanced than domestic firms, especially in emerging markets, which allows them to reduce their production costs. Moreover, being much larger, less financially constrained and more experienced than domestic entrants, they can better exploit economies of scale or incur huge sunk costs such as advertising expenses. In addition, generous FDI incentives from local governments often help them out-compete domestic firms on the local labor markets. Those negative spillover effects or no effects were usually reported for the transition economies (Djankov & Hoekman, 2000; Konings, 2001; Sabirianova et al., 2005).

A number of previous studies tested the effects of FDI on entrepreneurship using a panel data approach. While Doytch & Epperson (2012) has found that FDI positively affect entrepreneurship only in the middle income country group, Kim & Li (2014) state that the main positive impact of FDI on business creation is most salient in regions with weak institutional support. Their findings obtained from 104 countries panel analysis are consistent with the predictions that foreign direct investment positively relates to business creation, especially in the less developed countries, characterized by lack of institutional support, political stability and good quality of human capital.

2.9. Mean establishment firm size (MES)
On the one hand, a large average firm size in a region had been found to have a negative impact on new firm formation (Garofoli, 1994; Audretsch and Fritsch, 1999; Shane, 2001). A small firm is better at providing employees with relevant experiences for new firm formation and the employees are more likely to have a closer contact with customers, hence they can get a better understanding of the market conditions (Mason, 1991; Fritsch, 1992). Therefore, skills needed to start a new firm are presumably best learned from previous employment experience in small firms. Firm size also captures sectoral differences across regions. A larger average size indicates a larger share of manufacturing firms, which tend to lower the creation of new firms (Parker, 2004). Fritsch and Falck (2002), Armington and Acs (2002) also observed a negative association between firm size and new firm formation because the existence of large firms and/or their branches can hinder new firm births. On the other hand, Sutaria and Hicks (2004) found a positive relationship between firm size and new firm birth since a large firm often depends on smaller firms for specialty goods and services.

3. Conclusion

In the case of Vietnam, according to information from the Ministry of Planning and Investment, the number of newly established businesses in 2019 reached 138,100 enterprises, 7,000 enterprises higher than that in 2018. With a total registered capital of VND 1,730.2 trillion and a total registered labor of 1,254.4 thousand employees, which equivalent to a rise of 5.2% of enterprises, it represents an increase by 17.1% in registered capital and 13.3% in the number of employees compared to 2018. The average registered capital of a newly established enterprise reached VND 12.5 billion, an increase of 11.2% compared to 2018. If counting VND 2,273 trillion of additional registered capital of 40.1 thousand enterprises then the additional total registered capital added to the economy in 2019 is 4,003.2 trillion dong. Meanwhile, the number of dissolved enterprises is estimated at 80,000, a decline of nearly 10,000 enterprises compared to the previous year. Thus, for each business dissolved, there are nearly two other businesses entered the market. Previously, according to the data in the book “White book on Vietnamese businesses 2019”, by the end of July 2019, Vietnam had a total of 714,000 businesses. As a result, with the added volume over the past time, the government’s goal of reaching one million enterprises by 2020 is unlikely to be achieved. As a result, it is necessary to propose some policy recommendations base on the regression results in the previous chapter so as to promote the formation of new businesses in Vietnam.

REFERENCES


