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Institutional barriers to firm entry and exit: Case-study evidence from the Brazilian textiles and electronics industries

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Abstract

What are the main barriers to firm entry and exit in developing countries and how do they differ from barriers to firm operation and growth? How important is the institutional and regulatory framework in this respect? This paper examines such questions using case-study evidence from the Brazilian textiles and electronics industries. We find that not only these institutional barriers are high in Brazil but also that they seem to have risen since the early 1990s, and that their effects vary across sectors. We also provide evidence from a survey we carried out in 2005 suggesting that institutions are more important as barriers to entry than as barriers to firm operation and growth.

JEL classification: O12; D23; K20; O17; K30

Keywords: Firm entry; Firm exit; Brazil; Institutions

1. Introduction

This paper considers the role of barriers to firm entry and exit and compares them with barriers affecting firm operation and growth. For developed countries, there is a well-established literature studying the main determinants and overall consequences of the process of entry and exit at the firm, sector, industry and country levels.[1] A similar literature is now emerging for

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[1] For reviews, see Geroski (1995), Caves (1998), and Berry and Reiss (in press).

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developing countries.[2] It concentrates on issues such as labour regulations, capital restrictions, red tape and administrative costs. One key hypothesis motivating this newer branch of literature is that entry rates would be lower in developing countries and that this could turn out to be helpful in explaining the large cross-country variation we observe in international levels of productivity per worker.[3] One reason for the expectation that entry would be systematically lower in poorer countries is that barriers to entry and exit seem to be more powerful and complex than in developed countries. Consider the effects of financial sectors that are underdeveloped, skilled labour that is often in short supply and rules and regulations that are cumbersome and unpredictable. Interestingly, this literature tends to take a more macro slant by examining these barriers across countries at a given point in time. Here, we study these barriers over time (from 1990 onwards) across industrial sectors and in one specific country (textiles and consumer electronics in Brazil) instead.

The approach we take in this paper is in three stages and is explained as follows. First, we discuss general barriers to firm operation and growth and entry and exit, on the one hand, and the overall features of the regulatory environment on the other. This is carried out with both previously unexploited survey data (World Bank's 1999 Brazil ''World Business Environment Survey'') and three data series from the International Country Risk Guide data set (these provide time-series information on institutional barriers). We find that these institutional barriers are high in Brazil and also that they have increased throughout the 1990s (which is the period the so called first generation reforms were being implemented).[4] In the second stage we examine the nature and extent of barriers to entry and exit in two industrial sectors that are comparably capital intensive, concentrated and technologically mature.[5] Using both primary and secondary data, we find that the effects of changes in institutional barriers to entry and exit since 1990 in the two sectors were significant but very different. In consumer electronics, the relaxation of minimum national content requirements translated into the entry of multinational firms. However, in textiles, lower levels of protection for domestic firms meant vigorous competition from imports, which in its turn led to modernization investments, and changes in the regional policy framework led to the un-clustering of the regional distribution of output, with recent entrants tending to locate in the Northeast rather than the more traditional Southern states. In the third and final stage of our analysis we present novel survey evidence (from a representative sample of about 100 Brazilian firms we carried out in 2005) suggesting that institutions in general, and corruption in particular, play a larger role in terms of barriers to entry than the one they play as barriers to firm operation and growth. This issue has received scant attention in the literature on investment climate.

2. Overall institutional barriers to entry and exit in Brazil

The objective of this section is to provide an overview of the general (as opposed to sector specific) institutional barriers to firm entry and exit in Brazil. One first important question is the

[2] See, among others, Bartelsman et al. (2004), Djankov et al. (2002), Fisman and Sarria-Allende (2004), Eslava et al. (2004), Fajnzylber et al. (2001), Klapper et al. (2004), Pavcnik (2002), Roberts (1996a, 1996b) and World Bank (2004).

[3] Desai et al. (2003) compare entry rates in Western Europe with those in Eastern Europe and find that they are lower and that institutional barriers play a significantly more important role in the latter.

[4] Due to space constraints, a chronology of the changes in government and regulation cannot be included in this version of the paper. These were discussed in previous (longer) versions of the paper and are available upon request.

[5] For the sake of space, the analysis is carried out in terms of firm turnover (or net entry) defined as the difference between entry and exit rates). A companion paper offers a fuller analysis of these data, covering 98 Brazilian manufacturing sectors (at the 3-digit level) yearly from 1996 to 2002 (Campos and Iootty, 2007).