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Business turnover in urban areas: size matters

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Business turnover—the rate at which new firms enter, and old firms exit, the economy—is an important indicator of a number of things: productivity, innovation, and economic growth, to name just a few. Higher turnover rates tend to produce greater productivity, more innovation, and more economic growth. Lower turnover rates result in less of these three factors. U.S. business turnover has been declining for at least the last 40 years, says Jason P. Brown, in his article "The widening divide in business turnover between large and small urban areas" (Federal Reserve Bank of Kansas City *Economic Review*, third quarter 2018), but more in small urban areas than in large ones. Worse, since the Great Recession, the gap between the two types of areas has been widening, so much so that the economic future of the smaller urban areas is in doubt.

Besides producing these two broad results, Brown's analysis turns up a couple of narrower, but no less important, findings. First, over all urban areas, business turnover declined more in service-providing industry sectors than in goods-producing sectors. However, the gap in turnover between large and small urban areas widened more in the goods-producing sectors than in the service-providing sectors. Second, dividing urban areas into four size classes—large, medium-sized, small metropolitan, and micropolitan, in order of size—Brown finds that large and medium-sized urban areas had a significantly higher level of business turnover than small metropolitan and micropolitan urban areas.

These findings are, of course, interesting in themselves, but what may be more interesting is what they might hold for the future. As Brown puts it, "The implications for future growth in small and large urban areas are striking." He points to several independent studies that touch on the economic effects of the declining overall U.S. business turnover rates and the ever-growing gap in business turnover between large and small urban areas that his own research has uncovered:

- Declining business turnover has been linked to a slowdown in aggregate productivity in the U.S. economy—a slowdown that, in turn, is associated with slower economic growth in general. Thus, if the trend in business turnover continues to decline, productivity, and hence economic growth, is likely to diminish.
- If turnover in large urban areas continues to decline at a slower rate than turnover in small urban areas (meaning that the gap between the two kinds of areas widens further), then the small areas will likely continue to see slower economic growth than the large areas—if they see economic growth at all.
- Given that innovation is associated with higher rates of business turnover, if the gap in turnover continues to widen, large urban areas will be more likely than small urban areas to attract more innovative workers and firms and will face a brighter economic future.