COPYRIGHT NOTICE
FedUni ResearchOnline
https://researchonline.federation.edu.au

This is the author's version of a work that was accepted for publication in the 59th Annual ICSB World Conference; Entrepreneurship and sustainability proceedings. Changes resulting from the publishing process, such as peer review, editing, corrections, structural formatting, and other quality control mechanisms may not be reflected in this document.

Paper Title: Small businesses, Institutions and Regional Incomes

Karim Mardaneh

Post-Doctoral Fellow and Lecturer

The Business School, Faculty of Business

Federation University Australia

Suite 16, Greenhill Enterprise Centre, University Drive, Mount Helen, Victoria, 3353,

Phone: +61 3 53279861

Email: k.mardaneh@federation.edu.au

www.federation.edu.au

Tony O'Malley

Adjunct Research Fellow

School of Management

University of South Australia Business School

Key words: Small businesses, Transaction, Transformation, Institutions, Market making, Clustering

Track Title: Sustainability

Paper Title: Small businesses, Institutions and Regional Incomes

Aim of the paper

Regional small businesses may rely on customers who earn income in local and global markets. Small business must transact with suppliers of knowledge and resources, transform those resources into innovative and saleable products or services, and transact with customers. Transformation, transaction and social activities, and the institutions which support them, are necessary for successful small businesses. Regional income and small businesses depend on innovation and trade provided by social and transaction institutions.

In this paper we demonstrate this proposition empirically using a model and by investigating the relationship between regional income, transaction institutions, transformation institutions, and social institutions for 140 functional economic regions (FERs) in Australia. The model suggests that social institutions create a macro-environment in which transaction institutions and the transformation and trading activities of businesses can thrive, and help to generate regional income and prosperity.

We follow others (Cooke et al., 2007) in arguing that strong transaction institutions are a necessary condition for regional innovation. Social institutions complement transaction institutions by providing education and training, arts and recreation, health care and social services. In the studies reported in this paper the capacity for search and intermediation of exchanges of all kinds (goods, services, knowledge etc.) is measured by the share of transaction institutions in regional employment. The capacity of social institutions is measured by the share of employment in social institutions. We argue that the market failures which cause regional failures to thrive may be made solvable by mobilising market making services to extend and provide governance for regional transactions with faraway markets.

Background Literature

The problem of persistent regional disparities in productivity and income has been attributed to a very wide range of contributing factors. Fujita and Thisse (2002) point to the importance of agglomeration economies in driving the growth of cities. Trade theory points to resource endowment and comparative advantage as determinants of trade, and Porter (1990) and Fairbanks and Lindsay (1997) extend the analysis to the competitive advantages of local industrial structures and clusters. Geographers such as Beer and Maude (2002) provide further insights into the persistent themes in regional development theory and practice including industrial recruitment. Florida (2002) gives emphasis to the social institutions which develop and sustain creativity and cosmopolitanism, in concert with talent and technology.

Transaction costs are the costs of the resources used to define and enforce exchange agreements. More resources are required when cooperation is particularly difficult to sustain and transactions must be undertaken with a large number of unknown agents (North, 1991: 97-98). The transaction institutions which ensure the reliable and trustworthy links required for exchange transactions between traders in markets (Wallis and North, 1986; North, 1991) are also required for exchange transactions between holders of related but different knowledge bases (Malerba, 2006). The transaction institutions support the integrity of transactions between traders by assisting traders to search and inspect goods and services, and to negotiate and execute a contract (Furubotn and Richter, 2010).

The 'New Institutional Economics' literature (Coase, 1937; Furubotn and Richter, 2010) argues that markets must be made and demonstrates the extraordinary efforts made through history to extend markets. The transaction costs literature (Coase, 1937; Wallis and North, 1986; Dollery and Leong, 1998) provides approaches to the measurement of the resources nations use to make and sustain markets.

Methodology

In this paper we use a sample of 140 functional economic regions (FERs) drawn from the Australian Census of Population and Housing 2006 (ABS, 2007). For each region we develop estimates for the year 2006 of median gross weekly income and an occupation by industry matrix for the employed population. Individual weekly income for functional economic regions and its connection to the transaction and transformation sectors are examined.

A cluster analysis is used to reveal the contributions to incomes of education and other social institutions in high income regions. In addition, regression and correlation analysis are used to reveal the contributions to regional income of transaction institutions and selected industries.

Results and Implications

We extend and upgrade the regression and correlation analyses, confirming a strong and positive relationship between incomes and institutional structure after accounting for industry structure. We also conduct a cluster analysis of the components of institutional structure which provides further insights into interactions between institutions.

The results show a large, significant and positive relationship between income, transaction and social institutions in regions. This suggests that regional development policies should pay attention to growing the transaction and social institutions within their region, thus stimulating small businesses growth. The model of regional income formation put forward in this paper is broadly supported by the statistical analysis. This has implications for further research as well as regional practices. The results show that median gross individual weekly incomes in Australian regions are strongly and positively associated with the share of the local employment employed in local market making services.

Further research on linkages between regional industries and local market making services is required to confirm the reasons for and the extent to which regional enterprises in agriculture, mining, manufacturing and public administration secure their market making services locally. This future research should address the effects of remoteness on the location of market making services for regions.

In this paper, we argue that regional economic development policy should seek to put within reach for each region the capacity to make markets for the unique products and services of each region. By delegating the responsibility for market making to regions, the problems governments face in attempting to stimulate sustained regional prosperity may become simpler, less contested and more transparent. We suggest that policies to strengthen regional transaction institutions would improve coordination across regional knowledge bases, regional innovation and regional incomes.The results of this study provide a strong case for regional policy makers to consider ways of strengthening the market making capacity of regions in order to develop viable and independent regional communities.

References

Australian Bureau of Statistics (ABS). 2007. *Census of Population and Housing, 2006*. Cat. No. 2068.0

Beer, A. & Maude, A. 2002. *Local and regional development agencies in Australia: Report prepared for the Local Government Association of South Australia*. Adelaide: Local Government Association of South Australia.

Coase, R. H. 1937. The nature of the firm. *Economica*, New Series, 4(16): 386–405. Stable URL: http://www.jstor.org/stable/2626876 Accessed: 11/03/2011 14:50

Cooke, P., De Laurentis, C., Tödtling, F. and Trippl, M. 2007. *Regional Knowledge Economies: Markets, Clusters and Innovation*. Cheltenham, UK: Edward Elgar Publishing.

Dollery, B., & Leong, W. H. 1998. Measuring the transaction sector in the Australian economy. *Australian Economic History Review*, 38(3): 207–231.

Fairbanks, M., & Stace, L. 1997. *Plowing the sea: Nurturing the hidden sources of growth in the developing world*, Boston, MA: Harvard Business School Press.

Florida, R. 2002. *The rise of the creative class: and how it's transforming work, leisure, community and everyday life*. New York: Basic Books.

Fujita, M. and Thisse, J-F. 2002. *Economics of agglomeration: Cities, industrial location, and regional growth*. Cambridge, UK: Cambridge University Press.

Furubotn, E. G., & Richter, R (Ed.). 2010. *The new institutional economics of markets*. Cheltenham, UK: Edward Elgar.

Malerba, F. 2006. *Sectoral Systems: How and why innovation differs across sectors*. Pages 382-406 in Jan Fagerberg, J., Mowery, D.C. & Nelson, R.R. (Eds.), The Oxford Handbook of Innovation, Oxford: Oxford University Press.

North, D.C. 1991. Institutions. *Journal of Economic Perspectives*, 5(1) (Winter):97-112.

Porter, M. E. 1990. *The competitive advantage of nations*. London: MacMillan.

Schumpeter, J. A. 1954. *History of economic analysis*. New York: Oxford University Press.

Smith, A. 1776. *An inquiry into the nature and causes of the wealth of nations*. London.

Wallis, J. J., & North, D. C. 1986. *Measuring the size of the transaction sector in the American* economy, *1870 to 1970*. In S. Engerman & R. Gallman (Eds.), Long term factors in American economic growth. Studies in Income and Wealth, Vol 51: 94-148. New York: National Bureau of Economic Research.