RESEARCH INSIGHTS

What Are the Welfare Effects of Large Firms Crowding Out Microenterprises?

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- **The entry of convenience chains in Mexico has reduced the number of neighborhood shops by 15%.**
- **Median and average consumers benefit from chains' entry, with an average welfare gain of 0.5%.**
- **Lower-income households may be worse off due to chains replacing neighborhood shops.**

CONTEXT

In Mexico, as in many other countries, neighborhood shops and chain stores like 7-Eleven coexist. Neighborhood shops, often family-run and located at the owners' houses, are the traditional component of the industry. However, convenience chains have rapidly expanded over the last two decades, with over 22,000 stores established. They are located in high-traffic areas and are perceived as very successful. Due to their advantages stemming from economies of scale and lower search costs for consumers, convenience stores represent a potential threat to neighborhood shops. This raises questions about how the replacement of neighborhood shops by convenience chains affects welfare.

PROJECT

A novel instrument is used to address the endogeneity in time and location of chain store openings. The project then investigates how the entry of convenience chains affects consumer welfare using a theoretical framework that estimates the compensating variation of convenience chains expansion. That is, it calculates the necessary change in household income for households to be indifferent between the presence or absence of convenience chains. The methodology decomposes the welfare effects into five categories: three effects on the household cost of living and two on nominal household incomes.

Key Concept

MICROENTERPRISES

Small businesses, often family-owned, typically with fewer than five employees.

RESULTS

The expansion in the number of convenience chain stores from zero to the neighborhood average (6.7) reduces the number of neighborhood shops by 15%. In terms of welfare, this phenomenon presents heterogeneous effects by household income level.

According to revealed preferences, higher-income households value convenience chains more, while lower-income households prefer neighborhood shops. Higher-income households allocate 9% of their spending to chains, compared to just 3% for lower-income households. On the other hand, poorer households dedicate 40% of their spending to neighborhood shops, whereas richer households allocate only 15%. The amenities offered by chains, such as parking, air conditioning, and acceptance of electronic payments, are appreciated more by higher-income households, leading to a 3% welfare gain from being able to purchase in convenience chains for the wealthiest quintile (Direct Price Index effect). As shown in Figure 1, the gains from the Direct Price Index increase as household income rises.

Key Concept

ENDOGENEITY

A situation in econometrics where the direction of causality between two variables is unclear.

On the other hand, the welfare loss due to the reduced number of shops is most extensive for the poorest quintile at 2.8% (Pro-Competitive Exit effect), because these households value shops more due to factors like informal credit options and proximity to home.

The income effects from the expansion of chains and the reduction of shops mostly cancel each other out. The expansion of chains leads to 10.7% fewer shops, resulting in a 0.31% income loss for these micro-business owners (Retail Profit effect). However, chains also generate employment, increasing income by 0.28% (Retail Labor Income effect). Nevertheless, the retail profit effect is 10% larger than the retail labor income effect, as shop owners' profits exceed the average wages in convenience chains.

In summary, the direct price index and the pro-competitive exit effects are the main drivers of the welfare effects. The richest households value the entry of chains the most and appreciate shops the least, leading to a welfare gain of 1.6%. Conversely, the poorest households experience a welfare loss of 0.5% due to their preference for shops over chains.

POLICY IMPLICATIONS

The phenomenon of more productive firms crowding out smaller, less productive ones presents a complex policy challenge. On one hand, it can lead to increased productivity and economic growth. On the other hand, it can have regressive effects, disproportionately benefiting higher-income households at the expense of lower-income ones.

The findings highlight these trade-offs in the context of convenience chains and neighborhood shops in Mexico. Higher-income households tend to prefer chain stores, and this preference leads to a welfare gain for these households. However, the expansion of these chains often comes at the expense of smaller shops, which are more valued by lower-income households due to factors like informal credit options and proximity to home. The resulting reduction in the number of shops leads to a welfare loss for these households. Moreover, while the expansion of chains can create jobs and provide a new source of income, it also leads to a loss of income for micro-business owners whose shops are crowded out.

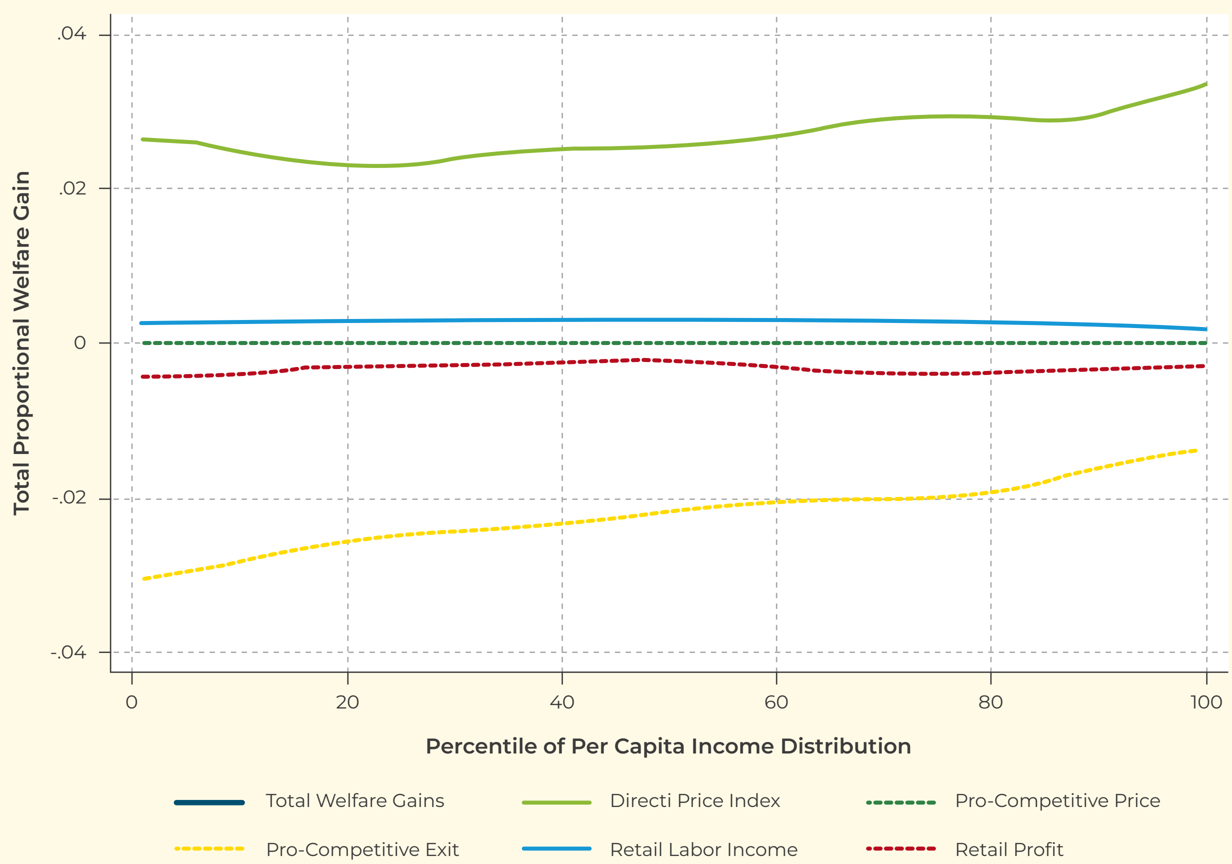
In light of these findings, policymakers might consider measures to mitigate the regressive effects of this phenomenon. On the neighborhood shops front, this could include supporting small businesses through grants or low-interest loans, or investing in job training programs for individuals displaced by the closure of small shops. In parallel, policies aimed at low-income households could mitigate the losses stemming from the decline in traditional establishments and augment the benefits derived from the proliferation of modern ones. For instance, enhancing financial inclusion could diminish the reliance of low-income households on informal credit provided by local shops. **Ultimately, the goal should be to strike a balance between promoting productivity and ensuring that the benefits of economic growth are equitably distributed.**

Key Concept

WELFARE

A measure of the satisfaction obtained by households, considering household income and what the household would choose to purchase with that income.

FIGURE 1. Welfare Effects of Convenience Chains Expansion



FULL STUDY

Talamas Marcos, Miguel Ángel. 2024. "Surviving Competition: Neighbourhood Shops versus Convenience Chains." *Review of Economic Studies*, March, rdae023. https://doi.org/10.1093/restud/rdae023.

This study also appeared as an IDB Working Paper.

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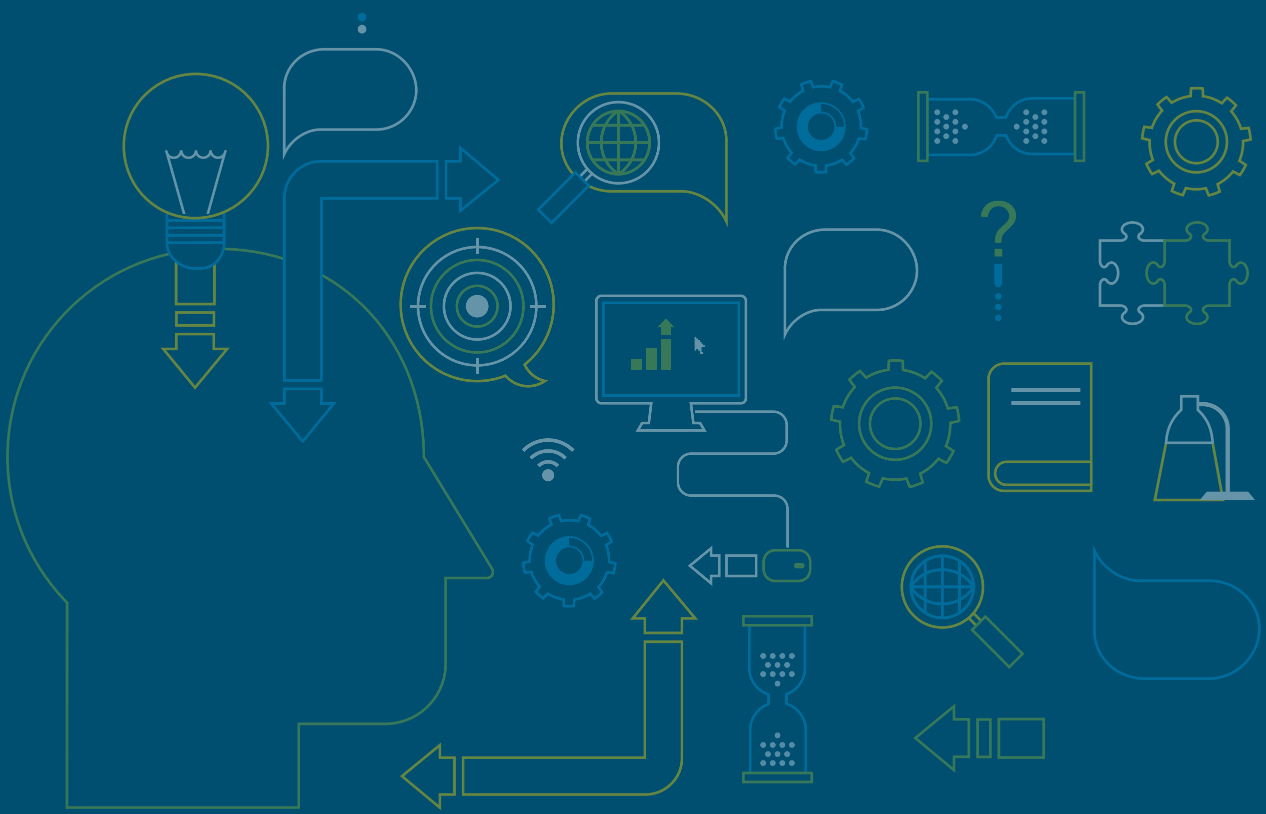

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