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INSTITUTIONAL PERSPECTIVE TO BUSINESS LOCALIZATION

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Abstract *The paper aims to assess the synergic impact of institutions, geography and culture on the decision of localization of operations and individuals. For this purpose, we will identify factors influencing the spatial distribution of operations and suggest an analysis of typology and institutions favorable for economic performance. We conclude that the benefits resulting from agglomerations would not be possible without inclusive political and economic institutions that allow exploitation of market opportunities, encourage technological innovation and investment in people and mobilize talents and skills of a large number of individuals*

Key words:
Business localization, agglomeration economies, institutions, agglomerations, path dependence.
JEL Codes:
R39, E02, O43.

1. Introduction

Agglomeration economies appear and develop when individuals are located in specific areas in order to benefit from better work and living conditions. These are correlated industrial clusters or big urban centers with increased productivity duet o agglomeration economies. There are several reasons for agglomeration economies formation, grouped into two big categories. The first category includes endowments viewed as given, immutable reasons, such as, the climate, geographical position, closeness to transportation routes, etc., while the second category refers to factors that influence the decision to localize in a specific area. Regarding the latter factors, businesses and individuals tend to localize themselves in a place with a pool of labor force, specialized suppliers and a spillover of knowledge (Marshall, 1920) and where there are opportunities provided by already existing business operations or a large market or due to entrepreneurial features or cultural belonging of the area. (Clipa, 2011).

Recent studies (Bembenek, 2015) showed that, on one hand industrial agglomerations are exemple of institutions and on the other hand they create institutions that allow to the member in the cluster satisfying their needs, activities, continuity and cooperation in order to fulfill the aim and the values. The paper aims to focus using a logical analysis on the synergic impact of institutions, geography or culture on the decision to localize a business operation in a specific area. For this purpose, we will show by means of empirical data and theories from literature that microfoundations of agglomeration economies (benefits that businesses and individuals perceive through their localization near other businesses and individuals) are essential for the localization decision. Then, we will show that benefits resulting from agglomerations would not be possible without inclusive economic and political institutions without inclusive political and economic institutions that allow exploitation of market opportunities, encourage technological innovation and investment in people and mobilize talents and skills of a large number of individuals.

2. Localization decisions of Business Operations

Understanding the geographical distribution of business operations evolution includes necessarily the identification and analysis of factors motivating the localization. Therefore, it is important to know and interpret factors influencing the decision-making on business localization. A business operation is viable when its localization proves to be „correct". This far too general term may be approached from two perspectives. First, we may talk about a localization within an economic system, a localization in a specific field, industry or in a network of business operations. Then, we may identify a spatial localization, a purely geographical approach but not independent from an economic one. The latter is very important as it is recognized that a part of the competitive advantage is not created inside a company or industry but is a consequence of industry localization in a region advantageous for its development and this process is self-sustaining.

Geographical areas differ significantly: some are richer in resources, other are more attractive as they are more favorable for specific business operations. These advantages are due to *geographic* factors related whether features of the area, such as distance, accessibility, size or to complex features of the land. Apart from these, we may identify a set of factors that are not geographical and which cause an advantageous localization. They include economic, political and cultural factors considered *indirect geographic factors* due to the impossibility to approach them outside the area.

Depending on the importance or force with which geographic or indirect geographic factors influence the localization of business operations, we may distinguish: *general factors* affecting international and regional localization and that are used both by geographers and economists and *special factors* influencing the localization and evolution of operations locally, studies especially by geographers.

Using an empirical research, M. Greenhut (1956) developed taxonomy of factors that may intervene in the localization decision: factors of demand, cost of factors and personal interest factors. *Factors of demand* include but are not limited to: the form of the demand curve for a given product, the localization of competition, the type and speed of service, the relation between producers and consumers, size of market area, the impact of localization and price on industry competitiveness. Greenhut includes into *cost of factors*: cost of land, availability of capital, cost of capital, cost of fuel and energy, cost of labor, cost of materials and equipment, offer extension, transportation cost. *Factors of personal interest* belong the third category of factors that have an impact on industry localization decision. These include: size of factory, preferences related to environment and safety measures.

Recent studies in localization economies (Fujita and Krugman, 2004; Krzysztofik et al., 2016) show that in the decision of business localization counts if the balance inclines in favor of dispersion or concentration forces. Precisely, there is a tendency to concentrate business operations in already agglomerated locations (center) based on *centripetal forces* (links, market, diffusion, knowledge) balanced with opposite trend based on *centrifugal forces* (real estate factors, rent/commuting, congestion) to delocalize business operations towards suburbs. Agglomeration of operations in an area is a premise for its economic growth attracting production factors and amplifying agglomeration. It may be explained by the fact that if agglomeration turns into growth of productivity, then it may lead to growth of salaries, income and living conditions. Individuals locate in agglomerations to get advantage of better living conditions. Implicitly, there is an intensification of business operations in areas with better living conditions and it, in turn, through agglomeration economies leads to additional growth of productivity attracting further growth of agglomeration. So, productivity and economic development gaps in different areas on the territory of the same country deepen through the emigration of population from low to higher productivity areas. However, this process of relocation inverses when, for instance, the increase of rent or price of housing discourages localization in the agglomerated region.

As we have mentioned in the introduction, there are three traditional sources of agglomeration economies first identified by Alfred Marshall (1920): links between suppliers of intermediary and final goods, interactions on labor force market and knowledge diffusion. So, closeness between suppliers and customers produces savings in traction costs easing input-output types of links. A bigger labor market may allow a better division of labor and may stimulate workers to invest in their skills. The diffusion of knowledge and ideas due to possibilities of companies and workers concentrated spatially to learn more easily from others.

Apart from these, the entrepreneurship, opportunities and cultural belonging are essential for the localization decision. Empirical research (Stuetzer et al., 2016) showed that *entrepreneurship* has a key role in the creation and development of big urban centers and is also supported by these. Entrepreneurship includes the openness of individuals to develop businesses and also the openness of owners of existing businesses towards new ideas and risk taking. New businesses appear in locations with pre-existent concentration of related economic activity. (Rosenthal and Strange, 2004). *Opportunities or positive feed-back refers to* the advantage generated by the proximity to other producers, consumption opportunities provided by the local market and natural resources available in a specific location. In their study Ellison and Glaeser (1999) examined the relation between the access to resources and the cost of key inputs, on the one hand, and concentration of some industries, on the other hand, twenty per cent of all analyzed agglomerations is explained statistically through a set of natural resources. Also, the direct relation between the development of cities in the South of the United States and the warm climate were underlined by Glaeser and Gottlieb (2009). In what regards *cultural belonging,* research (Nikolic, 2015) showed that social relations between business operators and cultural features specific to each location shape business behavior with a key role in setting up and development of agglomerations. Such behavior may be trust, cooperation, risk taking and information dissemination.

The effect of agglomeration and the resulting effects could not be obtained without inclusive economic and political institutions that allow exploitation of market opportunities, encourage technological innovation and investment in people and mobilize talents and skills of a large number of individuals.

3. Economic and political institutions

There are two main types of institutions: economic and political. *Economic institutions* provide economic incentives: savings, investments, education, innovation, adoption of new technologies, etc. We believe the most important for economic performance are institutions that guarantee *protection of property rights* by means of developing individual socioeconomic behavior aimed to improve movable and immovable property with direct impact on annuities. We may not neglect the importance conferred to institutions aimed to *limit the area of state intervention* in economy; they may discourage the opportunism of business operators in profiting from excessive and restrictive state intervention. Such institutions stimulate productive economic behavior, rational allocation of resources, eliminating the *status quo* obtained artificially by some social categories by "state confiscation" by specific interest groups (case of the nomenclature in former Communist states). Similarly, the *institutions contributing to conflict solving, contract enforcement, reduction of transaction costs* are also very important for economic performance as they ensure social cohesion and stability as pre-conditions for functional market economies.

In their turn, *political institutions* decide how the political process works; it decides under which economic institutions people live. They include power of the state to regulate and govern society. For instance, political institutions of a country set citizens' power to control the activity of politicians and influence on the way these behave (Acemoglu and Robinson, 2015). Political institutions contribute to guaranteeing that the state complies with duties undertaken under various contractual arrangements (repayment of amounts borrowed from domestic and foreign creditors). These also protect ownership rights (expropriation only for public use, against fair and compensation paid in advance while reducing the incidence of such measures by removing arbitrariness in assessing public utility etc).

The bi-univocal relation between institutions and economic performance is based on the corollary identifying human behavior as being shaped by a set of constraints and incentives derived from the institutional paradigm. As institutions influence behavior and incentives in real life, they model their success and the failure of nations (Acemoglu and Robinson, 2015). Specialized studies showed that this behavior may be influences also by other non-institutional elements existent in society, including physical features of the population, culture and geographical position. We should note the geographical and cultural aspects in terms of path dependence as factors influencing the success of a nation. Their correlated interaction shapes the environment open to localization.

4. Path dependence, geography and culture in economic performance

Apart from institutional factors responsible for economic performance, different level of development of countries may be explaine rom a diachronic perspective (Nunn, 2009). In other words, institutional genetic heritage, institutional path dependence that makes some institutions (formal and informal, stimulating or not the behavior of actors) develop over a long period of time are important for current and future economic performance. So, history plays an important role in the export (transplantation) of legal system (*British common* and *Roman civil law*) together with the arrival of European colonists. La Porta et al. (2008) argue that the *common–law* system provides a better protection to investors by means of more stable ownership rights. The author believes that this is the explanation for differences in economic development among countries of the former British Empire (*common law) and countries belonging to Spanish, French or Portuguese empires (Roman civil law* turned into Napoleonic Code).

Advocates of theory that there is a direct link between geographical location and the level of development suggest in their analysis such factors as climate, natural resources, diseases showing by means of quantitative methods their influence (Kamarck, 1976; Dell et al., 2014). Besides institutional quality, geographical position is viewed as producing a different level of economic performance if we consider three important geographical and location factors: tropical climate, access to the sea through seaports and distance of a country to main world trade centers. Humid climate may be a threat to economic performance through the increased incidence of diseases, such as malaria and through less favorable environment for sustained physical work having a direct impact on the decrease of work productivity. Lack of a river or sea port decreases the degree of addressability of indigenous goods for various trade locations and increases implicitly transaction costs. The distance to main trade centers inhibits exchanges with the outside world; all three listed factors contribute aggregately to decrease of attractively of a specific economy for foreign investments (Sachs, 2003).

Khan (2014) mentions again geographical position as the basis for differences in development between the states of South America arguing that the possibility to grow sugar cane on a large scale on extended land together with harvesting through the exploitation of slaves were also sources for institutional lagging behind. Paradoxically, even though there had been opportunities for collecting large income from the sale of sugar cane, there is huge political and economic inequality in these countries. It is a result of the evolution of national institutions that preserved the privileges of the elites and limited the participation of other social categories in the economic life. In addition, the research shows a direct causal link between the level of investments of colonists in health, education, infrastructure and the current state in these areas, in former French colonies in Africa (Huillery, 2008).

As mentioned above, we believe that historical events impact economic performance in several aspects. Firstly, the evolution of national institutions, in terms of deep alteration of aspects is important for long-term economic performance in the context of *historical circumstances*; a phenomenon that despite path dependence has still survived. The geographical position together with the intensification of maritime trade led in countries having access to the sea to the formation of a social class of merchants that consolidated in time its status by maintaining its own economic interests with the help of formal institutions. In addition, research attributes unequal economic development in these countries to different degree of development of the two institutional categories: institutions of ownership rights and contract institutions (Acemoglu şi Robinson, 2015).

Also, history may impact the evolution of important informal institutions, *culture and behavior norms.* In this context, we should note that this claim is not recent. The idea that behavior norms are channel through which history impacts economic development on long-term may be found in Max Weber (Rosenberg, 2016), who views Protestantism as being the source of development and expansion of capitalism in Western Europe. The superiority of British culture is also mentioned by Landes (1999). In his theory, Northern Europeans developed a unique set of cultural behaviors that made them work hard, save and innovate. Putnam, Leonardi and Nanetti (1994) explain also from the cultural perspective the discrepancies in development between Northern and Southern Italy. Similarly, other authors argue that another cause that cannot be neglected is the Industrial Revolution that brought into social norms honesty, cooperation and trust (De la Croix et al., 2016).

Another interesting theory admits the transmission of levels of economic performance from the past to the present Therefore, back in history certain institutional arrangements between formal and informal institutions generated a specific level of economic performance in a country, a level that is still high nowadays or, in other words, there is *a path dependence* for economic performance. In support of this theory comes the fact that there is a positive link between the stock of technological knowledge (knowledge and technology being facets of economic performance) at a specific time in history in a country and the current level of income per capita. The higher was the level of technology in the course of history (mainly due to low purchasing costs), the higher is the current stock of technology, the purchasing costs being inversely proportional with positive variation of income (Barbier, 2015).

CONCLUSIONS

Spatial variation of business operation depends on a set of factors that may be limited to geographical, cultural and institutional factors. These include the links between suppliers of intermediate and final goods, interactions on the labor force, diffusion of knowledge and ideas in agglomerated areas, entrepreneurial features, opportunities specific to locations and cultural belonging of individuals. All these lead to agglomeration economies perceived through savings in transation costs, increase of productivity, higher salaries, better division of labor, human capital development, innovation, in short, economic growth. But the benefits arising from agglomeration would not be possible without economic and political institutions that allow exploitation of market opportunities, encourage technological innovation and investment in people and mobilize talents and skills of a large number of individuals.

Institutional approach in the analysis of spatial localization of business operations opens a new research direction for empirical studies that should assess the efficiency of industrial agglomerations in the context of different types of investments.

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