Financial Markets and Firm Dynamics*

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Abstract

Recent studies have shown that the dynamics of firms (growth, job relocation and exit) are negatively associated with the firm's size. In this paper we analyze whether financial factors are important in generating this negative relation. We develop a model in which, at each point in time, firms are heterogeneous in the amount of equity, and the equity affects their financing decision. The production and investment behavior of small and large firms differs substantially, and the model replicates many of the key features of industry evolution: smaller firms experience faster growth, higher rates of job creation and destruction and lower survival rates.

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