

Title

Do Agglomeration Externalities Form Service Clusters? Evidence from a Location Lottery

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Abstract

Do agglomeration externalities drive the formation of service clusters, even when firms compete in close proximity? This paper provides causal evidence from the largest wholesale apparel and fabric market in Hanoi. After a fire destroyed the market building in 1994, slots in the reconstructed building were allocated by lottery among previous owners, generating an essentially random initial distribution of products. Despite this randomness, product clusters formed rapidly and have continued to agglomerate over two decades. Using detailed shop-level survey data, we show that initial coincidental agglomeration strongly predicts the subsequent adoption of similar products in neighboring stores. Clustering arose through both within-owner product switching and ownership transfers. Spillovers of products across distant stores within the same owner are limited, suggesting that agglomeration externalities are more likely to be driven by demand-side factors (e.g., shopping externalities) than by supply-side factors (e.g., knowledge spillovers). Even today, stores in initially clustered neighborhoods are more likely to remain active and attract more customers. These findings highlight the strength of agglomeration externalities in shaping service cluster formation, even in the presence of local competition and adjustment frictions.