

Cluster Brief: Connecting Businesses to Improve Market Access and Promote Spillovers¹

July, 2017

The Competitiveness Policy Evaluation Lab, or ComPEL, supports the rigorous impact evaluations of interventions that connect businesses to improve market access and promote spillovers. In both developed and developing economies, firms can improve their performance if they are better connected to other firms, whether they are buyers, sellers, or peers. These connections take on a variety of forms. For example, through an intermediary, local firms can connect with buyers who are geographically further away and thus participate in larger markets (Atkin, Khandelwal, and Osman, 2014; Ashraf, Giné, and Karlan, 2016). In another example, a handful of firms can create an informal networking group, sharing know-how on financing, operations, and trends (Cai and Szeidl, 2016). In low and middle income countries with weaker institutions, the impact of these relationships is greater (Anras and Foley, 2015; Macchiavello and Morjaria, 2015). In the long term these interventions are aimed to induce firm growth, measured by revenue, profits, and employment. Impact evaluations of these interventions are valuable because they show what roles the government and third-party actors can play to create a more robust market for firms.

Incorporating Demand

Common interventions that target firm growth, especially SME development programs, have largely targeted supply-side constraints. The main assumption behind these projects is that firms are not productive because of their lack of abilities, thus improving their abilities can in turn increase their bottom line. Prominent examples are management training, employee skills training, and subsidies to firm inputs. Interventions that connect businesses, on the other hand, incorporate demand-side elements. Not only can higher demand directly increase firm revenue, but can motivate firms to be more competitive in a larger market.

One source of this new demand comes from foreign markets. Given the large amount of variation in productivity across countries, providing access to high income markets can play a significant role in the bridging the gap. Benefits from connecting with foreign markets can be direct, or indirect through intermediaries or lead firms. SMEs that market themselves to lead firms in SEZs are prime examples of the latter, as they benefit from spillovers from trade. Furthermore, connecting to new and sophisticated buyers can bring upon dynamic effects. This is best demonstrated in an artisan project in Egypt, where buyers from abroad gave feedback to Egyptian rug producers on product quality and tips on improvement (Box 1).

¹ This brief was prepared by Tommy Kim (jkim34@ifc.org), Impact Evaluation Specialist, Competitiveness Policy Evaluation Lab, World Bank Group.

Box 1. Egypt Rug Makers Demonstrate Learning-by-Exporting

In a randomized controlled trial, researchers Atkin, Osman, and Khandelwal collaborated with the NGO Aid for Artisans and an Egyptian intermediary in securing orders from foreign buyers for handwoven rug makers. Essentially, the treatment was the opportunity to export to high-income countries. By the end of the study, treatment firms exhibited 16-26% higher profits, depending on the measurement used.

What is particularly notable is that over time treatment firms overall produced fewer quantities, but of superior quality that were sold at higher prices. This increase in productivity was evident when treatment and control firms were asked to reproduce rugs of identical specifications for experts, and the former produced rugs of higher quality but in the same amount of time. The researchers also collected communication logs between foreign buyers and rug makers, finding evidence of skills transfer with tips on improving quality. These results demonstrate learning-by-exporting, which is the positive relationship between access to export markets and firm productivity. Atkin, Khandelwal, and Osman, 2014.

Search and Contract Enforcement Frictions

The question that then arises is: why are SMEs not connecting with other firms already? Two reasons stand out: search costs and lack of contract enforcement mechanisms. Search costs are costs that are involved in finding buyers, seller, and peers. Lack of information acts as a key inhibitor as firms are obliged to dispense resources to find who these other firms are. One can easily imagine a local firm not knowing whom to contact when considering exporting, especially in the absence of a trade facilitation agency. The direct search costs can be high if firms are required to travel long distances to source their inputs. Indirect search costs include the time it takes to find a firm to connect to and the effort required to validate one's credibility prior to engaging in a business relationship.

Contract enforcement involves trust and assurance that goods will be delivered and payment will be made as agreed. Businesses in established relationships are not too concerned about this aspect as they have already established their credibility through repeated successful transactions (Macchiavello, 2010). In short, budding relationship requires firms to dispense costs, whether in the form of marketing, lower prices, and travel, to solidify. On the other end, parties in a budding buyer-seller relationships have doubts about each other's commitment. This results in firms paying more for marketing, selling at a discount, or contracting at smaller quantities. These twin problems of search and contract problems are well exemplified by a study on Nigerian importers (Box 2).

Box 2. Nigerian Traders Who Travel

One action firms can take to overcome search and contracting issues is to meet face-to-face. In this study, Startz surveys 620 Nigerian importers of readymade consumer goods and finds that firms that do *not* travel sell goods that are 2.5 months behind the frontier, meaning that they are not as up-to-date. Furthermore, these non-traveling firms also pay an 11.9% price premium for reliable delivery and payments. With the advancement in communication technology and financial services, remote searching and transaction have become more convenient, but face-to-face interaction remains a strategy in reducing uncertainties and costs associated with searching and contracting. Startz, 2016.

Role of Technology

Technology can play a key role in connecting businesses, in terms of lowering both search and commitment frictions. With the proliferation of mobile internet, fintech, e-commerce platforms, and other technological services, there are new ways to connect with other firms, whether new buyers, suppliers, or peers. The impact of these technologies, however, require an evaluation themselves. While the benefits of their use may be intuitive, there may be untested constraints that prevents the benefits from being materialized. One example is a startup that uses mobile phone technology to agglomerate orders from small-scale food vendors in Bogota, Colombia (Iacovone and McKenzie, 2016). Given that these vendors buy only small quantities for their inventory, researchers are investigating whether the technology can combine many of these small orders to add up to wholesale quantity. The hypothesized benefits are that these vendors will spend less time going to the markets to buy their goods, and that they would pay lower wholesale prices for their products. The impact evaluation is currently ongoing.

Cluster of Impact Evaluations on Connecting Businesses to Improve Market Access and Promote Spillovers

ComPEL works closely with government representatives and World Bank project teams to provide technical and financial support to incorporate impact evaluations into programs that aim at connecting businesses to improve market access and promote spillovers. Our aim is to build a body of evidence that can better inform which interventions have proven to be impactful and which have not in this policy space. Sample interventions currently supported by ComPEL include: promoting linkages between lead firms and SMEs, productive alliance of agribusinesses, consulting firms on operational improvements to meet national quality standards, and diagnostics of firms' export readiness. More information about this cluster and its related impact evaluations is available in:

<http://www.worldbank.org/en/programs/competitiveness-policy-impact-evaluation-lab#2>

References

- Antras, Pol, and C. Fritz Foley. "Poultry in motion: a study of international trade finance practices." *Journal of Political Economy* 123.4 (2015): 853-901.
- Ashraf, Nava, Xavier Giné, and Dean Karlan. "Finding missing markets (and a disturbing epilogue): Evidence from an export crop adoption and marketing intervention in Kenya." *American Journal of Agricultural Economics* 91.4 (2009): 973-990.
- Atkin, David, Amit K. Khandelwal, and Adam Osman. *Exporting and firm performance: Evidence from a randomized trial*. No. w20690. National Bureau of Economic Research, 2014.
- Breinlich, Holger, et al. "Information, Perceptions and Exporting-Evidence from a Randomized Controlled Trial." (2016).
- Cai, Jing, and Adam Szeidl. *Interfirm Relationships and Business Performance*. No. w22951. National Bureau of Economic Research, 2016.
- Grossi, Julia Cajal. "Searching for Trade Partners in Developing Countries: Testing Firms in the 'Fast Fashion' Industry." (2016).
- Hardy, Morgan, and Jamie McCasland. "It Takes Two: Experimental Evidence on the Determinants of Technology Diffusion." *Unpublished paper, University of British Columbia* (2016).
- Iacovone, Leonardo, and David McKenzie. "Using Technology to Improve Microentrepreneurs' Supply Chain in Colombia." Study Summary. Innovations for Poverty Action (2016). [Website](#).
- Macchiavello, Rocco, and Ameet Morjaria. "The value of relationships: evidence from a supply shock to Kenyan rose exports." *The American Economic Review* 105.9 (2015): 2911-2945.
- Macchiavello, Rocco, and Josepa Miquel-Florensa. "Vertical Integration and Relational Contracts: Evidence from the Costa Rica Coffee Chain." (2017).
- Macchiavello, Rocco. "Development uncorked: Reputation acquisition in the new market for Chilean wines in the UK." (2010).
- Startz, Meredith. "The value of face-to-face: Search and contracting problems in Nigerian trade." Job Market Paper, available on [scholar website](#).