Private Enterprise Development in Low-Income Countries

## Interfirm Relationship and Business Performance

Jing Cai and Adam Szeidl

***Regular meetings between managers of young Chinese firms substantially improved firm performance. Channels included learning from peers and new supplier-client matches.***

## Introduction

In the quest for identifying barriers to firm growth, much attention has been paid to barriers that act at the level of the individual firm. But firms do not operate in a vacuum: business relationships are potentially central. In this project we organize regular meetings for the managers of young firms to experimentally increase their business networks. We find that the meetings have large and persistent positive effects on a range of firm performance measures, especially when meeting partners come from larger firms. Using additional interventions we find direct evidence for two channels: learning from peers and improved supplier-client matches. Our results suggest that frictions in networking are an important growth barrier, and highlight a simple policy intervention that can improve firm performance in similar contexts.

## Methodology

To create variation in business networks, we organized regular meetings for randomly selected managers of young Chinese firms. We invited firms created between 2010-13 in Nanchang, Jiangxi province, to participate in business meetings. We randomly selected 2,820 firms from the total applicants as our study sample, which in practice consists of young firms whose managers have an interest in networking.

In our main intervention we randomly divided the 2,820 managers into a treatment group and a control group. Within the treatment group, we further randomly split the managers into subgroups of ten people. Each subgroup then held monthly business meetings for one year. We did not organize meetings for managers in the control group. We surveyed all firms before (baseline), immediately after (midline) and one year after (endline) the intervention. We also introduced additional interventions---discussed below---to analyze channels.

## Results

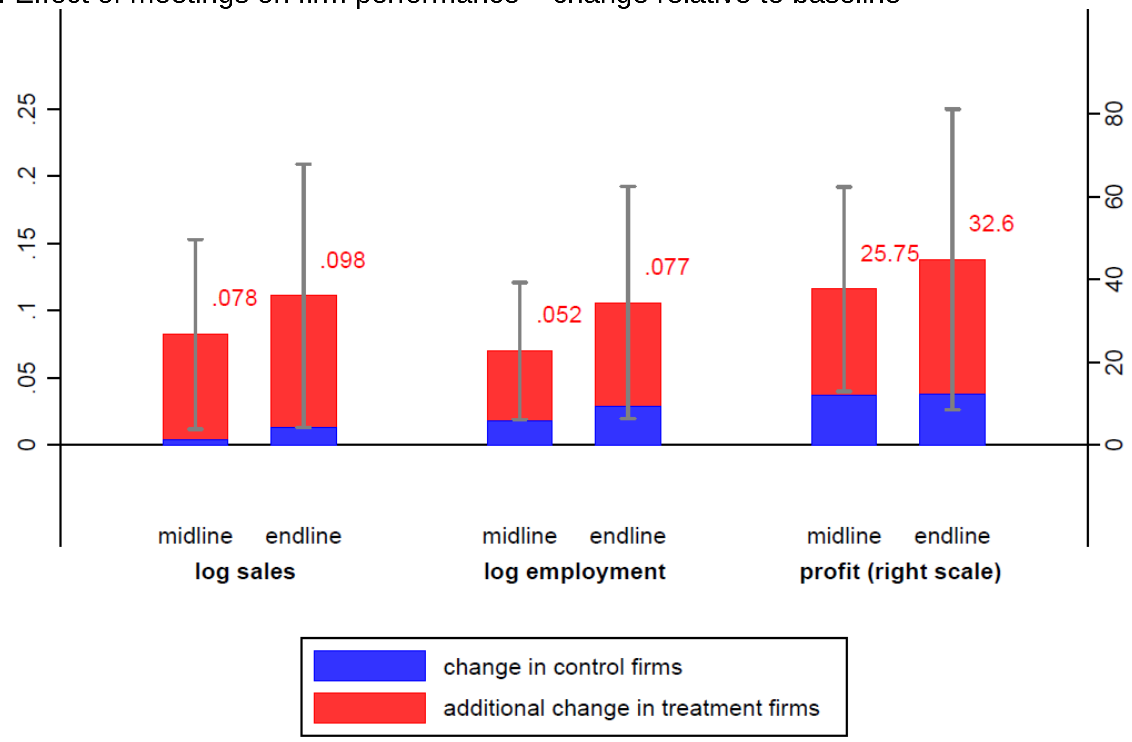
- *Business meetings had a large and persistent effect on firm performance.*

Figure 1 shows the effect of business meetings on key performance measures, both in the fiscal year during which the meetings take place (midline) and the fiscal year after the meetings finished (endline). The blue bars act as a benchmark by showing the performance of control firms which did not participate in the meetings. The red bars measure the additional change in treatment firms which did participate in the meetings.

The figure shows large, significant, and persistent gains for a range of outcomes following our intervention. For example, by the midline, sales (revenue) increased by only 0.4 log points in the control group, but it increased by an additional 7. 8 log points in the treatment group. Because each log point is approximately a percentage point, the meetings increased firm sales by about 8 percent in the first year.

The bar for the endline shows that this increase persisted in the following year. We find similarly large and persistent effects for employment and profits.

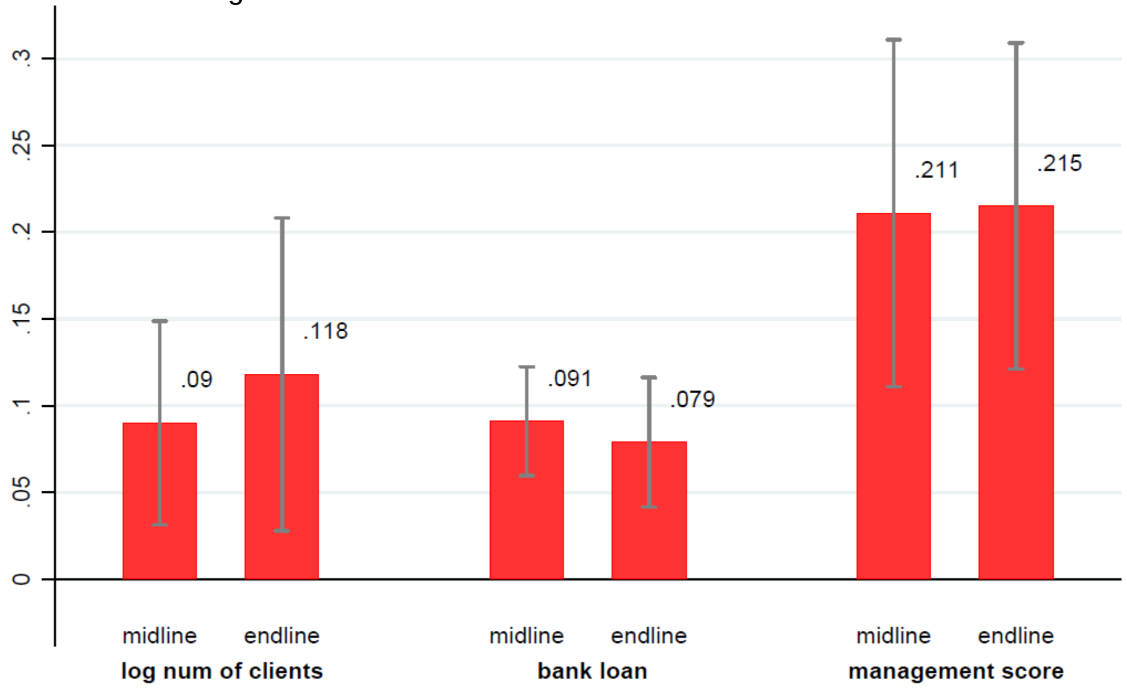
**Figure 1:** Effect of meetings on firm performance – change relative to baseline




- *Positive effects on intermediate outcomes related to improved firm-to-firm matching and learning from peers.*

What explains these positive effects? Figure 2 gives a hint by showing the effect of the meetings on intermediate outcomes. For simplicity here we only show the additional effect of the meetings relative to the control group. The outcomes are related to particular channels. The first two should be directly affected by improved firm-to-firm matching: the number of clients, and borrowing from a bank. And the third should be directly affected by learning: a management score that measures a range of business practices. There are significant and persistent effects for all three outcomes. These results are only suggestive that the learning and matching channels are active: it is possible that a third channel, which we do not observe, creates firm growth which then improves these outcomes. Below we present more direct evidence on these channels.

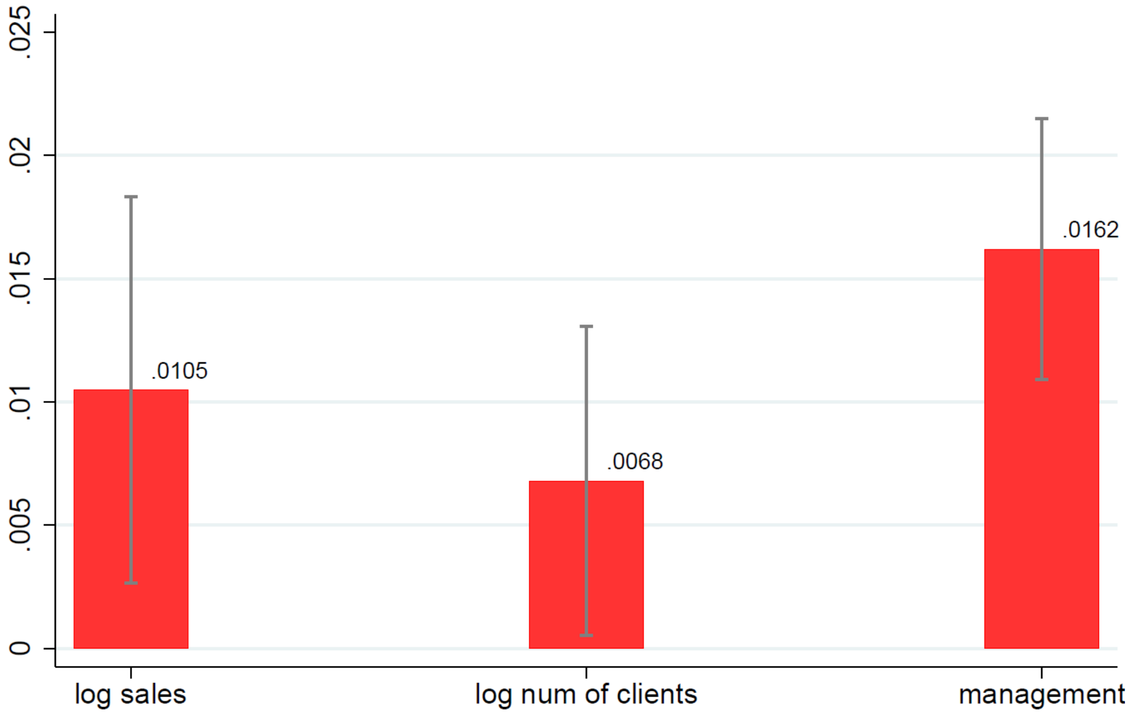
**Figure 2:** Effects of meetings on intermediate outcomes




- *Better peers generate larger improvements.*

How does group composition, i.e., the type of peers in a group, affect performance? Figure 3 shows the effect of having better peers, where peer quality is proxied with firm size (employment) measured at the baseline survey. For simplicity, in this figure we combine the midline and endline effects into a single measure. The figure shows that both main and intermediate outcomes improve more when peers are larger. This result further confirms that the meetings matter and highlights that not just the meetings per se, but also the identity of peers matters.

**Figure 3:** Effect of 10% large peers on firm performance



- *Direct evidence on the learning channel.*

To directly show that the learning channel is active, we distributed business relevant information---about a grant opportunity---to a subset of managers. We found that uninformed managers in groups in which some peers were informed were much more likely to apply to this grant than uninformed managers in groups in which no peers were informed. This result is direct evidence on the learning-from-peers channel.

- *Direct evidence on the matching channel.*

To show that the matching channel is active, we compared new partnerships in the regular meetings versus in one-time cross-group meetings which we also organized. We found that more new partnerships are created in the regular meetings. Thus regular meetings indeed reduced the cost of firm-to-firm matches.

## Policy impact

In our context business meetings were a low-cost intervention that generated substantial and persistent performance gains. Although further research is needed to fully evaluate whether these results generalize to different contexts (external validity), they suggest that business associations can be an effective tool for private sector development. Specifically, our results suggest that governments and NGOs interested in improving firm performance should organize regular business meetings for young SMEs interested in networking.

**Moving Forward…**

A key next step within this project is to decompose the total gains into the contributions of specific channels. Doing this will likely require additional assumptions but can help identify domains in which barriers to networking are particularly harmful.

We see two main next steps in the broader research and policy agenda. (1) Investigate concrete mechanisms. For example, we have a plan to study firm-to-firm matching by randomizing supplier-client matches. (2) Evaluate external validity. For example, we are planning to organize business associations in Chinese communities in East Africa.