Private Enterprise Development in Low-Income Countries

The Value of Face-to-Face: Travel and the Information Costs of Trade

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Distance between buyers and sellers can create information problems that pose a barrier to trade. By collecting new data on a sample of Nigerian importers, and connecting transaction details to trade process variables (such as whether the trader travelled), the researchers show that frequent, costly travel by Nigerian traders to meet with suppliers abroad is symptomatic of underlying information problems.

Introduction

Figure 1 Photo by Sunday Alamba

Distance between buyers and sellers is a drag on business for well-known reasons: transporting goods is costly, and tariffs and other regulatory burdens are often imposed when crossing national borders[1]. Information problems may also arise when potential trade partners are in distant locations, but the effect this has on trade is not well understood. A recent literature highlights the difficulty of finding out about prices in other locations, but this has been restricted to the special case of commodities, and doesn't address information about characteristics other than price or information asymmetries in buyer-seller relationships[2]. In this project, we take a new approach, making inferences about unobservable information frictions based on the observable strategies traders use to cope with them.

We collect transaction-level panel data on purchases by approximately 1,500 traders in Lagos, with the novel feature of connecting transaction outcomes (e.g. prices) to trade processes (e.g. traveling abroad to facilitate the purchase). We find that most market associations do not provide trade-promoting services, such as facilitating information sharing about dishonest trading partners. In the absence of reliable information about suppliers, traders frequently travel to source countries in order to ensure that suppliers follow through on business agreements (a contract enforcement problem). They also travel to find out what products are available (a search problem). Expenditures on travel suggest that the value of solving these search and contracting problems is large. This points to the potential for new trade facilitation strategies to increase consumer welfare by targeting information problems, particularly in developing countries.

Data collection and context

We collected transaction-level panel data on purchases by a sample of traders in Lagos, Nigeria over a 2-year period. Lagos is a mega city of approximately 21 million people, and also serves as the commercial

[1] Anderson and Van Wincoop, 2004
[2] Allen 2014, Steinwender 2014, Aker 2010, Jensen 2007

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hub and main port of entry for a country of 185 million. Most manufactured consumer goods (such as clothing, electronics, home furnishings, and hardware) are imported. These goods currently account for about 15 percent of consumer spending in Nigeria, a fraction that is increasing as incomes rise[3].

We defined a sample frame by conducting a census of 52,193 shops in the main commercial areas of Lagos. The shop census lists the number of shops selling a given type of product on every floor of every building in each market in commercial areas of the city. Only businesses with permanent physical premises are included in the census (i.e. not hawkers or street vendors), and some traditional markets focused on small scale retail of food and household items are also excluded.

We surveyed a random sample of just under 1,500 traders identified in the census. The survey focuses on traders' interactions with suppliers and attributes of the market associations the traders belong to. The data include a retrospective panel of all sourcing transactions in 2013 and 2014, combining detailed transaction outcomes (goods, quantities, prices, defects and delays) with process variables (travel, communication and payment methods, use of agents, etc.). We are able to trace the full history between a trader and a particular source country or supplier.

Facts about Lagos Traders and Travel

The surveyed traders deal in products such as clothing, personal electronics, homewares, and cosmetics, which are manufactured abroad – often in China – and are characterized by huge variation in type, style, quality, and price. Technology and fashion change rapidly, and their domestic customers can choose between a large number of potential sellers. These traders are middlemen – neither manufacturers, nor final consumers. Their business revolves around searching globally for the products their customers will like the most, and facilitating the process of bringing it from one part of the world to another.

For this note, we focus on the 53 percent of traders who import directly from suppliers in other countries. These traders are typically male (74%) and highly educated (with 54% having some tertiary education). Most operate a single shop with on average one paid worker or apprentice, but have high revenues (median $27,000 per year) relative to other types of developing countries SMEs. They import several times per year, and 62 percent travelled at least once in 2013-2014. Thirty percent travelled every single time they imported, and 12 percent have a partner in the business living full time in a source country. When asked what the value of traveling to do business in person is, traders give answers like "I go to see new things, like designs [and] styles" or "To be sure of what is inside my container; not low quality or less than what I order."

Findings

Fact #1: Business is secret

Conventional wisdom suggests that in the absence of reliable public contract enforcement institutions, groups will emerge to privately provide these services. We show that the emergence of pro-trade institutions is not a foregone conclusion. For example, we find that 66% of market associations do not facilitate information sharing about dishonest suppliers.

[3] Euromonitor, 2015

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Fact #2: Expenditures on travel are large; comparable to transportation and tariffs

Figure 1 shows the average cost of goods (blue), transportation and tariff/regulatory expenditures (red), and travel expenditures (green). When traders travel, travel costs are comparable to total transportation and regulatory costs at about 8 percent of the total value of goods purchased. Overall, travel expenditures add up to 3.8 percent of the value of imported goods in the entire market.

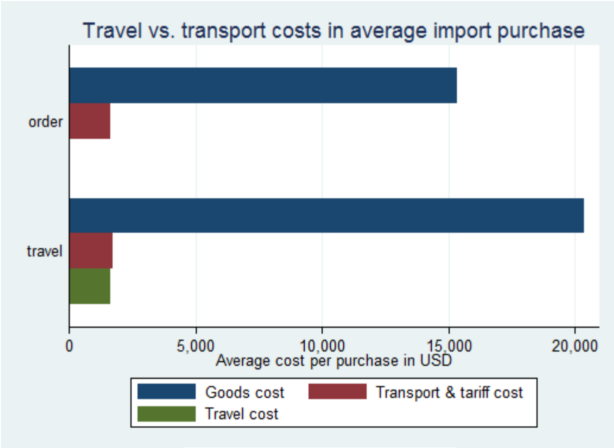

Figure 1

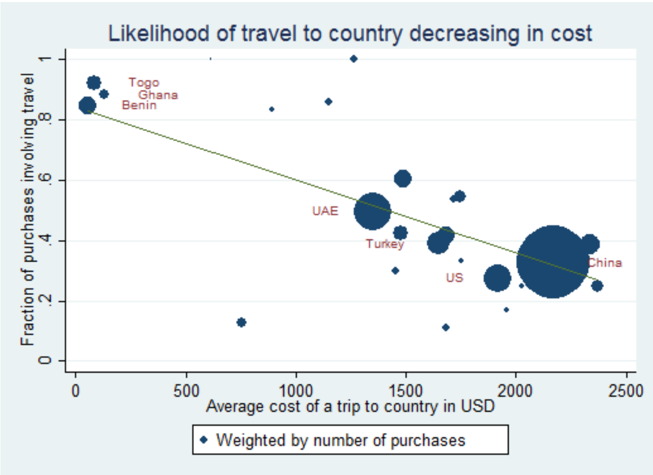

Figure 2

Fact #3: Travel responds to costs, but not to the length of experience in a particular country or with a particular supplier

Traders are more likely to travel to facilitate purchases when the costs of traveling to the source country are low, as shown in Figure 2. Purchases from Ghana and Benin almost always involve travel, but are much less likely to do so in hard to reach countries like China. However, the probability of travel is unrelated to years of experience – in business, buying from a given country, or doing business with a particular supplier. This suggests that the underlying motivations for travel are persistent, rather than diminishing with learning over time.

Fact #4: Purchases made while traveling have lower costs, higher markups, and are more likely to involve new products and suppliers

Transactions made while traveling look different from those made via remote order, even controlling for the source country and type of product. Travel purchases have lower unit costs, but higher markups (i.e. price charged in Lagos relative to unit cost). Traders are more likely to buy a new product (e.g. a new model or style) or deal with a new supplier when traveling.

These findings are all consistent with a model in which importers face search and contracting frictions, and optimally choose whether to pay a fixed cost to solve them via travel, or to accept lower marginal profits and order remotely without traveling. In ongoing work, we develop this model formally and estimate it using the data collected in this project.

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Policy Implications

Understanding the size and causes of trade costs is important, because they determine what set of goods and prices will be available to consumers. Costs driven by information frictions are unlikely to be mitigated by traditional trade facilitation policies focused on infrastructure and tariff reduction. This study suggests two main channels for policies to address information problems and increase consumer welfare in developing countries. First, free movement of people across countries is relevant to the movement of goods. Lowering visa barriers and improving air travel regulation could reduce trade frictions in developing countries, particularly in Africa. Second, new policies and private sector solutions can address information problems directly, improving flows of information about products and firms to decrease search and contracting costs. Examples might include new financial services, trade fairs, online aggregation of product information, and international credit bureaus.

Moving Forward…

Figure 2 Photo by Sunday Alamba

We are continuing the work begun in this ERG project in three ways. First, in the summer of 2016 we completed a second follow-up round with the same respondents, in order to extend the panel by a year and examine the impact of Nigeria's 2015 exchange rate crisis on imports and travel decisions. Second, in ongoing research we build a model of importing in the presence of search and contracting frictions, and consider the consumer welfare effects of various policy interventions. Finally, we are conducting a randomized trial of a new mobile money financial service intended to help traders solve contracting problems.