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What prevents more small firms from purchasing professional business services?

An experiment to test a business services marketplace[1]

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Introduction

The professional business services market of providers offering accounting, marketing, human resources, consulting, and legal services to other businesses is estimated to exceed US$5 trillion in annual revenue. However, few small firms in developing countries use these services. In a recent experiment in Nigeria (Anderson and McKenzie, 2020), we provided subsidies to firms with 2 to 15 workers, which paid for them to use a human resources firm to insource an accounting or marketing worker, or paid for them to outsource business functions to a professional accounting or marketing firm. We found that this approach of getting firms to use the market for business services led to a much larger improvement in business practices than the traditional approach of trying to train the entrepreneur in these skills, and resulted in these firms using higher quality digital marketing practices, innovating with new products, and achieving greater sales and profits growth over a two-year horizon.

The natural question that then arises is Why don't more small firms simply purchase these services for themselves? That is, why are government subsidies needed to get firms to start using these services? In a new working paper, we report on a series of follow-on activities designed to better understand how the marketplace for professional business services works in Nigeria, and on an experiment to test the effects of providing small firms with information and quality ratings on the business service providers. We then draw lessons for policymakers interested in helping small firms grow.

[1] This Policy Brief was prepared in May 2021 by Stephen J. Anderson, McCombs School of Business, UT Austin, and David McKenzie, Development Research Group, The World Bank, as part of the Economic Development and Institutions (EDI) Programme funded by UK Aid.

Firms lack information about the existence and quality of most business service providers, and word- of-mouth is the dominant way providers find customers

When firms in our previous study were directly asked why they thought more firms did not use the market for business services, approximately half said a reason related to information or search frictions, such as firms not knowing of any business service providers that could help them, finding it difficult to judge the skills and quality of outside providers, believing it will take a lot of time to find someone, and not being confident that they can trust an outside firm. In more developed economies, these frictions are reduced through information sources such as business directories and industry organizations; reputation mechanisms such as the Better Business Bureau and Angie's List; and functioning legal institutions that can provide a remedy for breaches in trust. The lack of these supporting institutions in many developing countries may lead to underutilization of professional business services by small firms.

The majority of service providers are unknown by most firms: We assess brand recognition of service providers in Lagos and Abuja amongst applicants to a government firm support program. Each firm was shown on a tablet, in random order, the brand name, logo, and tagline of up to 38 different business service providers that were registered as providers for this government program and that operated in the same city as the firm. The median provider on the platform had only been heard of by 7 percent of firms in the program, and 75% of the on the platform were only known by 10 percent or fewer of the firms.

The providers are hard to find and rely mostly on word-of-mouth: We then attempted to do a survey of the different HR firms, accounting firms, marketing firms, and small scale consulting firms in the market.

The first challenge was even putting together a sample frame, since there was no master list, database, or single website listing these providers. We had to work through different industry associations, web search, snowballing, and word of mouth to get a list of providers, and then surveyed 271 of them. These providers have an average of 11 professionals working for them, with a 10-90 range of 3 to 18 professionals. It is very rare to use any form of money-back guarantee, with only 2 percent of providers offering a financial guarantee if customers are not satisfied. We asked the providers how they find the majority of clients. The most common method is through word-of-mouth, which is the main method for 66 percent of firms. Only 16 percent of firms get most customers through advertising, and only 8 percent are walk-in customers. This reliance on word of mouth and lack of advertising is consistent with the lack of brand recognition seen in our survey of firms, and shows providers using informal reputation as the main way of trying to overcome information and quality concerns.

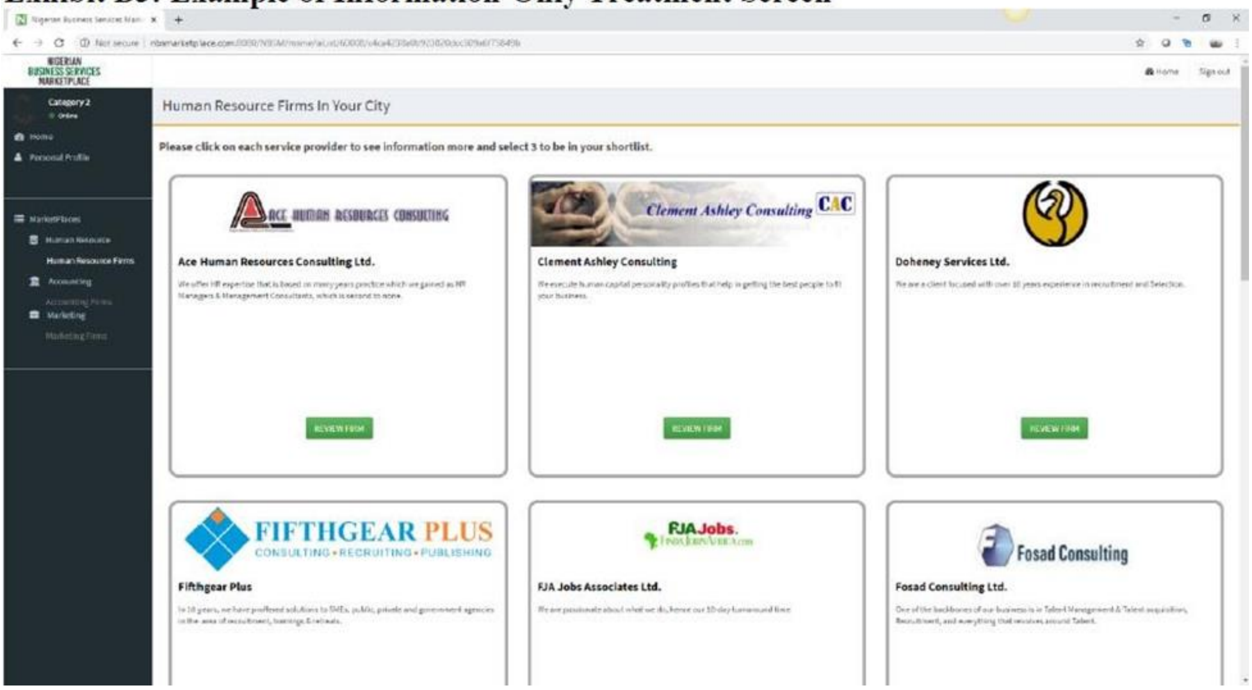
Setting up a marketplace and providing quality ratings in an experiment

We conducted a baseline survey of 1,054 firms in Lagos and Abuja that had 2-15 workers, and randomized them into a control group of 297 firms, and an information treatment group of 757 firms. The information treatment group were shown a Business Services Marketplace that we had set up. Upon logging into this marketplace, the entrepreneur was asked to look through a list of providers in their city in each of three categories: HR providers, accounting firms, and marketing firms. The marketplace contained information for 35 business service providers in Lagos, and 25 in Abuja, with 7 to 15 providers in any given provider type-city category. They were then instructed to short-list and rank their top three providers in each category. This was an incentivized choice, since they would have the option to go into a draw to win funding that they could use to spend on their top choice among this list.

Firms were further randomized into one of four groups that were provided with different information on the platform when making this choice:

- 187 firms were allocated to an *information only* treatment group, where they were shown information about the business service providers such as their name, logo, tagline (e.g. "We are client-focused with over 10 years of experience in recruitment and selection"), and contact information. This group were not given any independent information about provider quality. The Exhibit below provides an example.
- 187 firms were allocated to a *ratings only* group, which supplemented the information with a star rating, based on a quality assessment done by mystery shoppers we had hired to assess the quality of providers;
- 183 firms were allocated to a *ratings plus negative comments* group, which provided the star ratings and any negative comments from the mystery shopper (mimicking the format of customer complaints on something like the Better Business Bureau platform);
- 200 firms were allocated to a *ratings plus all comments* group, which received star ratings and both positive and negative comments provided by the mystery shopper (mimicking an Angie's List or Yelp type of format where both positive and negative feedback is given).

Exhibit B3: Example of Information-Only Treatment Screen

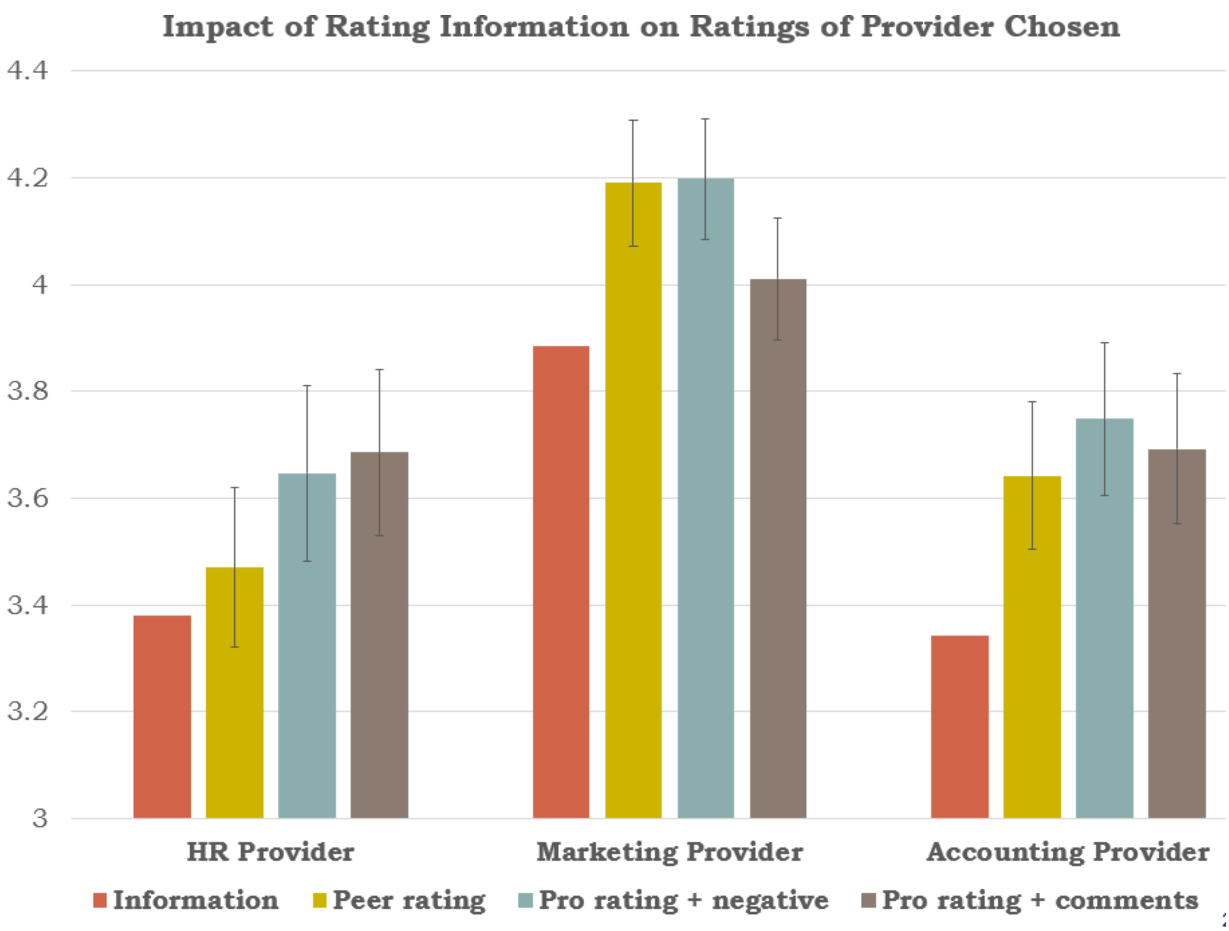


After rating their top three firms in each category, firms were given a printed pamphlet which listed all the service providers, and highlighted the top three they had selected in each category. They were then encouraged to contact any providers of interest, and research which one was of most interest to them by calling or visiting any providers.

Results: Quality Ratings Change which Providers Firms Prefer, but Information and Ratings Alone is Not Enough to Get Firms to Purchase These Services

Providing the quality ratings did lead firms to choose higher-quality providers in their incentivized choices. (Figure 1 below). The information only treatment group chose providers with an average rating of 3.44 stars overall, which is very close to the average rating among all providers of 3.35. This is consistent with the firms having very little pre-existing information about the quality of providers and not being able to distinguish amongst them. Providing them with a star rating increases the average rating of providers shortlisted by 0.2 stars, while also providing comments increases it by 0.35 to 0.39 stars, with very little difference between negative comments only and both positive and negative comments. Quality ratings information works to both increase the number of providers chosen with the highest score of 5 (by 7 to 11 percentage points), as well as to reduce the number of bottom-ranked firms (by 9 to 15 percentage points). Thus it does not seem to be a story of firms using these rankings to simply screen out really bad providers and then other information such as location or how attractive they find the company's logo and tagline to then choose providers, but rather than there is a demand for the highest quality as well as just for avoiding low quality.

Figure 1: Quality Ratings did lead to higher quality providers being chosen in incentivized choices



Yet this information and quality provision did not lead firms to use the market more. We conducted a six-month follow-up survey by phone between March and May 2020, just as the COVID-19 pandemic was starting. Our main question of interest is then whether firms have actually used a business service provider in the past six months. Our estimated treatment effects are all very close to zero in magnitude, and not statistically significant, with 95 percent confidence intervals of approximately ±3 to 5 percentage points. Given that only 7 percent of firms used an HR provider and 3 percent any marketing and accounting provider, these do allow for the possibility of large relative effects, but any effects will still be small in absolute terms. That is, alleviating informational frictions and concerns about quality is not enough by itself to get most SMEs to use the market for business service providers.

Why did this information and quality ratings not have more of an effect?
One potential reason is the existence of other information and knowledge frictions that simply providing access to the marketplace does not correct. Surveys of management practices find that many badly managed firms do not know that they are badly managed. A consequence is that firms may not know that they need to improve. Then even if they know they need to improve, the information they may be unsure about is whether the business service providers can provide the right expertise and advice for their specific needs. Even knowing that providers have offered quality services to other firms may not be enough to resolve this uncertainty, and as a result, firms may only be able to learn the value of using professional business services through learning-by-doing. Evidence for this is seen in the fact that many of the firms in our previous experiment do go back to the market for services after having been subsidized to try it out.

Indeed, these problems in the market of advice are not just issues for developing countries, but also in more developed ones, and has led to a discussion that initial subsidies for firms to try out these types of services may actually create market demand and help build this market for services. For example, Ezell and Atkinson (2011, p. 16) quotes Petar Sotjic, the Director of the U.K. Business Support Policy in charge of their Manufacturing Advisory Service (MAS) as saying "The market failure we are trying to address is the information asymmetry market failure. SMEs do not always know what they do not know, and they do not know how useful business expertise can be. And even when the SME manufacturer knows it has a problem, it does not always know how to procure the right solution. After they have worked with MAS, they understand … the value of external expertise in general, so when they have to pay the full rate in the future, they now know what to look for and have greater confidence in approaching the market". Over time, one can then think of using feedback from the firms which have received subsidies to provide word- of-mouth recommendations to other firms in their networks, as well as to offer peer quality feedback to further help build up a marketplace platform for these services.

Policy recommendations and next steps

1. Professional business services like accounting and marketing provide a cost-effective way of helping small growth-oriented firms to improve their business practices and grow, and should be considered as an alternative to traditional business training programs.
2. The marketplace for these services in many developing countries is opaque, with small firms not being aware of most of the providers in the market, and finding it difficult to ascertain quality. There is therefore a role for government in helping to improve the functioning of these markets.
3. One way to reduce information asymmetries is for policymakers to support the creation of marketplaces for these services, in which providers are listed and quality feedback ratings are

provided. However, our experiment shows that such a marketplace does not seem to be enough by itself to get more firms to purchase these services.

4. Instead, our results provide support for the view that the value of professional business services is often only learned and appreciated by small firms through trying out these services for themselves, potentially leading firms to underinvest in this management technology. Business service providers may need to experiment with discounts or free trials to attract customers. Another potential solution is government programs which subsidize the initial use of these professionals, and couple this with providing information and credentialing of providers that can be used. For example, the Business Link Pacific program provides subsidies for small and medium enterprises in several Pacific nations to use a provider (such as an accountant) from a network of approved providers. Such programs are not only used in developing countries. For example, the
5. £30 million Growth Vouchers program in the United Kingdom provided small firms with vouchers of up to £2,000 to help them access specialist support on hiring, financial management and marketing. Coupling these subsidy schemes with a mechanism to allow feedback into provider reputations would be a useful area for future policy and research

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