Production Networks, Geography and Firm Performance

joint paper with
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Abstract

This paper examines the importance of buyer-supplier relationships, geography and the structure of the production network in firm performance. We develop a simple model where firms can outsource tasks and search for suppliers in different locations. Firms located in close proximity to other markets, and firms that face low search costs, will search more and find better suppliers. This in turn drives down the firm's marginal production costs. We test the theory by exploiting the opening of a high-speed (Shinkansen) train line in Japan which lowered the cost of passenger travel but left shipping costs unchanged. Using an exhaustive dataset on firms' buyer-seller linkages, we find significant improvements in firm performance as well as creation of new buyer-seller links, consistent with the model.