

## 2.2 – Practical cases on classifying activities

# Outsourcing and Factoryless Goods Producers (FGP)

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# Outsourcing – Definitions

Outsourcing is the practice of contracting with a third-party provider to perform specific tasks, services, or functions that were previously handled in-house. This can include a wide range of activities, such as manufacturing, customer service, accounting, IT etc.

In an outsourcing contract

- the principal is a unit that enters into a contractual relationship with another unit (contractor) that is to carry out some part (or all) of the production process
- the contractor is a unit that carries out specific tasks, such as parts of a production process or even the full production process or support functions on a contractual relationship with a principal

Outsourcing is a contractual agreement according to which the principal requires the contractor to carry out a specific production process. Sometimes the term 'subcontracting' is used as well

# Outsourcing (2/7)

## Outsourcing of parts of the production process

- If only part of the production process is outsourced, the principal activity of the principal is classified in the class that corresponds to the activity representing the complete production process, in other words the principal activity is classified as if the principal were carrying out the complete process, including the contracted work, itself. The principal activity of the contractor is classified with the activities of units producing the same goods or services for their own account.
- This also applies to the outsourcing of support functions in the production process, such as accounting or computing activities

# Outsourcing (3/7)

## Outsourcing of the complete production process – manufacturing (1/2)

- In general, if the principal outsources the complete production process of a good or service, its principal activity is classified as if it were carrying out the production process itself. In the case of manufacturing, however, there are some considerations to be taken in account
- For its principal activity to be classified in Section C ‘Manufacturing’, a principal should not only own the final output, but also satisfy one of the following conditions:
  - a) it owns the input materials (raw materials or intermediate goods) to the production process, or
  - b) it owns the intellectual property products (IPPs)

Examples of such activities are metal manufacturing (for example, forging, casting, cutting, stamping and foundry works), processing of metals (for example, chrome plating), manufacturing of apparel, finishing of apparel and similar elementary parts of the production process. The principal activity of the contractor is classified with that of units producing the same goods for their own account which, in this case, would be the same class as that of the principal.

# Outsourcing (4/7)

## Outsourcing of the complete production process – manufacturing (2/2)

- A principal who completely outsources the transformation process of a manufacturing activity but does not own the input materials and does not supply inputs of intellectual property, is in fact buying the completed good from the contractor with the intention to re-sell it. Such an activity is classified in section G ‘Wholesale and retail trade’, specifically according to the type of sale and the specific type of good sold. The contractor is classified with units producing the same goods for their own account.

# Outsourcing (5/7)

## Outsourcing of the complete production process – other than manufacturing (1/3)

- When a principal carries out the whole or a part of the production process (of a good or a service) but delegates to a contractor certain support activities (such as accounting or computer services), which are not part of the production process and do not directly lead to the final good or service, but support the general functioning of the principal as a production unit, the activities of the principal are classified to the ISIC code that represents the core production process.
- The principal activity of a principal outsourcing a part of the goods production process in section A 'Agriculture, forestry and fishing', section B 'Mining and quarrying', section D 'Electricity, gas, steam and air conditioning' and section E 'Water supply; sewerage, waste management and remediation activities', it is classified as he would cover the whole production process. The principal activity of the contractor is classified with units producing the same goods for their own account. If the contractor carries out other activities, its principal activity should be determined in accordance with the value-added principle

# Outsourcing (6/7)

## Outsourcing of the complete production process – other than manufacturing (2/3)

- A principal outsourcing the whole production process of section A 'Agriculture, forestry and fishing', section B 'Mining and quarrying' and section E 'Water supply; sewerage, waste management and remediation activities' but does not own the input materials (for example, seeds, plants, trees, herds of animals or fry) is in fact buying the completed good from the contractor with the intention to re-sell it. Such an activity is classified in division 46 'Wholesale trade' (depending on the activity and the specific good sold). The contractor is classified with units producing the same goods for their own account
- The principal activity of a principal outsourcing the whole production process of section D 'Electricity, gas, steam and air conditioning' is classified in section D as per the activity and the specific good sold. The principal activity of the contractor is classified with the principal activity of units producing the same goods for their own account

# Outsourcing (7/7)

## Outsourcing of the complete production process – other than manufacturing (3/3)

- When a principal subcontracts construction works to other units but remains responsible for the overall construction process, the principal activity of both the principal and the contractor is classified in section F 'Construction', specifically to the class that corresponds to the construction activities carried out
- Concerning the outsourcing of services (for example, group 822 'Activities of call centres'), the principal who outsources a part of the service-producing activities should have its principal activity classified as if providing the whole service process. The principal activity of the contractor is classified according to the portion of the service provision it is undertaking. When the principal subcontracts the whole service activity, both the principal and the contractor are classified as if they were carrying out the complete service activity



# Factoryless goods producer (1/2)

- A factoryless goods producer (FGP) is a principal that controls the production of a good by undertaking the entrepreneurial steps and providing the technical specifications required to produce the good, but that outsources all or most of the material transformation process required to produce the output
- A principal who completely outsources the transformation process but does not own the input materials, and does not supply inputs of intellectual property as in the case of FGPs, is in fact buying the completed good from the contractor with the intention to re-sell it. Such an activity is classified in section G (Wholesale and retail trade), specifically according to the type of sale and the specific type of good sold

# Factoryless goods producer (2/2)

- The importance of separately identifying the activity of FGPs has long been recognised. However, based on current practices and the stakeholder discussions, it is difficult at this stage to classify separately the activity of FGPs in ISIC. As a result, NACE Rev. 2.1 classifies the activity of FGPs in section C in the same class where it would have been classified if FGPs carried out the manufacturing process themselves. In addition, countries are encouraged to develop approaches to identify FGPs, so that this issue can be reconsidered as part of the research agenda for the next revision of ISIC

