

## **1. DEFINITIONS AND RULES OF CLASSIFICATION FOR UNITS OUTSOURCING THEIR PRODUCTION**

### **1.1. Introduction**

In both classifications, ISIC (classification of economic activities of the UN) and NACE, the treatment of units which outsource the transformation process of goods to other units was in some way ambiguous.

NACE Rev. 1.1 defined outsourcing as follows.

‘Units which sell goods and services under their own name, but arrange for their production by others. These units are classified to Sector G (wholesale and retail) except when they own the legal right and the concept, in which case they are classified as if they produce the goods themselves.’

Although, the definition seemed clear, the concept of ownership of legal right or concept was not always interpreted in the same way.

In fact, some Member States did not take into account outsourcing when classifying units according to NACE and those who took it into account did not always use the same criteria for the classification, and therefore the statistics were not completely comparable.

In an attempt to tackle this lack of comparability the Expert Group and the Technical Subgroup of the Expert Group on International Economic and Social Classifications, at their meeting held in New York from 16 to 20 April 2007 agreed, for ISIC Rev. 4, that units which completely outsource the transformation process should be classified in manufacturing only if they own the raw material used as input to the production process.

This rule was included in the introductory guidelines to NACE Rev. 2, which were endorsed by the SPC at their 62nd meeting in May 2008. Nevertheless, at the same meeting, the SPC mentioned the need to carefully consider the implications of the rules on outsourcing activities (points 80 to 84) with a view to ensuring coherent implementation.

The concerns of the SPC were mainly on the clarity of definitions and on the need for unambiguous rules for classification of units. It was equally mentioned that best practices for a timely update of the business registers should be identified.

In order to answer to these concerns, Eurostat set up a task force composed of experts from Germany, France, Lithuania, the Netherlands, Austria, Poland, Portugal and the United Kingdom which met first time on 27 and 28 September 2007 to tackle these issues.

This annex is the output from this task force and includes the comments from the members of the NACE/CPA working group, who were consulted after the meeting of the task force. The UN Economic Statistics and Classifications Section was also consulted.

## **Terminology**

### **Outsourcing**

Contractual agreement according to which the > *principal* requires the > *contractor* to carry out specific tasks, such as parts of a production process or even the full production process, employment services or support functions.

The term outsourcing is also valid if the > *contractor* is a subsidiary unit and if the tasks are carried out on market conditions or not.

The > *principal* and the > *contractor* may be located within the same economic territory or in different economic territories. The actual location does not affect the classification of either one of these unit.

### **Principal**

Unit that enters into a contractual relationship with another unit (> *contractor*) for that other unit to carry out specific tasks, such as parts of a production process or even the full production process, employment services or support functions.

### **Contractor**

Unit that carries out specific tasks, such as parts of a production process or even the full production process, employment services or support functions on a contractual relationship with a > *principal*. The term *sub-contractor* is also used. In NACE the activities performed by the > *contractor* are denominated "on a fee or contract basis".

### **Manufacturing activities**

The physical and/or chemical transformation of materials, substances or components into new products. The material, substances or components are raw materials which are product of agriculture, forestry, fishing or mining as well as products and semi-finished products of other manufacturing activities.

### **Sub-contractor**

See > contractor

## **1.2. Classification rules**

These rules set out how to classify the outsourcing activities of principals and contractors, as defined in 1.2 Terminology above. It is important to note that the rules apply only to the classification of the outsourcing activities and that where principals or contractors are also involved in other activities, their overall activity classification must be determined by applying the value added principles set out in paragraphs 60 to 79 (*as numbered in the NACE Rev. 2 introductory guidelines*) to all of their activities.

### **Outsourcing of parts of a manufacturing production process**

A principal delegates a part of a manufacturing production process to a contractor.

### **Classification rules**

The principal has to be classified as if were carrying out the complete production process.

The contractor is classified with units producing the same goods or services for their own account.

### **Outsourcing of the complete manufacturing production process (i)**

A principal who owns the main material inputs sub-contracts the complete manufacturing production process of products to another unit.

### **Classification rules**

The principal who owns the main material inputs (e.g. textiles and buttons for the production of apparel, wood and metal accessories for the manufacture of furniture) and thereby owns the final outputs, but who has the production carried out by contractors, is classified in section C (Manufacturing), specifically to the class that corresponds the full production process.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of the complete manufacturing production process (ii)**

A principal who doesn't own the material inputs sub -contracts the complete manufacturing of products to another unit.

### **Classification rules**

The principal that has the production carried out by others and that does not own the material inputs, should be classified in section G "Wholesale and trade" (depending on the activity and the specific good sold) if it only carries out this activity. If he carries out other activities, it should be classified in accordance with the value added principle: this might be in section G or in other sections.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of construction activities**

A principal sub-contracts the construction work to other units, but remains overall responsible for the construction process.

### **Classification rules**

Both the principal and the contractors are classified in section F (Construction), specifically to the class that corresponds to the construction activities carried out.

### **Outsourcing of support functions**

A principal carries out the whole or a part of the production process (of a good or a service) but delegates certain support functions, such as accounting or computer

services, to a contractor. These support functions are not part of the core production process, they do not directly lead to the final good or service, but support the general functioning of the principal as a production unit.

### **Classification rules**

The principal is classified to the same NACE code that represents the core production process. The contractor is classified to the specific activity he is carrying out, e.g. class 69.20 (Accounting, bookkeeping and auditing activities; tax consultancy), class 62.02 (Computer consultancy activities) etc.

### **Outsourcing of employment services**

In the case of outsourcing of employment services a distinction should be drawn between outsourcing on a temporary or on long-term and permanent basis.

### **Classification rules**

- a) In outsourcing on a temporary basis, the principal is classified on the basis of the activity actually performed (e.g. manufacturing). The contractor is classified in class 78.20 (Temporary employment agency activities).
- b) In outsourcing on a long-term or permanent basis, the principal is classified on the basis of the activity actually performed (e.g. manufacturing). The contractor is classified in class 78.30 (Other human resources provision).

### **Outsourcing of service-producing activities**

The principal sub-contracts a part or the complete provision of services (excepted support functions, see rule "Outsourcing of support functions" above) to another unit.

### **Classification rules**

- a) The principal who outsources a part of the service-producing activities has to be classified as if were provisioning the whole service process. The contractor is classified according to the portion of the services provision he is undertaking.
- b) If the principal sub-contracts the whole services activity, both the principal and the contractor are classified as if they were carrying out the complete services activity.

### **Outsourcing of the complete agricultural or animal production process (i)**

A principal who owns the seeds or the plants (seedlings, cuttings, sprays) or the fruit trees (including grapevines) or herds of animals sub-contracts the complete agricultural or animal production process of agricultural products to another unit.

### **Classification rules**

The principal who owns the seeds or the plants (seedlings, cuttings, sprays) or the fruit trees (including grapevines) or herds of animals and thereby owns the final

outputs, but who has the production carried out by contractors, is classified in division 01, specifically to the class that covers the full production process.

The contractor is classified in the appropriate class of group 01.6.

### **Outsourcing of the complete agriculture or animal production process (ii)**

A principal who doesn't own the seeds or the plants (seedlings, cuttings, sprays) or the fruit trees (including grapevines) or herds of animals sub-contracts the complete production process to another unit.

#### **Classification rules**

The principal who has the production carried out by others and who does not own the seeds or the plants (seedlings, cuttings, sprays) or the fruit trees (including grapevines) or herds of animals, is classified in section G "Wholesale and trade" (depending on the activity and the specific good sold) if he only carries out this activity. If he carries out other activities, he should be classified in accordance with the value added principle: this might be in section G or in other sections.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of the complete forestry production process (i)**

A principal who owns the trees sub -contracts the complete forestry production process of forest products to another unit.

#### **Classification rules**

The principal who owns the trees and thereby owns the final outputs, but who has the production carried out by contractors, is classified in division 02, specifically to the class that covers the full production process.

The contractor is classified in class 02.40.

### **Outsourcing of the complete forestry production process (ii)**

A principal who doesn't own the trees sub -contracts the complete production process to another unit.

#### **Classification rules**

The principal who has the production carried out by others and who does not own the trees is classified in section G "Wholesale and trade" (depending on the activity and the specific good sold) if he only carries out this activity. If he carries out other activities, he should be classified in accordance with the value added principle: this might be in section G or in other sections.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of the complete aquaculture production process (i)**

A principal who owns the fry sub-contracts the complete aquaculture production process of aquaculture products to another unit.

#### **Classification rules**

The principal who owns the fry and thereby owns the final outputs, but who has the production carried out by contractors, is classified in group 03.2, specifically to the class that covers the full production process.

The contractor is classified in the appropriate class of group 03.2.

### **Outsourcing of the complete aquaculture production process (ii)**

A principal who doesn't own the fry sub-contracts the complete production process to another unit.

#### **Classification rules**

The principal who has the production carried out by others and who does not own the fry is classified in section G "Wholesale and trade" (depending on the activity and the specific good sold) if he only carries out this activity. If he carries out other activities, he should be classified in accordance with the value added principle: this might be in section G or in other sections.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of the complete energy production process (i)**

A principal who owns the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.) sub-contracts the complete energy production process of energy products to another unit.

#### **Classification rules**

The principal who owns the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.) and thereby owns the final outputs, but who has the production carried out by contractors, is classified in section D, specifically to the class that corresponds the full production process.

The contractor is classified in the appropriate class of section D.

### **Outsourcing of the complete energy production process (ii)**

A principal who doesn't own the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.) sub-contracts the complete production process to another unit.

#### **Classification rules**

The principal who has the production carried out by others and who does not own the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.)

is classified in section D class 35.14 or 35.23 (depending on the activity and the specific good sold) if he only carries out this activity. If he carries out other activities, he should be classified in accordance with the value added principle.

The contractor is classified with units producing the same goods for their own account.

### **Outsourcing of other complete goods-production process**

In the cases of fishing, mining and quarrying and water supply, the principal who has the production carried out by others is classified in trade (depending on the activity and the specific good sold) if he only carries out this activity. If he carries out other activities, he should be classified in accordance with the value added principle: this might be in section G or in other sections.

The contractor is classified with units producing the same goods or services for their own account.