



ISIC Rev.4 – Application rules

Top-down method
Vertical integration
Outsourcing

United Nations Statistics Division



ISIC – concepts

- Reviewed concepts in this version of ISIC:
 - Top-down method
 - Vertical integration
 - Outsourcing
- Application and impact depends strongly on the selection of units
 - ISIC does not define units, but provides information
 - Int. Recommendations for Industrial Statistics gives guidance
 - Choice of unit depends on statistics collected and on organizational settings
 - ISIC can theoretically be applied to all units



Top-down method



Top-down method

- Method has not changed from previous versions of ISIC
 - Exception for trade activities has been made explicit
 - Applies to units carrying out multiple activities
- > selection of unit is important ! (but this is not an ISIC issue)



Top-down method

- The top-down method follows a hierarchical principle:
 - the classification of a unit at the lowest level of the classification must be consistent with the classification of the unit at the higher levels of the structure.
- To satisfy this condition the process starts with the identification of the relevant position at the highest level and progresses down through the levels of the classification in the following way:



Top-down method

Section	Division	Group	Class	Description of the class	Share of value added (percentage)	
D ✓	28	281	2812	Manufacture of tanks, reservoirs and containers of metal	7	
	29 ✓	292 ✓	291	2915	Manufacture of lifting and handling equipment	8
			2921	2921	Manufacture of agricultural and forestry machinery	3
			2922	2922	Manufacture of machine-tools	21
			2924	2924	Manufacture of machinery for mining, quarrying and construction	8
	34	343	3430	Manufacture of parts and accessories for motor vehicles and their engines	5	
G	51	511	5110	Wholesale on a fee or contract basis	7	
		515	5159	Wholesale of other machinery, equipment and supplies	28	
K	74	742	7421	Architectural and engineering activities and related technical consultancy	13	



Vertical integration



Treatment of vertically integrated activities

- Vertical integration of activities occurs where the different stages of production are carried out in succession by the same unit and where the output of one process serves as input to the next.
- Examples of common vertical integration:
 - tree felling and subsequent sawmilling
 - production of wearing apparel in a textile mill



Treatment of vertically integrated activities

- Vertical integration should be treated like any other form of multiple activities, i.e. the principal activity of the unit is the activity accounting for the largest share of value added, as determined by the top-down method.
- This treatment has changed from previous versions of ISIC.



Treatment of vertically integrated activities

- If value added or substitutes cannot be determined for the individual steps in a vertically integrated process directly from accounts compiled by the unit itself, comparisons with similar units could be used. Alternatively, valuation of intermediate or final products could be based on market prices.
- Impact of the changed rule should be minimal, since in many cases units will be broken up statistically if portions are substantial



Outsourcing



Outsourcing

Can take many forms:

- Outsourcing of labour
- Outsourcing of support functions
- Outsourcing of parts of a production process
- Outsourcing of the complete production process



Outsourcing - Terminology:

- Principal = unit that enters in a contractual relationship with another unit (here called contractor) to carry out some part of the whole production process. Sometimes, the terms "converter" or "contractor" had also been used.
- Contractor = unit that carries out a specific production process based on a contractual relationship with a Principal. The term "subcontractor" had been used too. The activities performed by the contractor are denominated "on a fee or contract basis".
- Outsourcing = 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 - Terminology

- Other terminology is sometimes used (e.g. in recent OECD documents), where in this context:
 - “insourcing” and “outsourcing” refers to relationship between units involved
 - “offshoring” refers to transactions between economic territories
- This terminology is not used here.



Outsourcing

- The principal and the contractor may be located in the same economic territory or in different economic territories: the actual location does not affect the classification of either one of these units.



Outsourcing

- Contractors, i.e. units carrying out an activity on a fee or contract basis, are usually classified with units producing the same goods or services for their own account
- Exception: wholesale trade



Outsourcing - manufacturing

- In manufacturing, the principal provides the contractor the technical specifications of the manufacturing activity to be carried out on the input material.
- The input material (raw or intermediate good) can either be provided (owned) by the principal or not.



Outsourcing - manufacturing

- A principal who outsources only part of the transformation process is to be classified into manufacturing.
- The activity of a principal who completely outsources the transformation process should be classified into manufacturing **only if** he owns the raw material used as input to the production process (and therefore owns the final output).



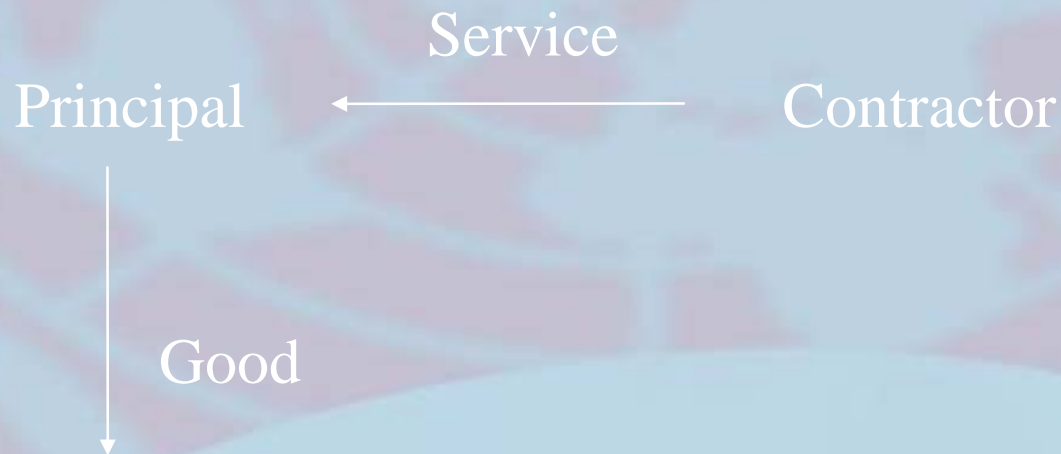
Outsourcing - manufacturing

- In all other cases, the activity of the principal should be classified in Section G "Wholesale and retail trade" (according to the type of operation and the specific good sold).
 - In this case the principal buys the good from the contractor and re-sells it without transformation



Outsourcing - manufacturing

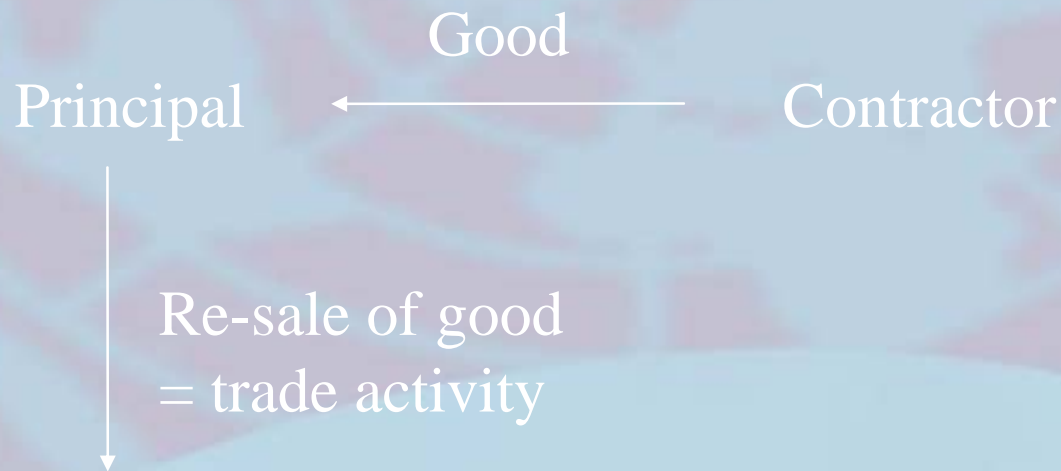
- Output of outsourced activities:
 - If principal owns the input materials:





Outsourcing - manufacturing

- Output of outsourced activities:
 - If principal does not own the input materials:





Outsourcing – manufacturing

- Some remarks:
 - A unit classified in Manufacturing can have two types of outputs:
 - a manufactured good
 - a manufacturing service
 - Both are identified in the product classification
 - Manufacturing is defined as a (mechanical or chemical) transformation process
 - This implies that the “manufacturer” has to have ownership of the good before and after the transformation process



Outsourcing – manufacturing

- Some remarks:
 - Proposals for classification (in this case) are often driven by a reference to “risk”
 - To take the risk of manufacturing, you need to have a liability in this process
 - Owning the concept is not sufficient
 - Owning the concept does not imply ownership of the produced good
 - Sale of goods
 - Wholesale/retail sale is defined as “buying and reselling without transformation”
 - Simply selling the goods that you produce does not make you a wholesaler/retailer



Outsourcing – services

- For services, the concept of a “service retailer” does not exist
- If the whole process (service provision) is outsourced, both the principal and the contractor are classified to the same ISIC class
- If only a portion of the process is outsourced, the principal remains classified as if it were carrying out the complete process
- If a separate class exists for the outsourced portion, the contractor is classified to that portion, otherwise to the same class as the principal



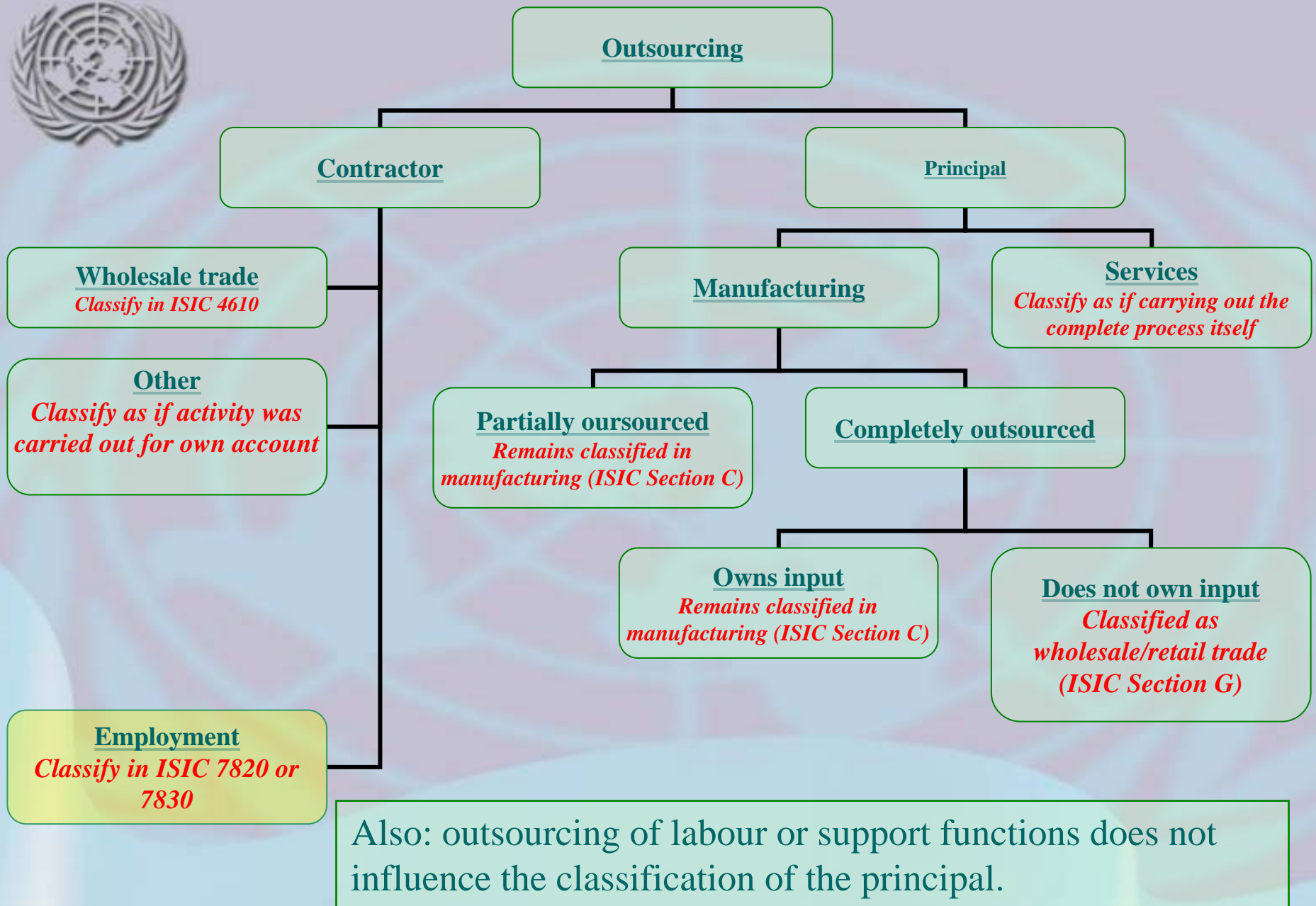
Outsourcing – support functions

- This applies to the outsourcing of functions like accounting, computer services etc.
- In this case, the principal is classified as if it were carrying out the complete core process. (In other words, support functions do not influence the classification of a unit.)
- The contractor is classified to the specific support function it is carrying out.



Outsourcing – employment

- Increasingly, companies emerge that provide only the labour force to their clients.
- In turn, producers (e.g. manufacturers) may have little or no employment
- In this case the principal is classified as if it were operating with own employees.
- The contractor is classified to ISIC 7820 or 7830, depending on the type of contract.





Stability



Stability rule

- Units may change their principal activity, either at once or gradually over a period of time, either because of seasonal factors or because of a management decision to vary the pattern of output. While all these cases call for the classification of the unit to be changed, too frequent changes could result in inconsistencies between short term (monthly and quarterly) and longer term statistics, making their interpretation extremely difficult.



Stability rule

- Whenever a unit performs two activities both contributing to around 50% of the value added, a stability rule has been established in order to avoid frequent changes not reflecting a substantial change in the economic reality.
- According to this rule, the change of the principal activity should be made when the current one had been accounting less than 50% of the value added for at least two years.



Thank You