

Factoryless Goods Producer (FGP) Fact Sheet

1. What is a Factoryless Goods Producer (FGP) Establishment?

A factoryless goods producer (FGP) establishment outsources all of the transformation steps traditionally considered manufacturing (i.e., the actual physical, chemical, or mechanical transformation of inputs into new outputs), but undertakes all of the entrepreneurial steps and arranges for all required capital, labor, and material inputs required to make a good.

Characteristics of FGPs include:

- Owns rights to the intellectual property or design (whether independently developed or otherwise acquired) of the final manufactured product;
- May or may not own the input materials;
- Does not perform transformation activities;
- Owns the final product produced by manufacturing service provider partners; and
- Sells the final product.

The FGP can provide information on the purchase of the manufacturing service, that is, the cost of the contract, but would not necessarily have production worker payroll or capital expenditures on plant and equipment. However, it can provide data on the number of units that were produced and the market value of the final product.

2. Why is this important?

Recent years have witnessed the rapid and widespread incorporation of specialization into goods manufacturing as global competition has forced producers to seek more efficient production methods. This has resulted in outsourcing manufacturing transformation activities (i.e., the actual physical, chemical or mechanical transformation of inputs into new outputs) to specialized establishments, both foreign and domestic. Such outsourcing can lead to inconsistent classification of business establishments in official statistics when the standard classification systems used by those programs do not provide adequate guidance. Statistics that are not comparable with other data series or that do not reflect current economic activity hinder sound decision making.

3. What are the three types of manufacturing establishments considered by the Economic Classification Policy Committee (ECPC)?

- **Traditional or Integrated Manufacturer** - The traditional or integrated manufacturer utilizes inputs such as capital, labor, and energy to transform material inputs into a new product to be sold.
- **Manufacturing Service Provider** - The manufacturing service provider (MSP) provides contract manufacturing services that utilize inputs such as capital, labor, and energy to transform material inputs according to the contract specifications. The growth of MSPs (foreign and domestic) is the result of traditional integrated manufacturers substituting away from direct expenditures on capital and labor

(i.e., factories, equipment, and production workers) to purchases of capital services and labor services. MSPs provide the capital and labor services.

- **Factoryless Goods Producer** - The factoryless goods producer (FGP) outsources all of the transformation steps that traditionally have been considered manufacturing, but undertakes all of the entrepreneurial steps and arranges for all required capital, labor, and material inputs required to make a good.

4. How are FGP establishments currently classified?

The treatment of units that outsource all manufacturing transformation varies among the U.S. Statistical Agencies. Some programs classify the units to manufacturing if the value of intellectual property is a significant portion of the value of the finished good. Other programs classify the units to wholesale trade because there are no factories, plants, or mills to classify in the manufacturing sector. In summary, there is not consistent classification of units that outsource manufacturing transformation in current economic statistics.

5. How does the ECPC recommend classifying FGP establishments?

The ECPC recommended guidance to classify FGPs in the manufacturing sector in NAICS. FGPs should be classified with the existing industries that include the integrated manufacturers and the manufacturing service providers. Programs are encouraged to provide sub-industry level identifiers to integrated manufacturers, manufacturing service providers, and FGP establishments and to develop and apply appropriate editing and imputation methodologies that recognize not only the differences between the three types of producers but also the different relationships among variables such as employment, shipments, and cost of materials for the three types of manufacturers.

6. Why did the ECPC recommend classification of FGP establishments in the manufacturing sector?

The basis for this decision is both conceptual and practical and will provide a consistent and stable classification framework regardless of changing outsourcing decisions based on the relative cost of the factors of production across time and international borders.

From a conceptual standpoint, at the most aggregate level, goods producers arrange for and bring together all of the factors of production necessary to produce a good. Goods producers accept the entrepreneurial risk of producing and bringing goods to market. When individual steps in the complete process are outsourced, an establishment should remain classified in the manufacturing sector.

A practical problem exists for longer-term consistency in classification. An FGP establishment may move production from point to point based on the relative costs as noted previously. A movement from offshore contractors to domestic contractors because of transportation costs should not change the classification of the establishment.

A more detailed discussion of the decision is available at:

http://www.census.gov/eos/www/naics/fr2010/ECPC_Recommendation_for_Classification_of_Outourcing.pdf

7. When will U.S. statistical agencies implement the classification changes?

The feasibility of identifying FGP establishments and collecting data that are reliable and useful to statistical agencies are still being determined. Research on the feasibility of data collection is ongoing. The ECPC expects the results of establishment classification research by the middle of 2015. If identification and data collection are determined to be feasible, statistical programs are expected to begin the work of implementing this change as soon as possible, and to the extent possible, apply the implementation to data releases as data collection and processing system changes allow; any implementation would have a reference year of 2017.

The decision to classify factoryless goods producers in manufacturing was included in the *NAICS United States 2012 Manual* and is subject to review during the NAICS 2017 Revision process.

8. What is the potential impact of the ECPC decision to classify FGP establishments to the manufacturing sector?

Classification of FGPs to manufacturing may expand the traditional definition of manufacturing beyond establishments known as factories, plants or mills to include a broader range of establishments undertaking the production of goods using the facilities of other companies for transformation or affiliated foreign establishments that are not generally counted in domestic statistics. Arguments can be made that this expansion will artificially increase the scope of manufacturing. Arguments can also be made that a strict requirement for physical, chemical, or mechanical transformation has unreasonably limited the definition of manufacturing in a global economy. Both arguments have merit. There is no “correct” argument or solution.

There may be unavoidable time series breaks because of the lack of historical data. The ECPC understands these implications, but takes the position that the inconsistency must be corrected through better classification guidance in NAICS. All of the ECPC agencies share a concern about the ability to identify and consistently classify FGPs.