



**NACE REV. 2 IMPLEMENTATION MANUALS**

# **OUTSOURCING MANUAL**

**DEFINITIONS AND RULES OF CLASSIFICATION  
FOR UNITS OUTSOURCING THEIR PRODUCTION**

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## 1. PRELIMINARY REMARK

This manual updates and supplements the rules originally published in 2008 as Annex II to the publication "NACE Rev. 2 – Statistical classification of economic activities in the European Community"<sup>1</sup>.

It should however be noted that this revised document does not contain new or modified rules. The mandate given to the Task Force which reviewed the manual in 2013<sup>2</sup> was limited to the following tasks:

- Provide answers to issues raised by several Member States as to the classification of certain activities based on the rules
- Make the rules and guidelines clearer and more operational

## 2. INTRODUCTION

In ISIC Rev. 3.1 (United Nations International Standard Industrial Classification<sup>3</sup>) as well as in NACE Rev. 1.1 (its European Union counterpart), 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 Section G (Wholesale and retail trade; repair of motor vehicles and motorcycles) 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 Rev. 1.1 and those who did so did not always apply the same criteria for the classification, with the consequence that the statistics produced were not fully comparable.

In an attempt to tackle this lack of comparability the Expert Group and the Technical Subgroup of the United Nations 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.

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<sup>1</sup> European Union (Eurostat), "NACE Rev. 2 – Statistical classification of economic activities in the European Community", Methodologies and Working Papers, ISBN 978-92-79-04741, Office for Official Publications of the European Communities, Luxembourg, 2008.

<sup>2</sup> The "Outsourcing" Task Force was made of the following countries: Austria, France, Switzerland and the Netherlands, and chaired by Eurostat.

<sup>3</sup> United Nations (Statistics Division), "International Standard Industrial Classification of All Economic Activities (ISIC) Revision 3.1", Statistical Papers, Series M No 4, Rev 3.1, ISBN 92-1-161456-2, United Nations, New York, 2002.

This rule was included in the introductory guidelines to NACE Rev. 2 which were endorsed by the Statistical Programme Committee (SPC)<sup>4</sup> at its 62<sup>nd</sup> meeting held in May 2008. Nevertheless, at the same meeting, the SPC mentioned the need to carefully consider the implications of the rules on outsourcing activities (paragraphs 80 to 84 of NACE Rev. 2 introductory guidelines) 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.

In order to address 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 for the first time on 27 and 28 September 2007.

The outcome of the work of the task force was then submitted to the NACE/CPA Working Group<sup>5</sup> and its comments integrated in the guidelines. The United Nations Economic Statistics and Classifications Section was also consulted.

As said in the preliminary remark, the manual was updated in 2013 in order to clarify the rules and make them easier to use and implement.

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<sup>4</sup> The SPC was established by Council Decision 89/387 and comprised the Director Generals of EU national statistical services and Eurostat. It has been superseded by the ESSC (European Statistical System Committee).

<sup>5</sup> Since renamed "Classifications Working Group".

### 3. GLOSSARY

#### Ancillary activities

Activities undertaken to support the main productive activities of a unit by providing goods (tools, scaffolding, etc.) or services (bookkeeping, storage, cleaning, security, etc.) entirely or primarily for the use of this unit. Ancillary activities are not part of the core production process as they do not directly lead to the final good or service, but support the general functioning of the principal as a production unit.

A given NACE activity can be an ancillary activity, a part of the production process or even a complete production process, depending on the context. For instance, computer programming activities for calculating salaries are ancillary activities in a large company, whereas it may be the main activity of a specialised IT firm.

The term "support functions" is also used with the same meaning in the current economic vocabulary (*inter alia* in the present rules for outsourcing mentioned in the introduction to ISIC Rev. 4).

#### Complete production process

In general the complete production process entails the use of inputs of labour, capital, and goods and services to produce outputs of goods and services. The concept of "complete production process" is limited to the core production functions. It does not include ancillary activities (see this term). It has to be assessed by reference to the type of activities typically carried out by the principal. The activities which are outsourced may be a part of the production process of the principal, but a complete production process for another company (e.g. the contractor). For a publisher which has a long and detailed business process, the outsourcing of IT activities will constitute only a part of the publishing process, whereas it can represent a complete process when the principal is an IT company.

#### Contractor

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

#### Main material input

Value should be used as criterion for the determination of the main material input. This is a quantifiable and rather objective measurement unit. The threshold for the main input is set to 80 %, thus indicating that the ratio main/secondary inputs must be high. Nevertheless, this threshold was adopted arbitrarily and should therefore be interpreted with flexibility.

It should be noted that intangible assets (software, patents, etc.), as well as machines or tools provided by the principal, are not to be considered as *material* inputs. Software products for instance interact in the production process in the same way as machines and other equipment, i.e. they are not incorporated or transformed into the final product. They are thus to be regarded as capital goods and not as physical material inputs.

## **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 the product of agriculture, forestry, fishing, mining or materials recovery as well as products and semi-finished products of other manufacturing activities.

## **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 complete production process, employment services or ancillary activities.

The outsourcing rules also apply if the contractor is a subsidiary unit and whether the tasks are carried out under 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 units. Furthermore the location where the production actually takes place (either on the principal's premises or the contractor's) is not a decisive criterion.

The term "sub-contracting" is often used as synonym for "outsourcing".

## **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 complete production process, employment services or ancillary activities.

## **Sub-contracting**

See outsourcing

## **Sub-contractor**

See contractor

## **Support functions**

See ancillary activities

## 4. CLASSIFICATION RULES

The rules set out how to classify the outsourcing activities of principals and contractors, as defined in section 3 "Glossary" 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 to all of their activities (see paragraphs 60 to 79 of the NACE Rev. 2 introductory guidelines).

No matter how detailed these rules are, they will most probably not accommodate all cases met by users. There will be cases where the classification issues raised are extremely complicated or made complex by external parameters (e.g. legal framework in force). In these cases, users should make use of common sense and develop their own solutions based on experience and the basic classification rules as far as they apply.

Another option consists in raising the issues on the dedicated forum maintained by Eurostat. The address of this forum is the following: <https://circabc.europa.eu/faces/jsp/extension/wai/login.jsp>. Please note that the participation in this forum is subject to prior registration.

Words shaded in grey (e.g. **principal**) are concepts which are defined in section 3 "Glossary".

### 4.1. Outsourcing of parts of a manufacturing production process

#### Description

A **principal** outsources a part of a manufacturing production process to a **contractor**.

#### Classification rules

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

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

#### Explanatory notes

This rule does not apply to the **outsourcing** of ancillary activities (see 4.5).

**Example**

A car manufacturer (principal) outsources the production of electronic door systems and bumpers to two specialised companies (contractors). In this case, the principal outsources only a part of its complete production process. According to the rule, the principal is to be classified as if it were producing the whole vehicle (29.10 "Manufacture of motor vehicles") and the contractors are classified on the basis of what they have actually produced (29.31 "Manufacture of electrical and electronic equipment for motor vehicles" for door systems and 29.32 "Manufacture of other parts and accessories for motor vehicles" for bumpers).

**4.2. Outsourcing of the complete manufacturing production process (i)****Description**

A principal which *owns the main material inputs* outsources the complete manufacturing production process to another unit.

**Classification rules**

The principal which owns the main material inputs and thereby owns the final outputs, but has the production carried out by a contractor, is classified in section C "Manufacturing", and more specifically to the class that corresponds to the complete production process.

The contractor is classified with units producing the same goods for their own account. As a consequence, the contractor is classified in the same class as the principal.

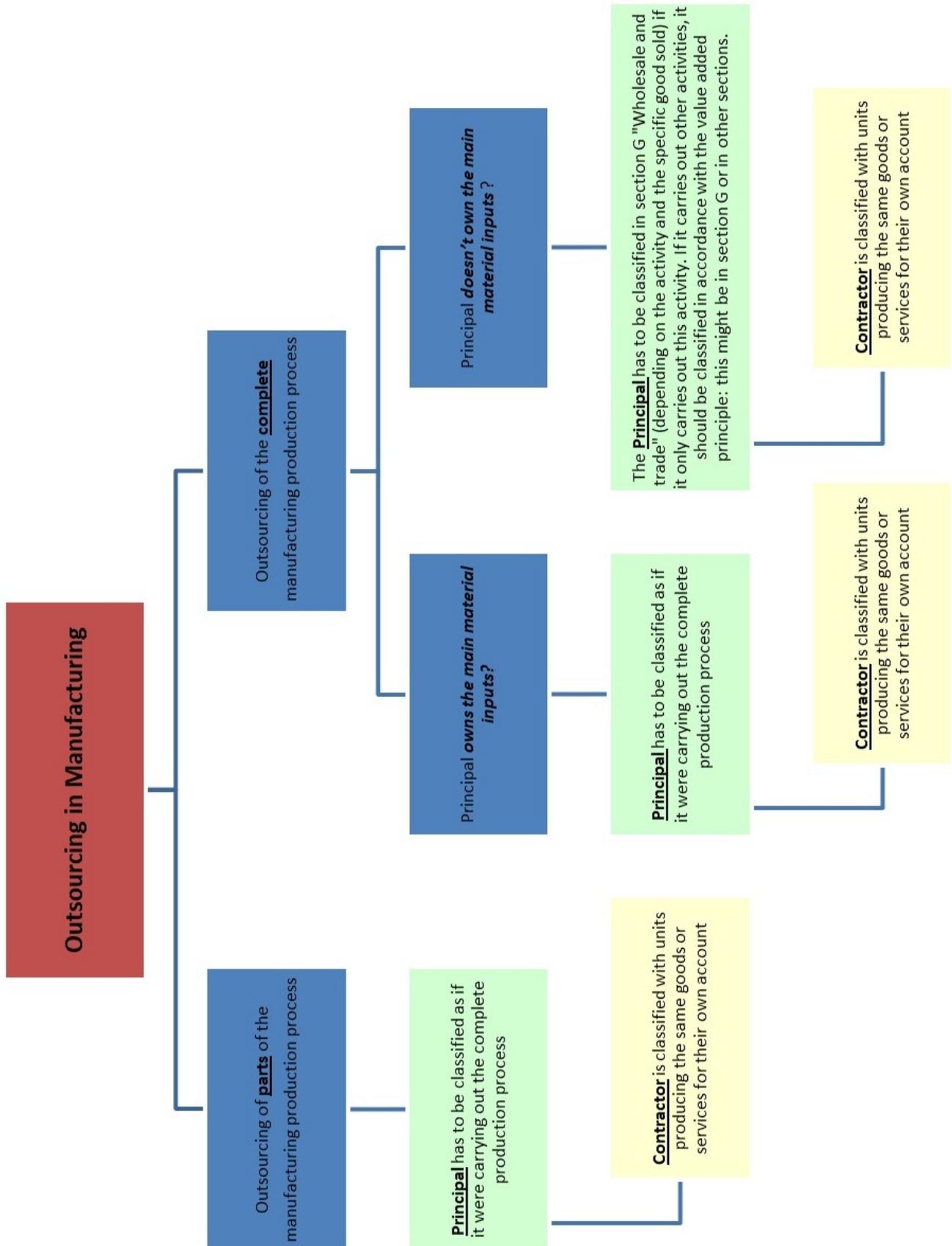


Fig. 1: Outsourcing in Manufacturing

**Example 1**

A principal owns the textiles and the buttons necessary for the manufacture of workwear but outsources the production of the final product to a contractor. In this case, the principal outsources the complete production process and is to be classified as if it were carrying out the whole sequence of tasks for producing the end product (i.e. NACE 14.12 "Manufacture of workwear") whereas the contractor is classified as if it had produced the same articles for own account (i.e. also 14.12 "Manufacture of workwear").

**Example 2**

For illustrating the "main material input" issue, one could take the example of a principal owning the textiles and the contractor owning the buttons and some trimmings. In this case, the classification rule will apply as in example 1.

**4.3. Outsourcing of the complete manufacturing production process (ii)****Description**

A principal which *doesn't own the main material inputs* outsources the complete manufacturing production process of products to another unit.

**Classification rules**

The principal which has the production carried out by others and does not own the main material inputs should be classified in section G "Wholesale and retail trade; repair of motor vehicles and motorcycles" (depending on the activity and the specific good sold) if it only carries out this activity. If it also 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.

**Example**

Unit A outsources the manufacturing of optical networking products to Unit B. Unit B owns the main material inputs needed for manufacturing. Unit A, however, develops and installs the software which is crucial for the product to properly work<sup>6</sup>.

A piece of software is not a physical material input but a capital good (see definition of "Main material inputs" under section 3 "Glossary"), so this is not to be taken into account in the assessment of the main material inputs which clearly consist of the optical networking products. From the information presented in this example, unit A may be considered as carrying out the following activities:

- Development of software (NACE 62.01 "Computer programming activities")
- Trade of optical networking products (NACE 46.69 "Wholesale of other machinery and equipment")
- Installation of software (NACE 62.09 "Other information technology and computer service activities")

The main activity of Unit A will then be determined by applying the usual top-down method. Unit B will be classified on the basis of the type of products produced.

**4.4. Outsourcing of construction activities****Description**

A **principal** outsources the construction work to other units, but remains overall responsible for the construction process.

**Classification rules**

Both the **principal** and the **contractor** are classified in section F "Construction", specifically to the NACE class that corresponds to the construction activities carried out.

**Explanatory notes**

Some confusion may arise from the fact that NACE code 41.10 "Development of building projects"<sup>7</sup> has no equivalent in Division 42 "Civil engineering". This non-equivalence is explained by the fact that there is hardly such activity as the development of civil engineering projects for later sale. So classification is to be done on the basis of the kind of civil engineering project.

However, it should be noted that in cases where the development of building projects for buildings or civil engineering works is carried out not for later sale of the construction projects, but for their operation (e.g. renting of space in these buildings, manufacturing activities in these plants), the unit would not be classified under Section F "Construction", but according to its operational activity, i.e. real estate, manufacturing etc. (explanatory notes to NACE Rev. 2 Section F "Construction").

<sup>6</sup> The software is for use by unit B only and is not sold with the product.

<sup>7</sup> The explanatory note for 41.10 reads : *Development of building projects for residential and non-residential buildings by bringing together financial, technical and physical means to realise the building projects for later sale.*

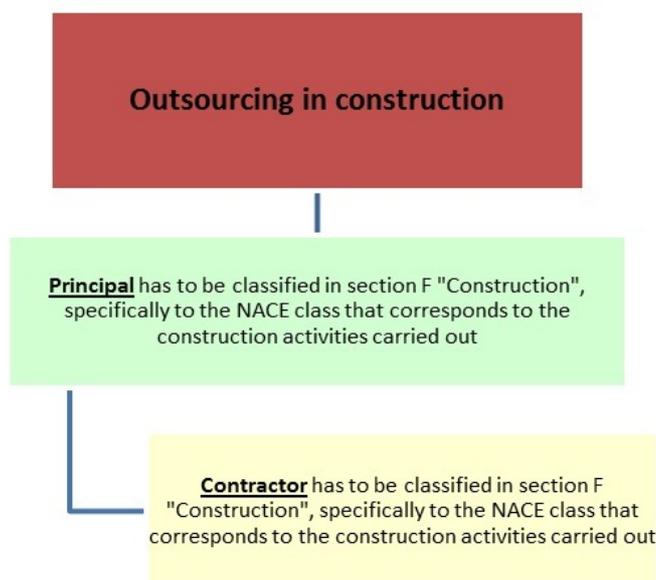


Fig. 2: Outsourcing of construction activities

#### 4.5. Outsourcing of ancillary activities

##### Description

A **principal** carries out the whole or a part of the production process (of a good or a service) but outsources certain **ancillary activities** (e.g. bookkeeping, storage, cleaning, security, etc.) to a **contractor**.

##### 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 it is carrying out, e.g. class 69.20 "Accounting, bookkeeping and auditing activities; tax consultancy", group 52.1 "Warehousing and storage", group 81.2 "Cleaning activities", division 80 "Security and investigation activities", etc.

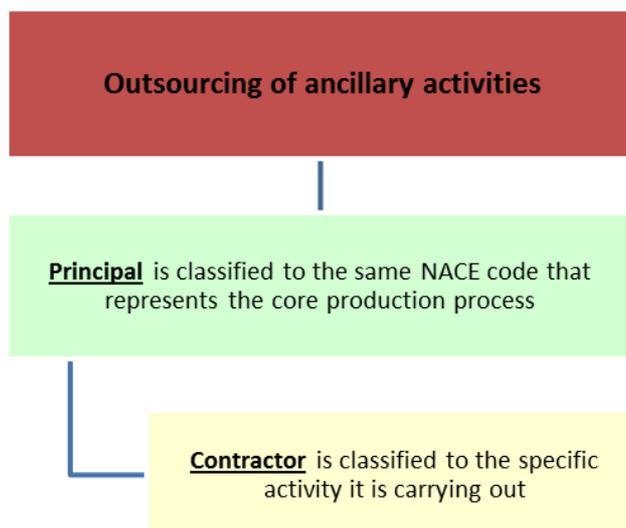


Fig. 3 Outsourcing of ancillary activities

## 4.6. Outsourcing of employment services

### Description

In the case of outsourcing of employment services a distinction should be drawn between [providing staff](#) on a temporary basis on the one hand and providing staff on a long-term or permanent basis on the other hand.

### 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".

### Explanatory notes

“Outsourcing of employment services” covers the hiring of staff but not the provision of equipment. If the contractor supplies equipment together with operating staff (e.g. transport or construction equipment), the contractor is to be classified on the basis of the activity actually performed, so the general NACE classification rules apply.

It is also important to note that the direction and supervision of the hired staff remains with the principal.

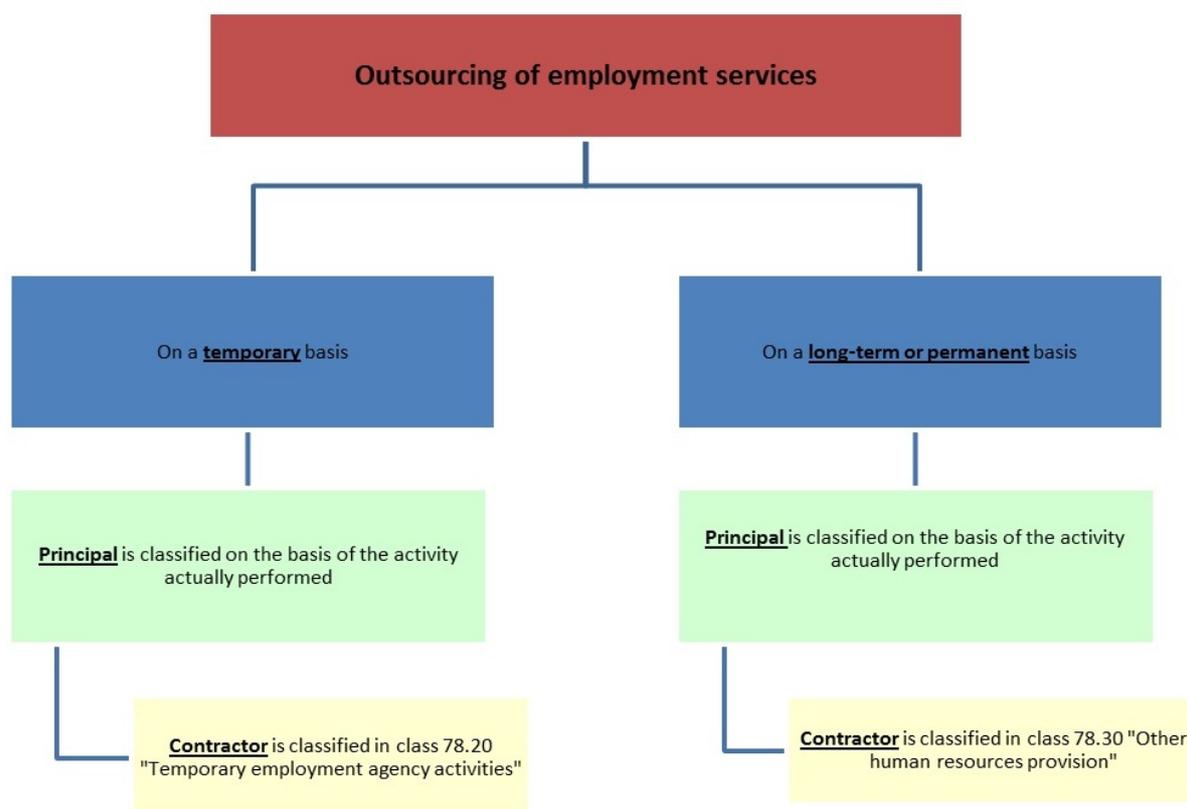


Fig. 4: Outsourcing of employment services

## 4.7. Outsourcing of service-producing activities

### Description

The **principal** outsources a part or the complete production of services (except ancillary activities, see rule "Outsourcing of ancillary activities" above) to another unit.

### Classification rules

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

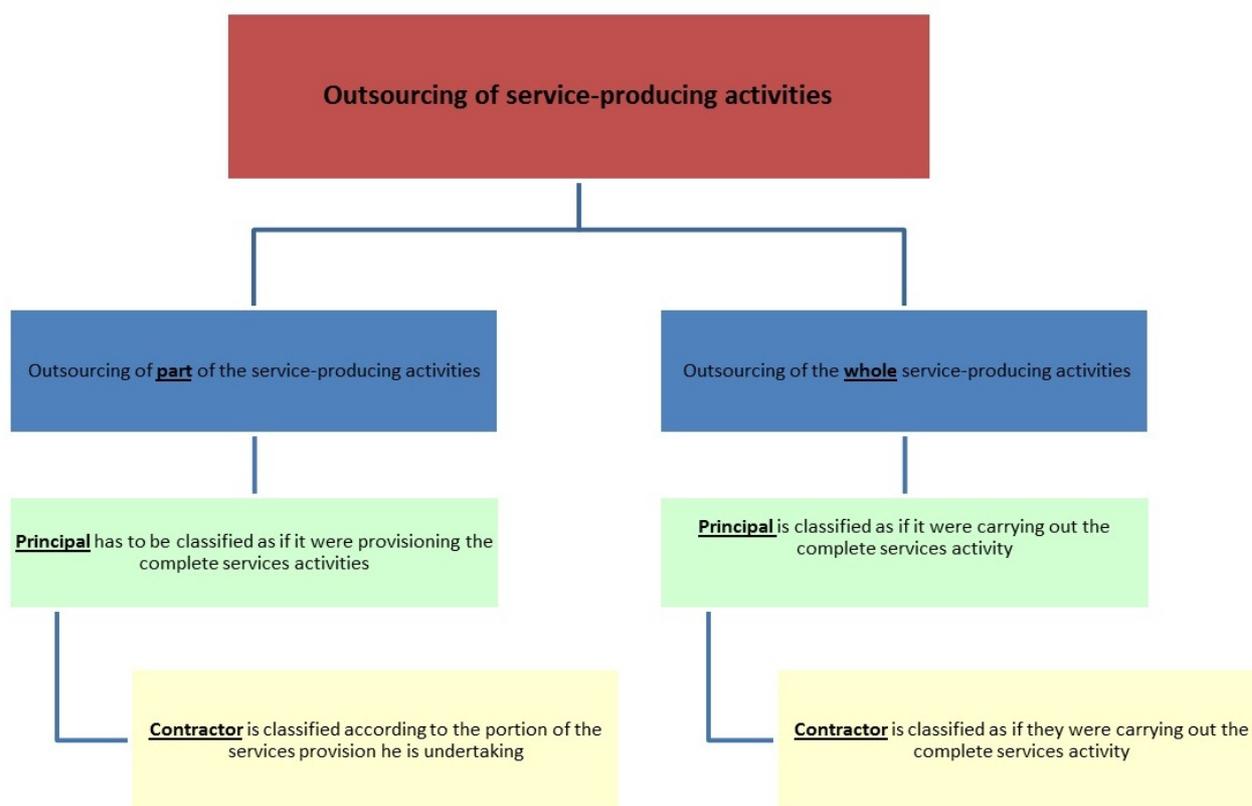


Fig. 5: Outsourcing of service-producing activities

### Example 1

A publisher intends to launch a new collection dedicated to the history of philosophy. The main steps in the publishing process for this collection are listed below. Most of the core activities are carried out internally; however, some tasks (highlighted in light blue) are outsourced.

- Managerial decisions (scope of the collection, target audience, etc.)

• Market research	→	<b>NACE 73.20 "Market research and public opinion polling"</b>
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- Buying rights for copying works under copyrighting; finding master files for no longer copyrighted works

• Contracting a philosopher to write an introduction to the collection	→	<b>NACE 90.03 "Artistic creation"</b>
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- Graphic design
- Proofreading

• Printing	→	<b>NACE 18.12 "Other printing"</b>
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- Development of the CD accompanying the paper publication
- Marketing
- Design of a webpage for e-marketing of the collection
- Distribution

The principal outsourcing only a part of the production process is to be considered as provisioning the whole process; the principal will thus be classified as publisher (NACE Rev. 2 58.11 "Book publishing"). The contractors are classified on the basis of the core task executed.

**Example 2**

A publisher intends to launch a new collection dedicated to the history of philosophy. However, it is already busy with two other collections (one on the history of sport and one on the First World War) and therefore has not the internal resources to carry out this new task. The publisher therefore decides to contract out the whole process of creating this new collection.

Unit A outsources the whole process to Unit B

- Managerial decisions (scope of the collection, target audience, etc.)
- Market research
- Buying rights for copying works under copyrighting; finding master files for no longer copyrighted works
- Contracting a philosopher to write an introduction to the collection
- Graphic design
- Proofreading
- Printing
- Development of the CD accompanying the paper publication
- Marketing
- Design of a webpage for e-marketing of the collection
- Distribution

Unit A and Unit B have to both be considered as carrying out the complete activity (NACE 58.11 "Book publishing")

**4.8. Outsourcing of the complete agricultural or animal production process (i)****Description**

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

**Classification rules**

The **principal** which 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 has the production carried out by **contractors**, is classified in division 01 "Crop and animal production, hunting and related service activities", specifically to the class that covers the **complete production process**.

The **contractor** is classified in the appropriate class of group 01.6 "Support activities to agriculture and post-harvest crop activities".

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

##### Description

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

##### Classification rules

The **principal** which has the production carried out by others and 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 retail trade; repair of motor vehicles and motorcycles" (depending on the activity and the specific good sold) if it only carries out this activity. If it also 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.

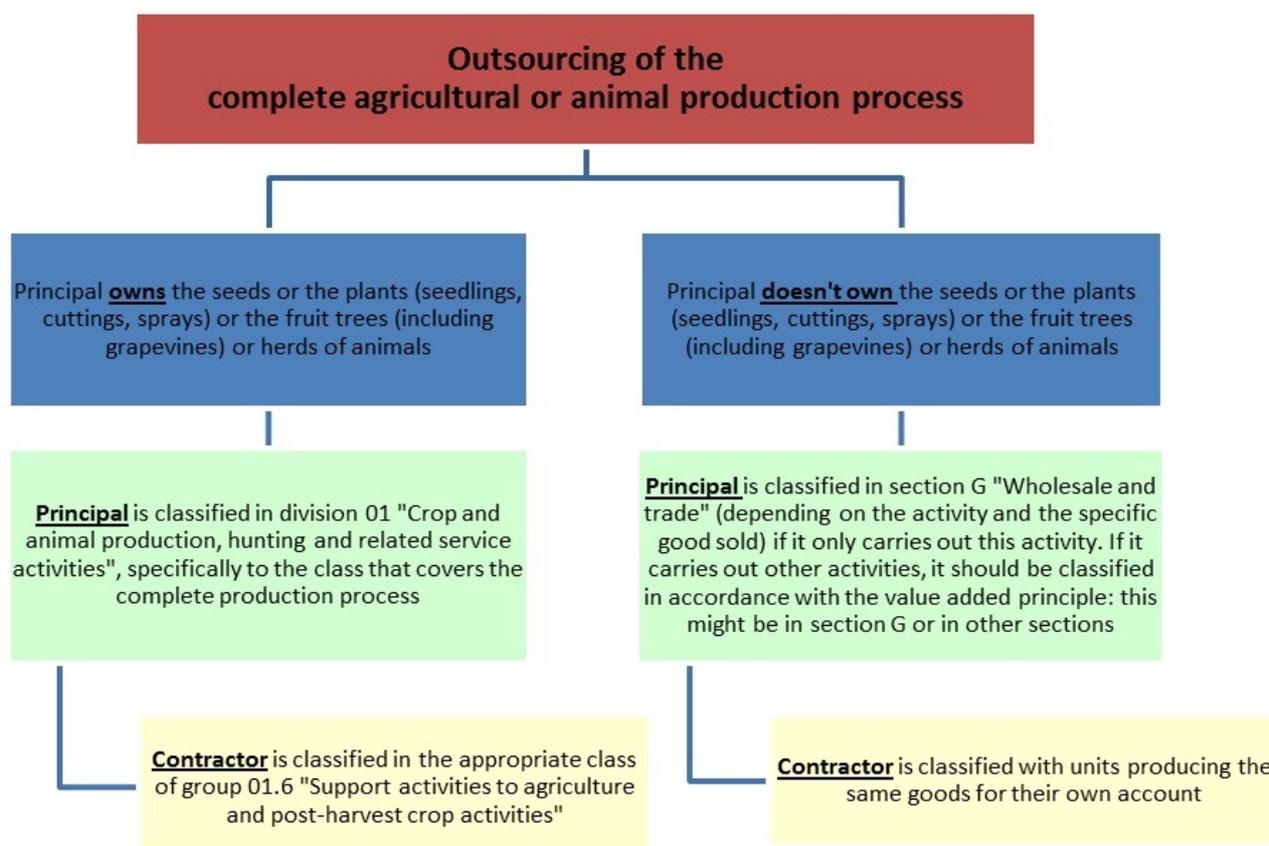


Fig. 6: Outsourcing of the complete agriculture or animal production process

#### 4.10. Outsourcing of the complete forestry production process (i)

##### Description

A **principal** *which owns the trees* outsources the complete forestry production process of forest products to another unit.

##### Classification rules

The **principal** which owns the trees and thereby owns the final outputs, but has the production carried out by **contractors**, is classified in division 02 "Forestry and logging", specifically to the class that covers the complete production process.

The **contractor** is classified in class 02.40 "Support services to forestry".

##### Explanatory notes

Owning the trees does not necessarily mean owning the land on which the trees are growing. The owner may simply buy the standing timber with a view to later fell it and sell it.

#### 4.11. Outsourcing of the complete forestry production process (ii)

##### Description

A **principal** *which doesn't own the trees* outsources the complete production process to another unit.

##### Classification rules

The **principal** which has the production carried out by others and does not own the trees is classified in section G "Wholesale and retail trade; repair of motor vehicles and motorcycles" (depending on the activity and the specific good sold) if it only carries out this activity. If it also 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.

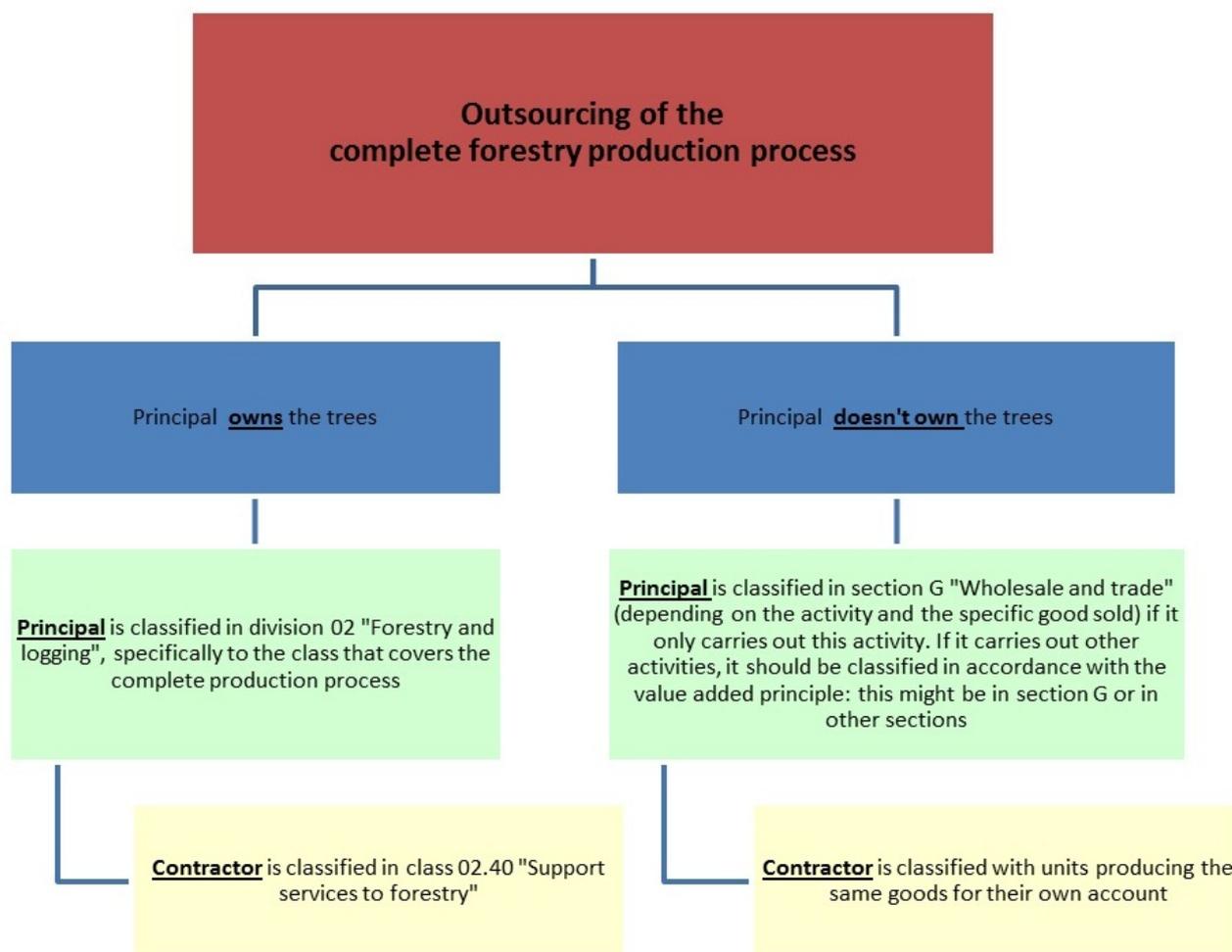


Fig. 7: Outsourcing of the complete forestry production process

#### 4.12. Outsourcing of the complete aquaculture production process (i)

##### Description

A **principal** *which owns the fry* outsources the complete aquaculture production process of aquaculture products to another unit.

##### Classification rules

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

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

#### 4.13. Outsourcing of the complete aquaculture production process (ii)

##### Description

A **principal** *which doesn't own the fry* outsources the complete production process to another unit.

### Classification rules

The **principal** which has the production carried out by others and who does not own the fry is classified in section G "Wholesale and retail trade; repair of motor vehicles and motorcycles" (depending on the activity and the specific good sold) if it only carries out this activity. If it also 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.

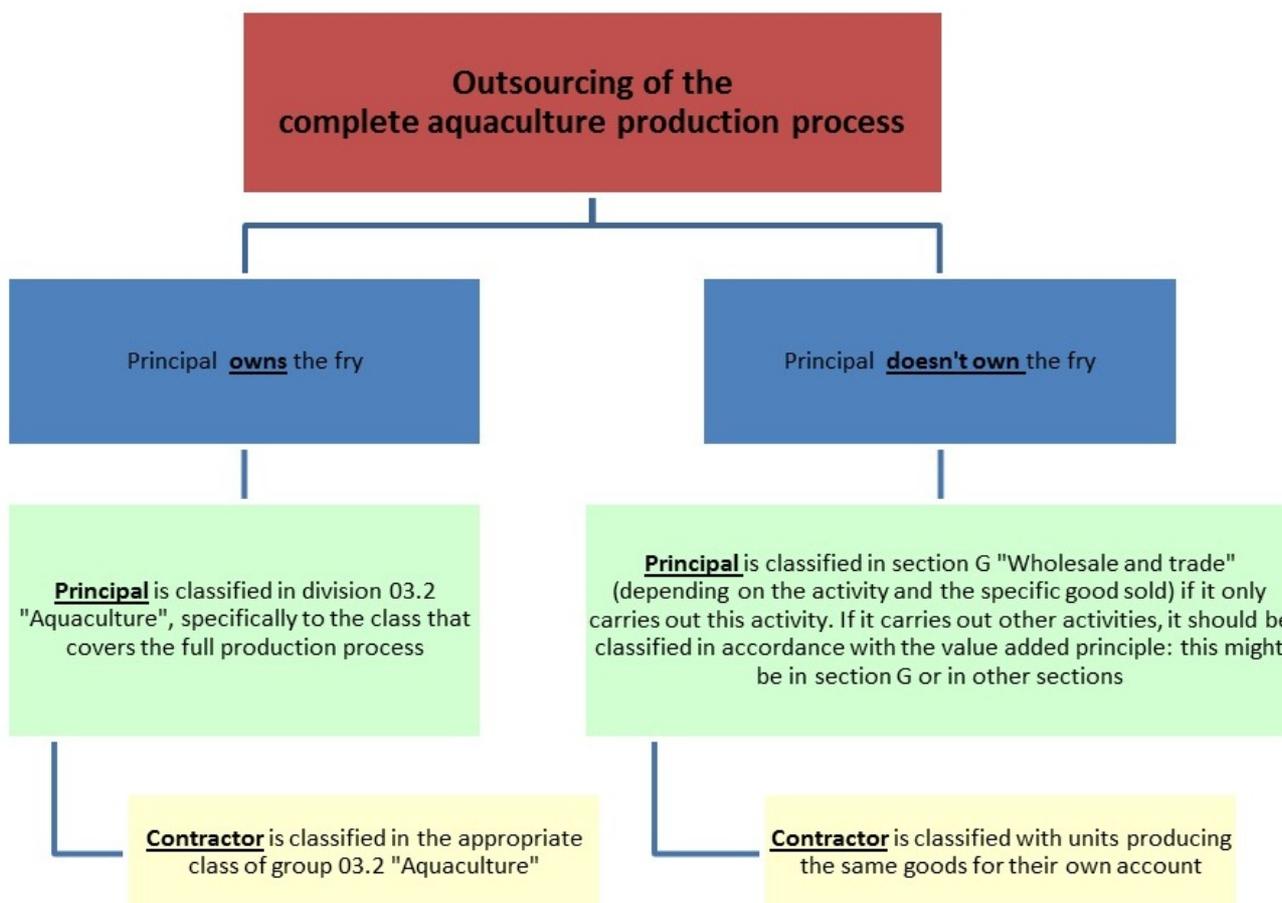


Fig. 8: Outsourcing of the complete aquaculture production process

### 4.14. Outsourcing of the complete energy production process (i)

#### Description

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

### Classification rules

The **principal** which owns the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.) and thereby owns the final outputs, but has the production carried out by contractors, is classified in section D "Electricity, gas, steam and air conditioning supply", specifically to the class that corresponds the complete production process.

The **contractor** is classified in the appropriate class of section D "Electricity, gas, steam and air conditioning supply".

#### 4.15. Outsourcing of the complete energy production process (ii)

##### Description

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

##### Classification rules

The **principal** which has the production carried out by others but does not own the energy sources material (such as oil, coal, gas, wood, agricultural residual, etc.) is classified in section D, class 35.14 "Trade of electricity" or 35.23 "Trade of gas through mains" (depending on the activity and the specific good sold) if it only carries out this activity. If it also carries out other activities, it should be classified in accordance with the value added principle.

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

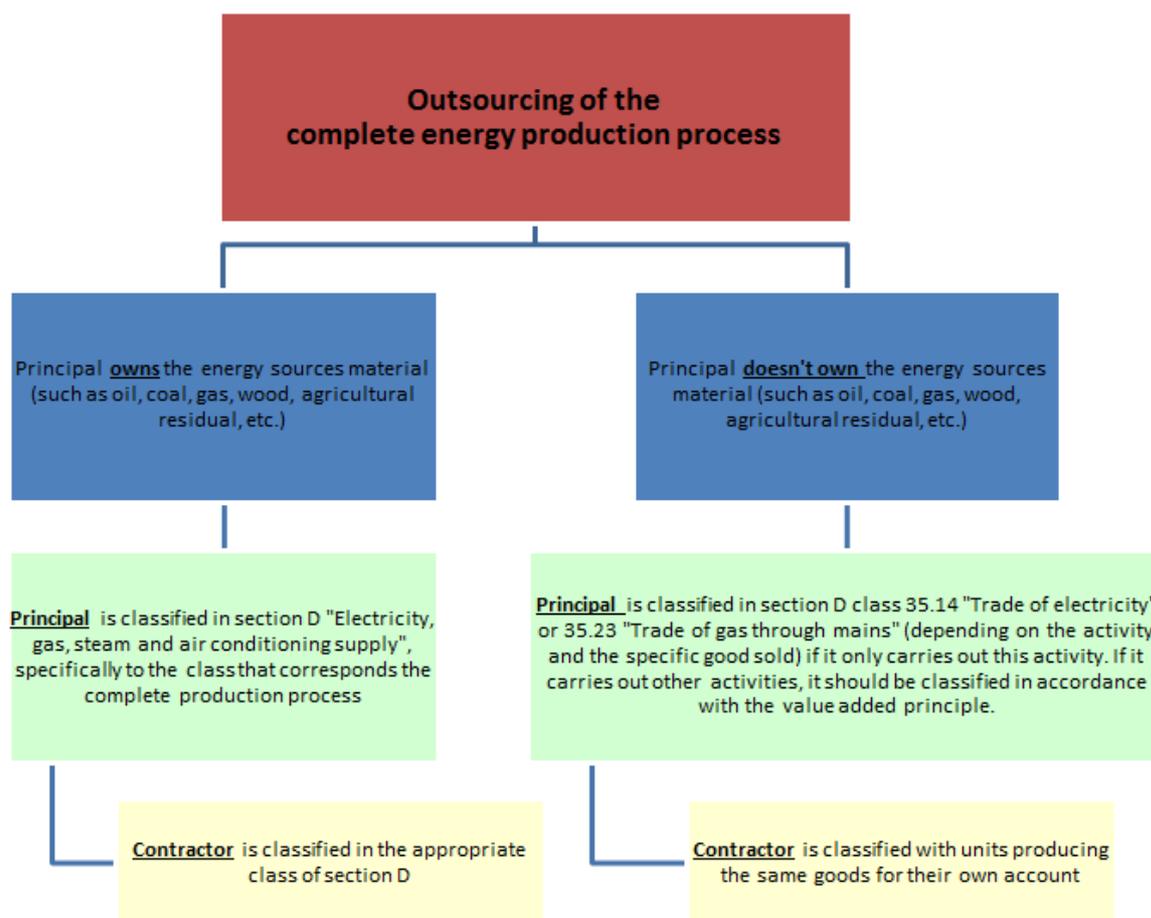


Fig. 9: Outsourcing of the complete energy production process

#### 4.16. Outsourcing of other complete goods-production process

##### Description

A **principal** outsources other complete goods-production process to another unit.

##### Classification rules

In the cases of fishing, mining, quarrying and water supply, the **principal** which has the production carried out by others is classified in trade (depending on the activity and the specific good sold) if it only carries out this activity. If it also carries out other activities, it should be classified in accordance with the value added principle: this might be in section G "Wholesale and retail trade; repair of motor vehicles and motorcycles" or in other sections.

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

##### Explanatory notes

This rule does not apply to the outsourcing of the complete aquaculture production process (see 4.12)

## Remark

Section J "Information and Communication" constitutes a special case, not involving classification in trade. The main inputs and outputs in section J are content products seen mainly as intangible products. The manufacturing part of the production process is included in division 18 "Printing and reproduction of recorded media". So, activities in section J are considered as services activities while the outputs are generally goods. In division 18 "Printing and reproduction of recorded media", the value of the material inputs (owned generally by printing units) is considered of minor importance compared to the value of the printed or reproduced content. So the output is considered as a service and not a good.

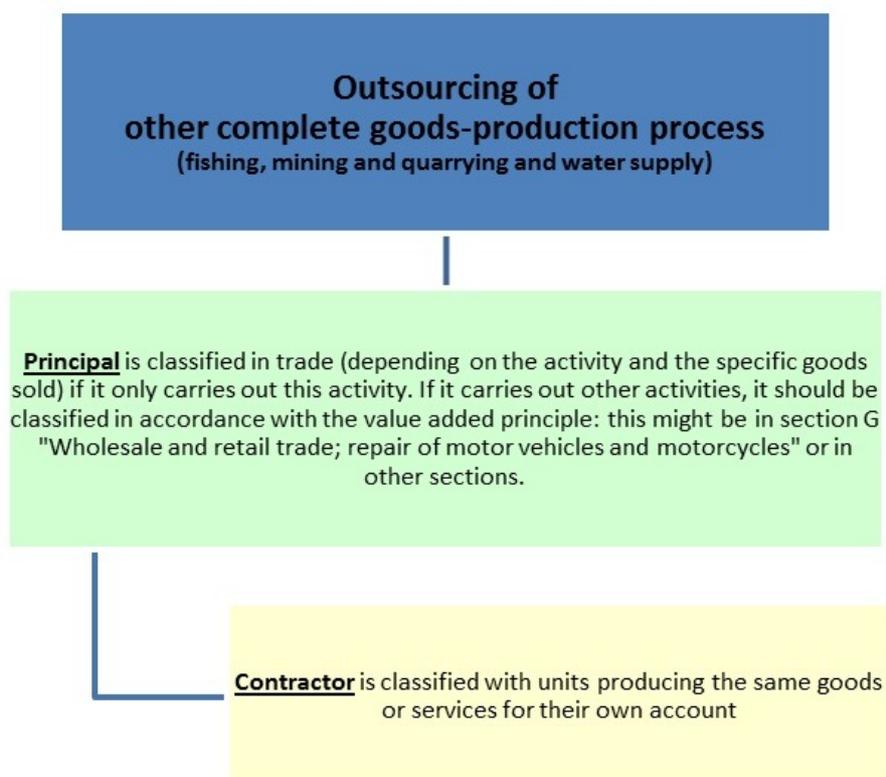


Fig. 10: Outsourcing of other complete goods-production process