

## MEASURING THE MULTINATIONAL ECONOMY<sup>‡</sup>

### Factoryless Goods Producing Firms<sup>†</sup>

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The global economy is undergoing a series of rapid, connected transformations that are changing the way products are produced and sold. International trade in goods has surged, with the ratio of trade to GDP increasing for almost all country pairs. This increase in trade has been accompanied by the rise of global value networks and the relocation of production activities across national borders. At the same time, there has been renewed interest in the fragmentation of production activities across the boundaries of the firm and its links to the increases in trade and offshoring of production. The different activities of the value chain for a product can be performed by one or more establishments of a single firm, or can involve many different firms. In both cases, the activities can be performed in different locations within and across country borders.

In this paper, we consider an extreme form of the fragmentation of production activities where the firm does not conduct manufacturing activities but nonetheless is heavily involved in activities related to the production of goods.

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Our focus is on firms in the wholesale sector. Traditional wholesalers are primarily, or exclusively, involved in intermediating goods between producers and retailers/consumers. Factoryless goods producing firms (FGPFs), in contrast, design the goods they sell and coordinate the production activities, either at the establishment itself or through the purchase of contract manufacturing services. In other words, FGPFs are manufacturing-like as they perform many of the tasks and activities found in manufacturing firms.

There are many ways to classify the activities or tasks needed to take a product from an initial concept through production until its delivery to the final customer. Pre-production activities can include development of the initial idea or conceptualization, R&D, product design, and engineering as well as development of specifications for production. Production itself involves transformation and assembly of inputs and coordination of the various production stages. Post-production tasks might cover the determination of prices and quantities, marketing and branding, logistics, and the ultimate sale of the good to final customers.

Traditionally, these activities were undertaken by the same firm in one location. Today, firms may perform different parts of each production stage in different domestic and foreign locations. When the activities are separated in space, firms can also decide whether they should outsource them to others. We define a FGPF as a firm that has no manufacturing establishments in the United States, but performs pre-production activities such as design and engineering itself and is involved in production activities, either directly or through purchases of contract manufacturing services (CMS).

FGPFs are present in industries from beer brewing to semiconductors. Perhaps the canonical example of a factoryless goods

producer is the British appliance firm, Dyson, best known for its innovative vacuum cleaners. The firm initially designed, engineered, and produced vacuum cleaners in Wiltshire, England but subsequently chose to offshore and outsource all the production to Malaysia while leaving several hundred research and other employees in the United Kingdom. Dyson's more recent innovations in product lines such as hand dryers and fans have never been produced in the United Kingdom or by Dyson itself.

The best-known example of a factoryless goods producer is Apple Inc. Apple designs, engineers, develops, and sells consumer electronics, software, and computers. For the vast majority of its products, including iPhones, iPads, and MacBooks, Apple does none of the production and the actual manufacturing is performed by other firms in China and elsewhere. While Apple is known for its goods and services and closely controls all aspects of a product, almost none of Apple's US establishments would be in the manufacturing sector.<sup>1</sup>

The semiconductor industry is well-known to have factoryless goods producers in the form of "fabless" firms.<sup>2</sup> Mindspeed Technologies, a fabless semiconductor manufacturer in Newport Beach, CA "designs, develops, and sells semiconductor solutions for communications applications in wireline and wireless network infrastructure equipment." Mindspeed outsources all semiconductor manufacturing to other merchant foundries, such as TSMC, Samsung, and others. Mindspeed's establishments would not be in the manufacturing sector.

Dyson and Apple started with production facilities inside the firm in the home country and subsequently shed their production lines and outsourced and offshored production. In addition, they retained or expanded other activities including research and development, design, engineering, marketing, and distribution.

These examples raise several important questions about FGPFs, their origins, and their

relationship to the offshoring of production. Are today's FGPFs more likely to have been involved in manufacturing in the past? Do FGPFs perform a wider range of activities than non-FGPFs? Are they larger firms? Are FGPFs more likely to be importers and do they import a greater share of final sales? We look at import activities of FGPFs and at the importance of manufacturing in the past activities of today's FGPFs.

To date there is very little systematic evidence on the extent of these types of firms.<sup>3</sup> In this paper, we use data from the US Census of Wholesale Trade in 2007 to systematically document features of factoryless goods producing firms in the wholesale sector in the United States.<sup>4</sup>

There are several reasons why distinguishing FGPFs from traditional wholesale establishments may be important for economic welfare or policy. First, the mere existence of the FGPFs highlights a new type of production function in the global economy involving extreme fragmentation of tasks. Second, the types of workers, and as a result jobs and wages, employed by FGPFs likely differ significantly from those at traditional wholesalers. Third, the relative importance of R&D and innovation is likely more important at FGPFs. These potential differences between FGPFs and traditional wholesalers introduce the possibility of very different wage, employment, and productivity dynamics if factoryless goods production grows as a fraction of aggregate activity.

Our research is related to a broader set of questions that asks how production, innovation, knowledge, and productivity are related. One perspective is that without production activities located nearby, in the long run a firm cannot continue to generate new ideas, improve product quality, innovate its designs, and raise productive efficiency. The counterpoint suggests that the advent of dramatic improvements in telecommunication technology, the rise of the Internet, and the reduction of transportation and trade costs have combined to allow firms to separate their activities geographically and potentially locate

<sup>1</sup>In December 2013, Apple began producing desktop computers at a US manufacturing facility jointly operated with Flextronics. The specific firms and details given here are based on publicly available information; they may or may not be present in the data used in our empirical analyses.

<sup>2</sup>Bayard, Byrne, and Smith (2014) document the extent and characteristics of FGPs in the US semi-conductor industry.

<sup>3</sup>In a related paper, Bernard and Fort (2013), we focus on FGP establishments in 2002 and 2007. Kamal, Moulton, and Ribarsky (2013) discuss data collection efforts to provide new information on FGPs.

<sup>4</sup>There may be substantial numbers of nonwholesale FGPFs in other sectors such as Business Services.

TABLE 1—FIRM CHARACTERISTICS, 2007

<i>Panel A</i>	Total sales	Plants	Wage	Age	
Non-FGP firms	10,053	1.38	46.8	14.8	
FGP firms	18,399	2.33	51.5	13.7	
					Employment
<i>Panel B</i>	Total	Wholesale	Service	Other	MPT
Non-FGP firms	22.1	14.9	2.0	3.6	1.0
FGP firms	50.0	24.4	15.3	5.4	3.0

*Notes:* MPT are Management, Professional, and Technical service workers. Other includes workers in Retail, Agriculture, Transportation, Warehousing and Utilities, Construction, and Public Administration. Employment figures are counts of employees. Total sales and Wages are in thousands of dollars.

them outside the firm. This perspective suggests firms will thrive if they can take advantage of comparative advantage and relative cost differences in the performance of the tasks involved in the creation, production, distribution, and marketing of a product. Co-location of these tasks may not be necessary and might be more costly.

### I. Data and Definition

The data employed in this paper are from the 2007 US Census Bureau Census of Wholesale Trade (CW), the Longitudinal Business Database (LBD) for 1992 to 2007, and US Customs trade transactions data on 2007 US imports. To create our definition of a factoryless goods producing firm, we proceed in two steps: first we identify FGP establishments in the wholesale sector and then we aggregate establishment to define FGP firms. We classify establishments in the wholesale sector as Factoryless Goods Producers if they both participate in the pre-production process of design or engineering of the product and are involved in the control of manufacturing through the purchase of contract manufacturing services.<sup>5</sup>

The Economic Censuses collect information at the unit of the establishment. Most firms are single-plant organizations in which establishment and firm definitions are the same. However the smaller number of multi-plant firms account

for a disproportionate share of output and employment, and are more likely to produce multiple products.

**DEFINITION 1:** *A factoryless goods producing firm (FGPF or FGP firm) is a firm with at least one FGP wholesale establishment and with no manufacturing establishments.*

The practical implementation of the definition is complicated by the fact that each wholesale establishment can be in one of three categories: FGP, non-FGP, or Missing.<sup>6</sup> In this paper we only consider firms where all the wholesale establishments can be classified as FGP or non-FGP.

### II. Characteristics of FGP Firms

We start by describing FGP firms compared to non-FGP firms in the wholesale sector. In Table 1, we consider characteristics of FGP firms in 2007. Only 12 percent of firms are FGPFs and they are found in all industries for which FGP-related data was collected. However, they are disproportionately active in pharmaceuticals and apparel, 24 and 23 percent of firms respectively. These two industries are well-known for having design and product development conducted at a location separate from the production site. As expected, FGP firms are substantially larger than non-FGPFs; they employ twice as many

<sup>5</sup>See Bernard and Fort (2013) for details about the survey questions used to identify establishments as FGPs and for information on FGP plants. These survey questions were asked of all establishments in 49 of the 71 six-digit NAICS industries.

<sup>6</sup>Establishments with a Missing designation either were not asked the FGP survey questions or did not answer all the questions.

workers, have 2.3 plants in contrast to 1.3 for non-FGPFs, and have average sales that are 83 percent larger. This size difference is not surprising if we consider that FGPFs are active in all phases of the production of a product from the design through the decisions about manufacturing to the branding and logistics. FGPFs also pay higher average wages and are younger. The relative youth of FGPFs is surprising given that large firms are typically older firms.

Accordingly, FGPFs are more active across sectors. The typical non-FGP wholesaling firm has 22.1 workers of whom 14.9 are at wholesale establishments. Employment shares in Services, Management/Professional/Technical (MPT), and Other sectors are much smaller. In contrast, the average FGPF has 50.0 workers of whom only half are at wholesale establishments. FGPFs have substantial workers in other industries, 10.7 in other Services sectors, 3.0 MPT, and 5.4 in Other. In the remainder of the paper we develop a set of facts around the hypotheses that FGPFs are likely to have made a transition from manufacturing to non-manufacturing and that FGPFs are more likely to have offshored production.

### III. FGPFs Over Time

To begin to understand the origins and evolution of FGPFs over time, we use information from the LBD to follow FGPFs and non-FGPFs over time. In 2007 we can define 112,300 firms employing over 2.85 million workers as either FGPFs or non-FGPFs, see Table 2. 13,500 of these firms are FGPFs while 98,800 are non-FGPFs. As noted previously, the FGPFs are substantially larger in terms of total employment and wholesale sector employment.

We track these firms back into past years in other rows in Table 2. For example, 40.5 percent (40,000) of these non-FGPFs existed in 1992. In contrast, only 36.3 percent of the FGPFs existed in 1992 confirming the finding that FGPFs are younger firms. Over time, the average wholesale employment at future FGPFs has increased and the relative size compared to future non-FGPFs has risen as well.

More interesting is that future FGPFs have much higher manufacturing employment than future non-FGPFs. Firms present in 1992 show that future FGPFs have 2.96 times as many manufacturing employees and have manufacturing

TABLE 2—FGPFs OVER TIME

	Firms	Total employment	Employees	
			Manufacturing	Wholesale
<i>Panel A. Non-FGP firms</i>				
1992	40,000	1,043,716	1.5 (0.75)	13.8 (0.96)
1997	56,500	1,356,654	0.9 (0.72)	13.6 (0.94)
2002	76,100	1,701,870	0.4 (0.70)	14.4 (0.93)
2007	98,800	2,186,891	0.0	14.9 (0.92)
<i>Panel B. FGP firms</i>				
1992	4,900	285,650	9.4 (2.96)	17.5 (1.34)
1997	7,300	425,244	6.2 (3.09)	20.5 (1.50)
2002	10,200	550,673	3.1 (3.17)	21.6 (1.52)
2007	13,500	672,443	0.0	24.4 (1.57)

*Notes:* Years prior to 2007 give average for firms existing in that year as well as in 2007 and were categorized as either non-FGPF or FGPF in 2007. Manufacturing (Wholesale) indicates the average number of manufacturing (wholesale) workers at the firm. Numbers in parentheses represent the mean for that group relative to all wholesale firms in the firm's primary wholesale industry in that year.

employment shares 2.48 times higher than the average firm in their industry. Future non-FGPFs are 54 percent smaller in terms of average employment and have manufacturing employment shares 19 percent lower.

These results provide some support for the hypothesis that FGPFs include a set of firms that made the transition out of manufacturing.<sup>7</sup> However, it is likely that the current set of FGPFs are a mix of different types of firms including former manufacturing firms, new firms created as FGPFs from their inception, and other firms that have made the transition to the design and manufacture of products. More work is needed to understand the evolution of FGPFs over time.

### IV. FGPFs and Imports

While Fort (2014) finds that US firms are much more likely to purchase contract manufacturing services domestically rather than abroad, there is still a strong presumption that production fragmentation also entails offshoring. We examine the import activities of both non-FGP and FGP firms in 2007 in Tables 3 and 4.

<sup>7</sup>Bernard, Smeets, and Warzynski (2014) document the prevalence and characteristics of these types of switching firms in the Danish manufacturing sector from 1994–2007.

TABLE 3—FGPFs AND IMPORTS, 2007

	Importer share	Imports	Imports/ wholesale sales
Non-FGP firms	0.354	3,566	0.856
FGP firms	0.499	4,998	0.380

*Notes:* Importer share is the fraction of firms that report positive imports. Imports are given in thousands of dollars. Imports/wholesale sales is the ratio of imports to sales by wholesale establishments at the firm.

Table 3 reports the share of importing firms, the level of imports per firm and the ratio of imports to wholesale sales at the firm in 2007. FGPFs are indeed more likely to be importers than non-FGPFs; one half of FGPFs are importers in contrast to just over one-third of non-FGPFs. In addition, the level of imports is 40 percent greater at FGPFs. Taken together these findings provide some support for the idea that FGPFs use foreign production sites to manufacture the goods they control. However, looking at the ratio of imports to wholesale sales, we find that FGPFs are importing a much smaller share of sales than non-FGPFs. Non-FGPFs importers have imports equal to 86 percent of their sales, compared to only 38 percent for FGPFs. These results suggest a more complex relationship of factoryless goods producing firms to offshoring.

Table 4 shows the top five importing sectors for both non-FGP and FGP firms as well as the share of imports in each of the top sectors. Import sectors for non-FGPFs include Machinery, Electrical equipment as well as Vehicles, Jewelry, and Toys. In the latter three sectors, importing wholesale firms are likely to be of the more traditional type providing search and matching services between producers and buyers.

FGPFs are much more concentrated in the top sectors. Almost two-thirds of their imports are in equipment (HS85 and HS84) and apparel and footwear (HS62, HS61, and HS64). Non-FGPFs are spread more evenly with less than half their imports in the top five sectors.

## V. Conclusions

The fragmentation of production across firms and borders raises important questions about the boundaries of the firm and the role of policy. We

TABLE 4—MAJOR IMPORT SECTORS, 2007

Rank	Non FGP firms		FGP firms	
	Sector	Import share	Sector	Import share
1	84	0.160	85	0.298
2	85	0.149	84	0.111
3	87	0.063	62	0.085
4	71	0.059	61	0.075
5	95	0.044	64	0.073

*Note:* The two-digit import (HS) sectors are: (85) Electrical machinery and equipment, (84) Machine and mechanical appliance and computers, (62) Clothing—not knitted, (61) Clothing—knitted, (64) Footwear, (87) Vehicles, (71) Jewelry and precious stones, and (95) Toys.

find that large numbers of workers in the wholesale sector are employed at firms that engage in manufacturing-related activities. Unlike traditional wholesalers, these factoryless goods producing firms are not primarily engaged in intermediation, but instead undertake design and engineering of products themselves and exert control over the production process. The potential for increasing fragmentation of production across firms and borders means that FGPFs are likely to play an even larger role in industrialized economies in years to come.

FGPFs are larger, pay higher wages, are active in more industries, and are more likely to be engaged in importing than typical wholesale firms. This paper represents a first step in developing an understanding of factoryless goods producing firms in the United States.

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