

Globalisation and Structural Adjustment

SUMMARY REPORT OF THE STUDY ON GLOBALISATION AND INNOVATION IN THE BUSINESS SERVICES SECTOR



Foreword

The services sector makes an important contribution to employment growth, productivity and innovation in OECD countries. At the OECD's 2005 Ministerial Council Meeting, Ministers stressed the need to deepen the understanding of globalisation and innovation in key services sectors. A programme of follow-up studies was subsequently approved by Council. The Committee on Industry, Innovation and Entrepreneurship (CIIE) provided guidance on the scope of this study.

This document, presented to the OECD's 2007 Ministerial Council Meeting, looks specifically at *business support services* and its strong linkages with other sectors. It aims to identify factors, institutions and policies that affect the delivery of business support services and that could enhance growth prospects more broadly. It focuses mainly on issues related to productivity, standardisation and regulation, and trade.

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Executive Summary

Firms are increasingly outsourcing business services...

The business services sector has been growing rapidly in most OECD countries. Software development, R&D, and other knowledge-intensive service activities – which include legal, advertising and recruitment services – are fundamental for the operation of a modern business. In the past, these activities were largely conducted in-house given their strategic importance and their firm-specific nature. Increasingly however, firms have been buying knowledge-intensive services from external sources in order to take advantage of economies of scale and scope.

... including to foreign providers.

This has led to a jump in international trade in business services, especially since the mid-1990s and in part as a result of the liberalisation efforts agreed at the time of the Uruguay Round. Although OECD countries are still the main origin and source of trade on business services, firms are increasing offshoring a range of business functions to countries with relatively lower labour costs and a talented workforce.

This process has contributed to economy-wide productivity growth...

Because of many industries use business services as inputs, access to an efficient business sector is essential for economy-wide productivity growth. Although analysis of macro-level data does not yet show an increase in productivity in the sector, partly as a result of measurement problems, several firm-level studies have confirmed the positive spill-over effects of business services.

... and helped accelerate and deepen the innovation process.

As the pressure to innovate increases and the means of doing so become more complex, there is a growing tendency to outsource knowledge input for innovation. This has sped up the shift of the innovation process from a closed to an open model. Business services can play several “supporting” roles in the innovation process: they can be a *source* of innovation if they play a role in initiating and developing innovation activities in client organisations. Alternatively, they may be *facilitators* of innovation if they support an organisation in the innovation process. Similarly, business service firms can be *carriers* of innovation, playing a role in transferring existing knowledge among or within organisations, industries or networks, so that it can be applied in a new context.

To realise the full potential of the sector, the regulatory framework should not be overly restrictive.

To seize the benefits of the strong forward linkages and this emerging innovation paradigm, government should provide an enabling business environment. The regulatory framework is especially important in this regard and should be made more flexible. Knowledge-intensive business services are subject to a wide range of regulations in most OECD countries, but more often than not, these regulations could be streamlined without jeopardising service quality. Indeed, evidence shows that the stringency of some service regulations is negatively correlated with productivity growth.

Common industry-wide standards can be beneficial...

The issue of standards is of particular relevance in the business services sector. Although there are potential costs in standardisation, widely-accepted and balanced standards can increase market transparency and competition, by facilitating switching between suppliers. Harmonised standards across countries can also reduce trade barriers, which tend to be inherently higher in most service sectors compared to the cross-border exchange of goods. Finally, standards can benefit service providers by enabling them to focus on the internal process of services production and obtain economies of scale.

...together with an IPR regime that favours access to knowledge...

The IPR regime should be efficient and balance incentives to innovate with consideration about access to knowledge. Issues to be considered include exemptions and limits on the use of IPR, such as research exemptions and rules on fair use. It could also include greater efforts to enhance the economic use of IPR, for example through good licensing practices, cross-licensing and patent pools.

...and the efficient reporting of intellectual assets.

Business services providers and most of the companies that make intensive use of their services depend heavily on investment in intangibles, such as training, customer relationship management, brand image, internal organisation, investment in software and ICT. Reliable information about the intangible assets of companies is needed to avoid inefficient resource allocation and facilitate innovation. Intellectual assets-intensive companies feature specific operational and business risks and this can have a major impact on the value of the companies concerned and therefore information about intellectual assets needs to be disclosed.

Globalisation and Structural Adjustment: Summary report of the study on Globalisation and Innovation in the Business Services Sector

Introduction

At its meeting in May 2003, the Ministerial Council asked the OECD to examine the contribution made by the services sector to employment growth, productivity and innovation and to identify factors, institutions and policies that could enhance the growth prospects of this sector. The main policy conclusions of the project were presented to Ministers at the OECD Ministerial Council Meeting in May 2005 in the synthesis report, *Growth in Services – Fostering Employment, Productivity and Innovation*. In addition, a compendium of the nine principal background papers was released under the title, *Enhancing the Performance of the Services Sector*.

The synthesis report identified the growing importance of globalisation as one of main drivers of the strong performance of many services sectors in recent years. At the Ministerial Council Meeting, Ministers stressed the need to deepen the understanding of the impacts of globalisation and policies and measures needed to meet adjustment challenges, and to share member countries' experience on policy responses. A programme of follow-up study was approved by Council in 2005. This appears in the Programme of Work and Budget (PWB) 2005-2006 under Output Area 1.1.3, "Cross-country Structural Policy Analysis", and consists of three studies: *i*) overall economic effects of globalisation; *ii*) globalisation and innovation in key services sectors; and *iii*) globalisation and sectoral adjustment.

The Directorate for Science, Technology and Industry (STI) conducted the second study in co-operation with the Trade Directorate. The CIIE (then CIBE), at its meeting in February 2006 provided guidance to the Secretariat on the scope of this study, which focuses on **business support services** and includes a discussion of issues related to: *i*) productivity, *ii*) standardisation and regulation, and *iii*) trade.

Growing business services sector presence

The business services sector is one of the most dynamic in OECD countries...

The business services sector has been growing rapidly in most OECD countries: the sector's share of GDP at least doubled in the past 25-30 years in all countries for which longer-term data are available.¹ Although data are available only for a few countries, the share of the sector in GDP is as high as 12-13% in countries such as France and the United States.

1. The OECD STAN database contains longer time-series for the value of business services as a percentage of GDP for six countries: Denmark, Germany and Norway from 1970, and Austria, Finland and France from 1980. Business services' share of GDP more than doubled in Denmark and more than tripled in Germany and Norway between 1970 and 2003. The share tripled for Austria and approximately doubled for Finland and France between 1980 and 2003.

Business services are defined to include “computer and related services”, “research and development” and “other business services” (ISIC rev. 3 categories 72, 73 and 74). Business services can also be sub-divided in two groups: the first subgroup is *knowledge-intensive business services*, which are professional services, including IT-consulting (72), R&D services (73), legal (74), accounting (74), marketing and advertising (74), business consulting and human resource development (74). The second subgroup consists of *operational services*, including industrial cleaning (74), security services (74) and secretarial services (74) (Table 1).

Table 1. Business services sector

	ISIC rev.3	Knowledge intensity	Globalisation
Business services	Computer & related service (72)	Knowledge-intensive business services	Offshorable
	Research & development (73)		
	Other business services (74)	Operational business services	Local

Due to the shifting boundaries between market (arm’s length) and in-house (intra-firm) activities, and between specialist and secondary supply, sectoral data may well understate the extent of business services activities in the economy.² In the past, most business service activities were conducted in-house. This was especially the case of knowledge-intensive business services, given their strategic importance and their firm-specific nature. Increasingly however, firms have been buying knowledge-intensive services from external sources in order to take advantage of economies of scale and scope.

This increasing outsourcing of business services has also led to a jump in international trade in the sector. Growth has been particularly buoyant since the mid-1990s, in part as a result of the liberalisation efforts agreed at the time of the Uruguay Round (Table 2).³ Rapid advances in information and communication technologies (ICTs) and the ongoing liberalisation of trade and investment in services have increased the tradability of many service activities, especially business services, and created new kinds of tradable services. Many types of business services are thus becoming increasingly internationalised, with ICTs enabling the production of services to be increasingly location independent. This has facilitated ICT-enabled offshoring of business services.

2. In 2002, on average about 40% of all persons employed in the manufacturing sector in OECD economies were employed in occupations that could be considered as services-related, *e.g.* scientific professionals, accountants, lawyers, managers, clerks or other services occupations. Huws (2001) shows 76% of the establishments surveyed that were supplying software development and support services were outside the software and computer-related services industry. This suggests that market-based business services activities may be significantly larger than industry-based analyses reveal.
3. Different classifications of business services are used in Figure 1 (ISIC Rev 3) and Table 2 (IMF BPM 5).

Table 2. Share (%) of exports and imports of business services¹ in trade and in GDP, 1995 and 2003

	Exports of business services				Imports of business services			
	In total exports		In GDP		In total imports		In GDP	
	1995	2003	1995	2003	1995	2003	1995	2003
Australia	1.7	3.3	0.3	0.6	2.8	2.8	0.6	0.6
Austria	13.3	12.2	5.0	6.3	11.1	15.0	4.3	7.6
Canada	3.1	4.1	1.2	1.6	3.3	3.9	1.2	1.3
China	2.5	3.8	0.5	1.3	5.1	2.5	1.0	0.8
Denmark	7.2	12.9	2.6	5.8	5.8	11.5	1.9	4.5
Finland	6.2	4.4	2.3	1.7	10.3	6.8	3.0	2.1
France	6.6	5.5	1.5	1.4	5.4	5.6	1.2	1.5
Germany	3.5	4.5	0.9	1.6	4.7	6.1	1.1	2.0
India	5.6	16.9	0.6	2.4	5.6	9.3	0.7	1.5
Ireland	2.8	16.6	2.1	13.9	10.8	21.8	6.9	14.9
Italy	4.5	5.8	1.2	1.5	6.7	7.1	1.5	1.8
Sweden	2.7	9.9	1.0	4.4	3.1	10.6	1.0	3.9
UK	5.7	11.5	1.6	3.0	3.0	4.6	0.9	1.3
US	4.0	6.8	0.4	0.6	2.1	3.0	0.2	0.4

1. For some countries, such as India, it is not possible to isolate business services. As a consequence, for India, the category includes total services, minus travel, transport and government services (*i.e.* including construction, insurance and financial services as well as business services). However, Indian firms are now extensively exporting ICT-enabled services and business process services and the remaining services included in the category are likely to be small in comparison. Furthermore, data on overseas revenues from annual reports of top Indian export firms show patterns similar to the IMF data.

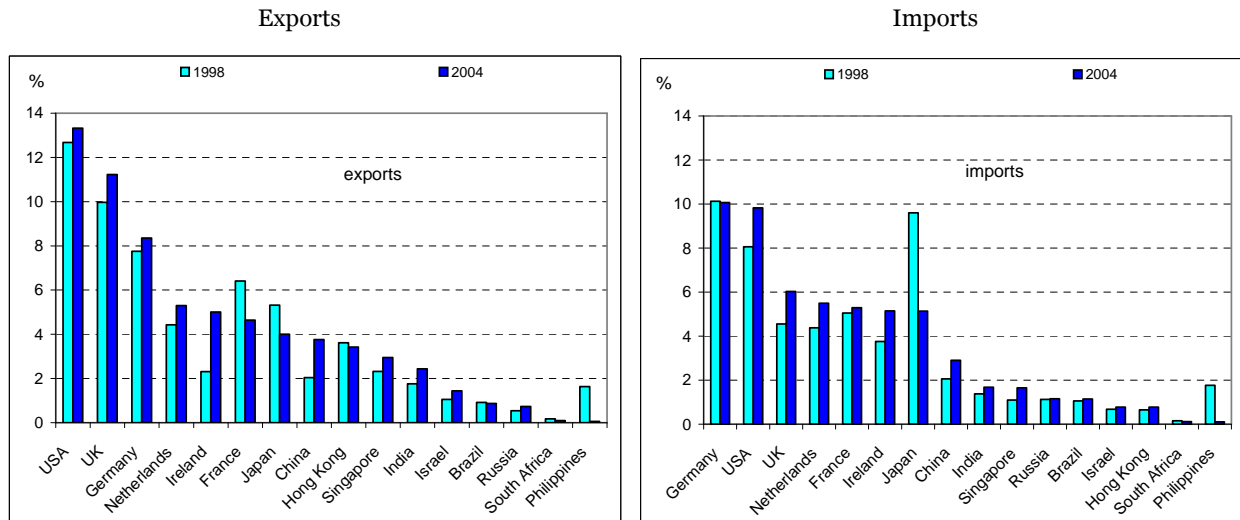
Source: van Welsum and Reif (2006), based on IMF Balance of Payments Database (March 2006).

OECD countries still account for a large share of international trade (around 80%) in business services, including computer and information services, but other countries have begun to account for a significant and increasing share of world trade in the sector (Figure 1). Indeed, firms are increasingly offshoring a range of business functions to countries with relatively lower labour costs and a talented workforce. India, some Central and Eastern European countries and more recently China are often mentioned as prime source of business services (Box 1).

Box 1. The offshoring of business services: the case of India

Due to the wage-cost advantage and the large pool of English-speaking skilled labour, India in particular has become a prime location for IT and ICT-enabled services offshoring in recent years. India's services companies have also become more globalised, establishing themselves, *inter alia*, in Central and Eastern Europe, the UK and US (OECD, 2006d). Many Indian companies are also establishing software development centres in other emerging market economies in close proximity to clients, including development centres in Central and Eastern Europe to service the Western European market and in Latin American countries to service the United States, Spain and Portugal. This geographical strategy is referred to as "near-shoring", which may help to overcome language and cultural barriers as well as certain restrictions to movement of service suppliers. The latter are of particular concern to the Indian IT industry since the global delivery model is dependent on frequent circulation of service professionals between home and client offices.

Figure 1. Share of total world trade in business services, selected economies, 1998 and 2004¹



1. Except Hong Kong (China) and India, 2003.

Note: 1998 is used in this graph to enable comparison with Hong Kong (China). Reported values are in current USD.

Source: van Welsum and Xu (2007), based on IMF Balance of Payments Database (March 2006).

Economy-wide linkages

Because of the strong forward linkages with other sectors...

The business services sector is of particular importance to the economy as a whole, as it has significant forward linkages with other sectors. The concept of forward linkages measures the inter-relationship of a given industry with the rest of the economy through the demand side. It shows what would happen to a given industry if the final demand of every other industry were to increase by one unit. Indices of forward linkages above one suggest that the sector is a “key” sector; in this case, as an important supplier of inputs to other sectors further along the value chain. In most OECD countries, the business services sector shows significantly stronger forward linkages than the average for the manufacturing sector, and these linkages are dispersed among a broad range of downstream industries (Figure 2). This is particularly true for the finance and insurance sector in OECD countries, where business services account on average for 13% of total cost.

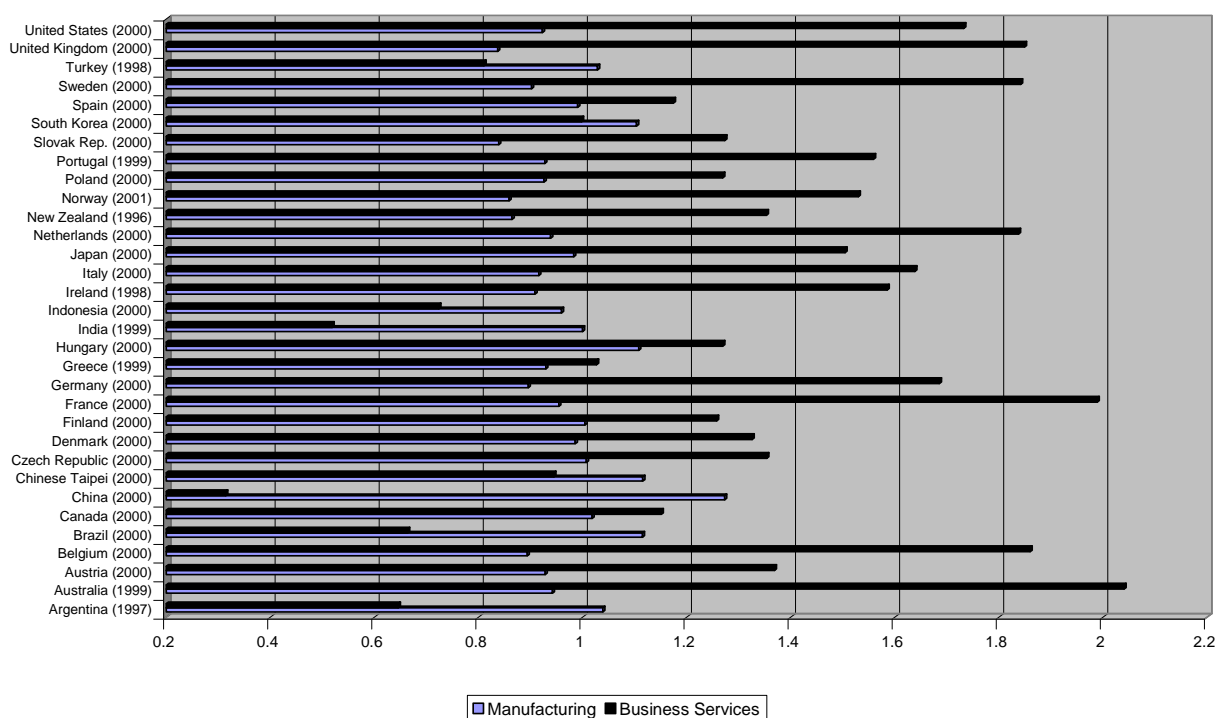
...access to an efficient business sector is essential for economy-wide productivity growth.

In theory, globalisation of the business services sector is likely to contribute further to productivity growth as it reinforces competitive pressure and increases efficiency, with firms focussing on their core competitive advantage activities and outsourcing/offshoring the rest. Furthermore, as business services often act as intermediate inputs in other sectors, increased productivity in business services resulting from a globally fragmented value chain is likely to also improve productivity in the sectors purchasing these services. Globalisation of business services also increases the range of services available and is likely to provide a better match in terms of quality and price sought; certain services may, in this way, also become available to countries and firms who could not afford to produce these services themselves.

Increased productivity thus arises from a structural change in access to an increased choice of possible inputs.

Increased global sourcing can affect a country's services productivity in various other ways. If imports compete with domestic production, efficiency gains can be achieved when the least efficient firms are driven out of the market, while competitive pressure forces remaining firms to become more efficient and innovative. Furthermore, when global sourcing allows countries, or firms, to focus on the areas where they have a competitive advantage, overall productivity is likely to increase too as more resources will be devoted to activities that achieve relatively greater gains.

Figure 2. Forward linkages



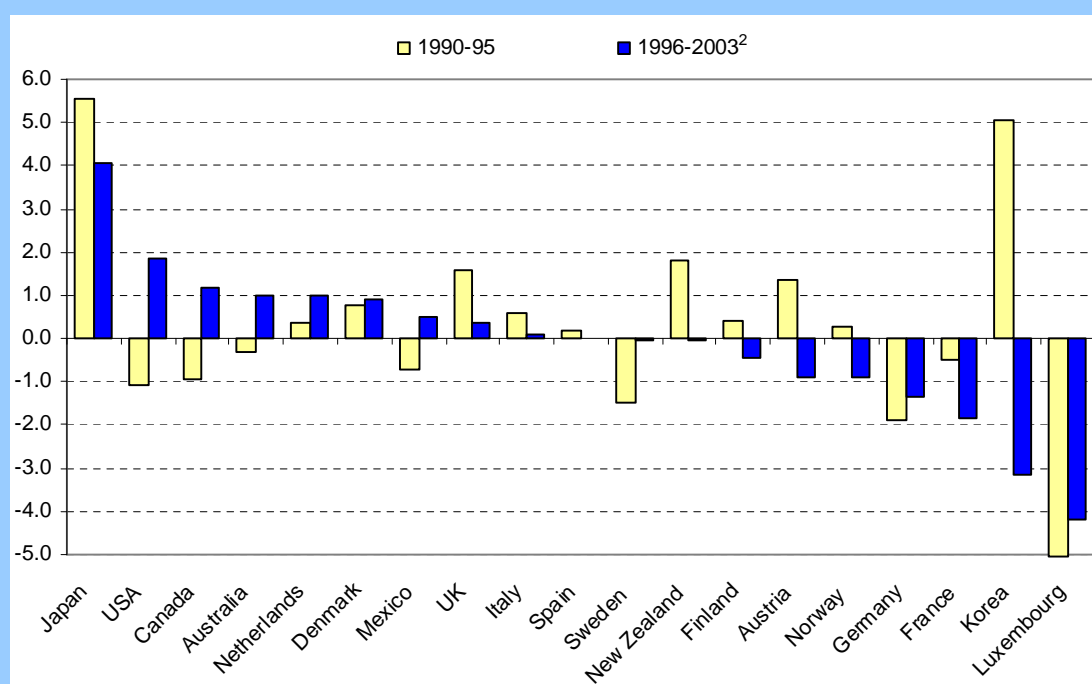
Note: Forward linkages are calculated from recent editions of the OECD input-output tables.

Despite predictions of increases in productivity in business services, and in the economy as a whole as a result of more productive business services, there is little concrete empirical evidence. In fact, often slow, stagnating or even declining productivity growth is observed in business services. It is likely that this can be in some part attributed to measurement problems (Box 2). It is also possible that there could be a significant time-lag for the productivity effects to emerge given the rapid changes in technologies and the locations of many services.

Box 2. Productivity in the business services sector: a “puzzle”

Several countries show negative productivity growth in the business service sector over long time periods. In some countries, notably the United States, Canada and Australia, negative rates of productivity growth in the first half of the 1990s have turned into positive rates of productivity growth over the more recent period. These three countries have all experienced a broad improvement in productivity growth in services over the second half of the 1990s and the business services sector played a clear role in this broader improvement.

Productivity growth in business services¹
Annual average growth in value added per person employed, percentage points



1. ISIC 71-74.

2. Or most recent year available, *i.e.* 1996-2002 for France, Germany, Norway and Sweden; 1996-2001 for Japan, Canada, Australia, Mexico, New Zealand, Korea and Luxembourg.

Source: Pilat (2007), based on OECD STAN Database, December 2005.

The official measures of productivity growth in several business services activities appear counter-intuitive, especially in the case for computer services, for example, where rapid technological progress would be expected to lead to positive rates of productivity growth. The principal reason for the lack of measured productivity growth in these business services is likely to be poor measurement. The common method for estimating real output changes in business services has been to project output growth on the basis of employment changes, or to use wages as a proxy for the deflator (Triplett and Bosworth, 2004). Both these methods are inadequate. Unfortunately, the value of knowledge, *e.g.* in the form of legal or consultancy advice, R&D, or knowledge on how to install computers, is hard to quantify. Furthermore, many business services are unique, making it difficult to develop price indices, especially as the business service sector has experienced large changes in quality and relative prices.

Despite these difficulties, some progress is being made in the measurement of outputs and prices for some of these services, *e.g.* certain legal, accounting and consultancy services, as well as computer services, architectural and advertising services (Varjonen, 2005). We hope to incorporate these advances in measurement into our analysis in the next few years.

Contrary to the macro-level data, some recent firm-level studies are starting to show the productivity impact of the increased penetration of business services. Mann (2005) computed the productivity increases of IT offshoring for the US and found that the globalisation of production of IT and ICT-enabled services resulted in lower prices for ICTs and ICT-related goods and services, and because of the high price elasticity of demand, encouraged their diffusion and use throughout the economy, enhancing productivity. Abramovsky and Griffith (2005), in a study using data for the UK, argue that the positive effects from services offshoring arise in the form of productivity gains stemming from the increased fragmentation and specialisation enabled by ICTs.⁴

Efficient business services can also help accelerate and deepen the innovation process.

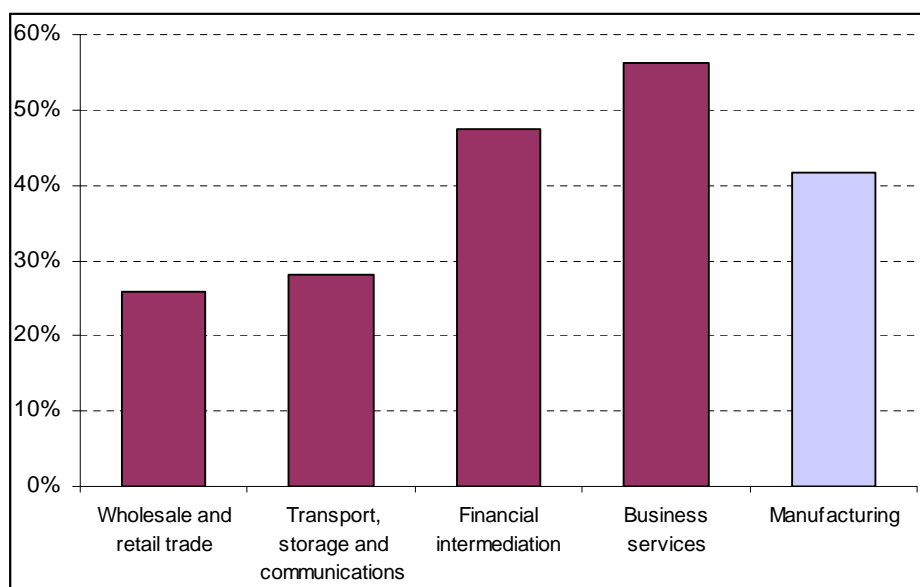
A significant amount of innovation takes place within business service firms, which tend to innovate more than firms in other sectors (Figure 3). But firms in business services can also play several “supporting” roles in the innovation process: they can be a *source* of innovation if they play a role in initiating and developing innovation activities in client organisations. Alternatively, they may be *facilitators* of innovation if they support an organisation in the innovation process, such as when the innovation does not originate from the supplier, nor is it transferred from an external organisation to the client organisation. Similarly, business service firms can be *carriers* of innovation, playing a role in transferring existing knowledge among or within organisations, industries or networks, so that it can be applied into a new context. The different roles of the business services sector depend partly on the response of the client organisation: how it engages with the supplier of the service, how it retains learning from the service, and how it manages knowledge throughout the organisation. All these features are part of the interactive nature of the service process (Box 3).

Research and development services and other business services – which include legal, advertising and recruitment services – are all fundamental for the operation of a modern business. Indeed, R&D services play an important role in the early stages of innovation, while other services such as those related to IPRs, commercialisation, marketing and production processes tend to be more important at later stages of the innovation life cycle. The role of these knowledge-intensive services in innovation depends on a number of dimensions including the nature of the organisation, characteristics of the value chain, the type of industry and the life cycle of the innovation process. What is clear however, is that innovative firms must increasingly mobilise a wide range of skills and competences (both technical and “soft” skills such as marketing), which often extend beyond their internal capabilities. As the pressure to innovate increases and the means of doing so become more complex, there is a growing tendency to outsource knowledge input for innovation.

4. Other firm-level studies confirm these findings. Amiti and Wei (2006) also find positive effects of services offshoring on US manufacturing productivity (contributing around 11% to labour productivity growth, versus only about 5% from materials offshoring). Criscuolo and Leaver (2005) also provide evidence of a positive productivity impact of services outsourcing at the plant level.

Figure 3. Average innovation density among European firms in selected industries, 2002-2004

Innovative firms as a % of firms in each sector



Note: Due to the survey design of CIS-4, business services here include NACE 72 (computer and related activities), 74.2 (architectural and engineering services) and 74.3 (technical analysis and testing). Innovative firms are those having introduced a new or significantly improved product or process.

Source: OECD based on CIS-4 data from Eurostat.

Box 3. Knowledge-intensive services activities and innovation

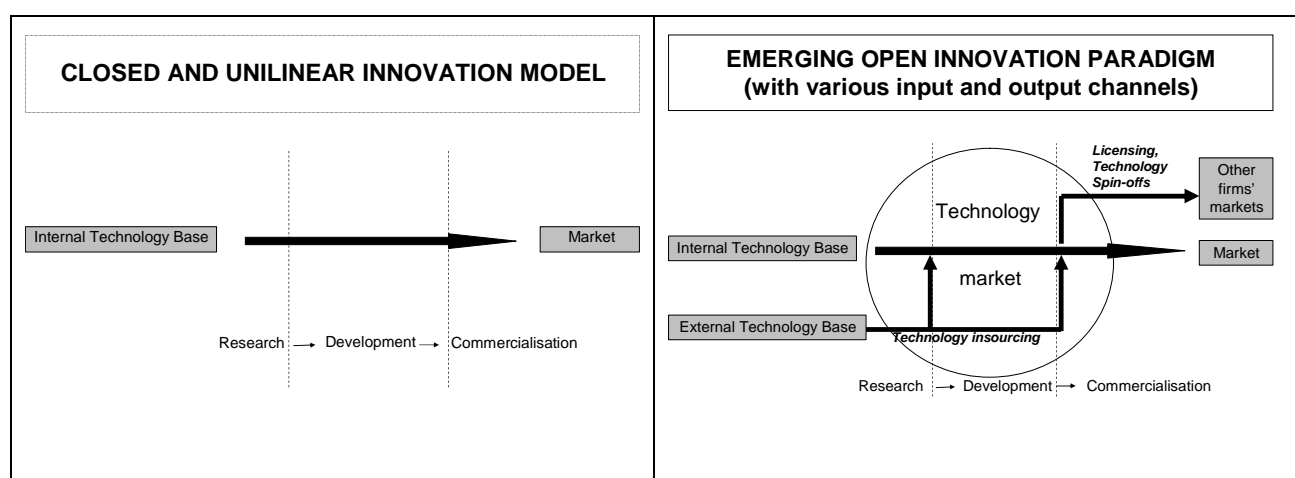
Knowledge-intensive services can affect the innovation processes in different ways. Some services, such as R&D and strategic management aim at firm renewal. Such renewal services are closely linked to innovation, but are relevant and accessible to a limited number of highly capable recipient organisations equipped with sufficient resources. Other, more routine services, such as accounting help maintain and improve existing systems and activities within organisations. Their significance for performance development is highly important for most organisations. Compliance services, such as auditing and some legal services are not obviously linked with innovation but they offer an access route to a wide range of organisations, among them the bulk of small businesses that may not make significant use of other types of knowledge-intensive service activities. By developing the quality and range of services offered through this established relationship, a large number of organisations could up-grade their innovation capacity. Network services provide an important platform for knowledge exchange within formal and informal networks. They also represent a flexible resource base for the members of the network.

Types of services and their role in innovation:

- **Renewal services:** Directly related to innovation, for instance R&D and strategic management consulting.
- **Routine services:** Contribute to improvement of maintenance and management of various subsystems within organisations, *e.g.* accounting.
- **Compliance services:** Help organisations to work within the legal framework and various other regulatory regimes, *e.g.* auditing and some legal services.
- **Network services:** Facilitate communication, knowledge exchange and flexible resource allocation, *e.g.* informal personal networks and production related networks.

This has had a significant impact on the shift of the innovation process from a closed to an open model (Figure 4). In the open innovation paradigm, firms use inflows of external knowledge with the same level of importance as internal ideas, and also seek external paths to the market through licensing or spin-offs in order to extract value from innovation which, in an earlier era, solely relied upon marketing their own products. Technology markets are growing rapidly, and outsourced R&D services are also increasing, though still relatively small compared to the intramural R&D. The purchase of advertising, marketing, and management consulting services has become comparable to total spending on scientific R&D and software in the US and UK.

Figure 4. A new innovation paradigm



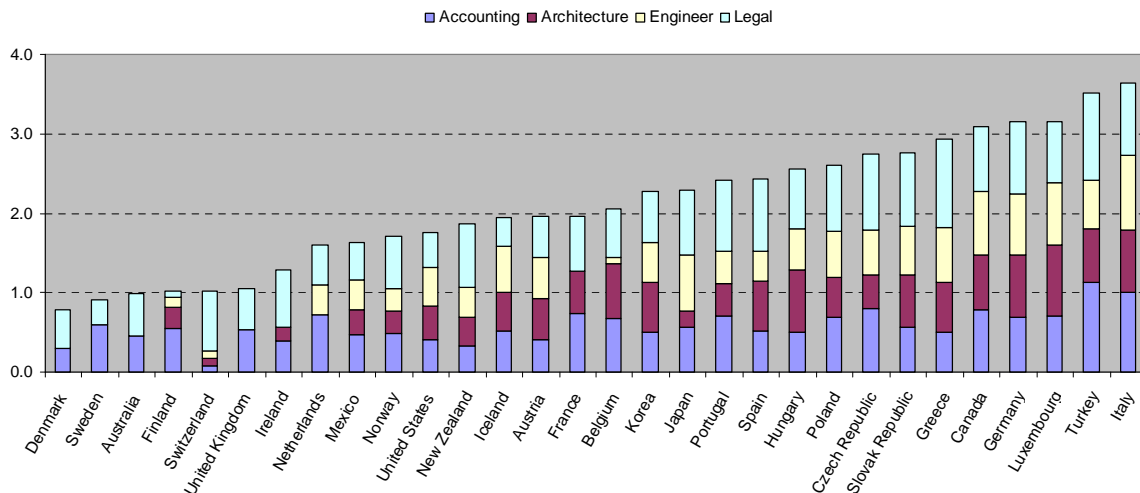
Creating a business environment favourable to enhancing the performance of the business services sector

To realise the full potential of the business service sector and maximise its positive spillovers to the rest of the economy, governments should provide an enabling environment. A recent OECD study of economies that have become successful global suppliers of business services (OECD, 2007a) shows that access to a stable ICT infrastructure and a highly educated and language-proficient workforce is essential in order to access foreign markets. Efficient infrastructure, simplified administrative procedures and reasonable regulatory burdens are also important factors. Last but not least, liberal rules for trade and foreign direct investment (FDI) are instrumental in allowing foreign firms to establish service centres. This has over time generated substantial transfers of technology and management practices.

The regulatory framework should not be overly restrictive...

On the regulatory front, the restrictiveness of the framework affecting knowledge-intensive business services varies considerably among OECD countries (Figure 5). Regulation of professional services is often designed to address a perceived market failure related to information asymmetries between services providers and their clients concerning the quality of services rendered. For instance, qualification-related entry rules of professionals can provide a minimum assurance to clients about the competence of services providers and thus may be legitimate and even efficient. On the other hand, restrictions on competitive prices, restraints on truthful advertising, relationships with other kinds of businesses, as well as limitation on foreign participation on grounds of nationality, do not explicitly address the issue of quality. Instead, they are more often associated with higher prices and less innovation.

Figure 5. Regulations in professional services, 2003

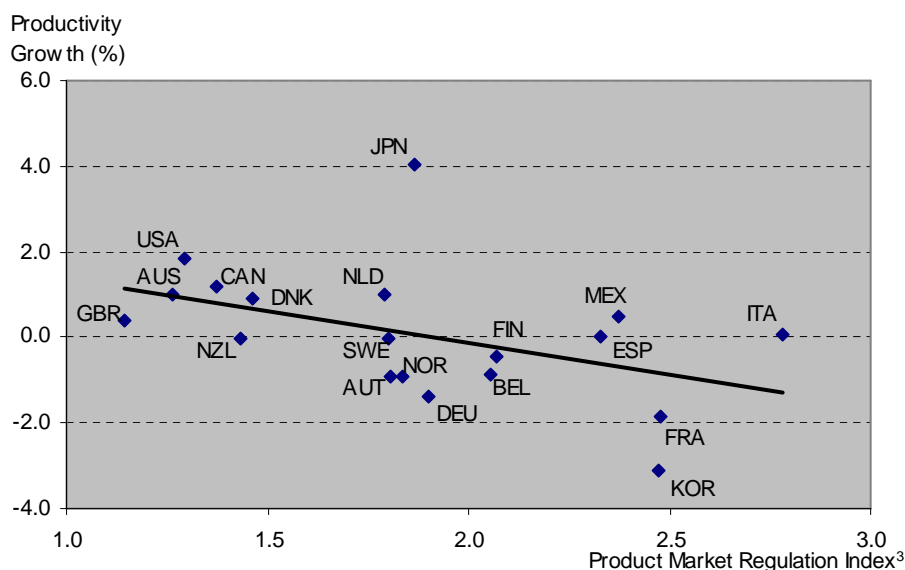


Note: Index 0-6 scale from least to most restrictive.

Source: OECD Product Market Regulation Database.

The fact that the stringency of regulation varies significantly across OECD countries suggests that more often than not, entry in professions is far more restricted than is needed for client protection or market integrity. Excessive regulation may be affecting the efficiency of the business services sector and thus of the economy as a whole. Indeed, evidence shows a negative correlation between stringent product market regulations and business services productivity growth (Figure 6). Evidence from detailed data on European professional services also suggests that stringent entry and conduct rules are associated with a relatively low number of professionals. Higher output per professional and most dynamic growth and market consolidation have been found in less-regulated countries. On the other hand, there is no clear evidence of market breakdown in less regulated countries vis-à-vis highly regulated countries. It implies that regulation could be streamlined without jeopardising service quality at least to the level of their peers in other countries (Box 4).

Figure 6. Product market regulations and productivity growth in business services sector¹, 1996-2003²



1. ISIC 71-74.

2. Or most recent year available, *i.e.* 1996-2002 for France, Germany, Norway and Sweden, 1996-2001 for Japan, Canada, Australia, Mexico, New Zealand, and Korea.

3. Index 0-6 scale from least to most restrictive, 1998.

Sources: Calculated by the Directorate for Science, Technology and Industry (STI) on the basis of OECD Product Market Regulation database and OECD STAN database.

Box 4. Regulating professional services: best practices

Regulation of professional services is often designed to address a perceived market failure related to information asymmetries between service providers and their clients concerning the quality of services rendered. Regulation should address this market failure as directly as possible and with means which restrict competition least. Principles for high-quality regulation of professional services include:

- Exclusive rights should not be granted where other mechanisms exist to address market failure directly and/or with less restriction on competition.
- Entrance requirements into a profession should not be disproportionate to what is required to perform the service competently.
- Regulation should focus on the need to protect small consumers. Sophisticated commercial purchasers of professional services are in a better position to assess their own needs and to assess the quality of the services they purchase and should not necessarily be required to use the services of a licensed professional.
- Restrictions on competition between members of a profession should be eliminated. These include agreements to restrict price, to divide markets, to raise entrance requirements, or to limit truthful advertising. Citizenship and residence requirement should be eliminated.
- Professional associations should not be granted exclusive jurisdiction and be subject to independent scrutiny in making decisions about entrance requirements, mutual recognition, or the boundary of their exclusive rights.
- Competition between professional associations should be encouraged.

Source: OECD (2002a).

...especially concerning digital delivery of business services.

Earlier studies identified regulatory barriers as a relatively minor impediments to digital delivery of business services, in comparison to such barriers as cost of technology, suitability of the service for digital delivery or shortage of skilled human resources. For the first decade of its existence, governments have encouraged the development of the Internet largely through a “hands-off” approach to allow maximum space for experimentation and innovation. “However, as the Internet becomes a key part of the economic, cultural and social infrastructure”, there is an increasing concern that the earlier laissez-faire approach “needs to be assessed in terms both of current policy goals and of the traditional role of governments with respect to shared resources of major significance.” (OECD, 2007b)

It is possible that, primarily in the context to business-to-consumer and government-to-citizen transactions, there will be stronger and more broad-based calls to revisit the current hands-off approach and consider various forms of re-regulation or more effective self-regulation in business transaction taking place in the digital environment. Looking ahead, it will be important for governments to review carefully the implications of such moves for innovation in business-to-business activities, in particular in business services, to ensure a regulatory framework that encourages innovation.

The appropriateness of labour market regulation is also critical.

Labour market regulation can have an impact on firms and other organisations (such as research labs) when they need to arbitrate between in-house production and outsourcing. This might include such things as the use of non-standard employment practices to enable the use of short-term contract and agency staffing – which would have an obvious and immediate impact on recruitment and labour supply services, and facilitate other services outsourcing and contracting. This observation applies equally to all business services, regardless of the degree of ICT-enabling, although digital delivery widens the feasibility of outsourcing considerably.

Widely-agreed common standards can be beneficial.

The issue of standards is of particular relevance in the business services sector (Box 5). Widely-accepted and balanced standards increase market transparency and competition, by facilitating switching between suppliers. Harmonised standards across countries also reduce trade barriers, which tend to be inherently higher in most service sectors compared to the cross-border exchange of goods. Finally, standards can benefit service providers by enabling them to focus on the internal process of services production and obtain economies of scale.

Box 5. Standardisation of business services

There are three broad types of standardisation of business services:

- Standardisation of the service output, which concerns the output itself, product-specific processes and the means of delivery. While standardisation of the service-providing process might be possible with quality management standards, measurement of service quality might be difficult where clients are intensively involved in service production.
- Standardisation of the performance capacity, which relates to the quality measurement of organisational and managerial capacity, financial soundness, and human resources. It may also include firm-specific general process of services production. Here we would find common elements with traditional standard frameworks developed for other sectors.
- Standardisation of the communication/interface, which includes issues related to the communication between a service provider and its clients, as well as its suppliers, which might include semantics, syntax, protocols, specification of ICT in use, code of conduct and approachability. Inter-operable and compatible standards are often recommended as a means to increase competition and market efficiency.

There are potential costs to standardisation, as they may discourage innovation, reduce variety of services and hamper flexibility in meeting new demands from clients. Standardisation can nonetheless be useful in seizing the full potential of business services. Since governments do not have the first-hand experience or technological foresight to pre-select standards in fast-moving areas, initial market experimentation is likely to be necessary to develop best approaches. Government and standards organisations, however, can provide frameworks for co-operation and can encourage business service firms, their clients and experts to work together to develop voluntary standards.

IPR regimes should be effective and favour access to knowledge.

Intellectual property rights are of growing importance in business services sector. Software and R&D services have intellectual property at the core of their service output and internal assets. While other business services firms typically rely more on secrecy and lead time to protect their competitive advantage, IPR could become more important as patent protection has been extended to service-related inventions, such as software and business methods. The scope of IPR protection has increased and higher damages have been awarded by courts to IPR holders.

At the same time, the innovation process itself has become more open; ideas and knowledge for innovation are now drawn from many, often global sources, linkages and co-operation are of growing importance for successful innovation, and key sources of knowledge are in the public domain. Concerns are being raised on whether the current system of IPR rules and practices achieve the right balance between stimulating innovation and providing wider access to knowledge, or if in certain cases the control with which IPR owners are endowed could hamper competition, fair use and the diffusion of technology. Complementing the IPR rules with practices, tools and networks that provide increased access to knowledge and enable more open forms of innovation may offer a way forward.

The reporting of intellectual assets can improve resource allocation.

Business services providers depend heavily on investment in intangibles, such as training, customer relationship management, brand image, internal organisation, investment in software and ICT. Reliable information about the intangible assets of companies is needed to avoid inefficient resource allocation and facilitate innovation in the business services sector.

Small listed intellectual assets-intensive companies, which predominate in this sector, face a particular challenge, as typically their coverage by financial analysts is poor. The lack of research coverage has been found to have a negative impact on company valuation, liquidity and ultimately the growth of the company. Small listed companies can mitigate the problem of poor analyst coverage by taking a proactive stance in their corporate reporting. The existence of special segments of stock markets might also improve the relationship between investors and the companies and thereby underpin valuations, innovation and growth.

Intellectual assets reporting is a useful managerial tool for business service companies. A feature of intellectual assets-intensive companies is that they incur specific operational and business risks and this can have a major impact on the value of companies concerned and therefore information about their intellectual assets needs to be disclosed. These companies face heightened risks as innovation cycles are variable and incur substantial investment costs. The risks must be identified and assessed, then managed and mitigated by the implementation of a strong internal control system. Intellectual assets reporting frameworks could be further developed to encourage consideration of implementing stronger internal control systems, based around existing standards.

Concluding remarks

The significance of the business services sector goes beyond its large and growing share of GDP, as it has strong linkages with most other sectors of the economy and is essential for the emergence of a new innovation paradigm. Access to an efficient business services sector is especially important for those sectors which are facing the double challenge of globalisation and the need to innovate in an increasingly knowledge-intensive economy. As such, liberalisation efforts in the business services sector should be a priority for policy makers. It is essential that remaining barriers to international trade and investment be removed and that the regulatory framework be made more efficient, with the removal of unnecessarily restrictive regulations, especially for professional services. IPR regimes that balance incentives to innovate with concerns about knowledge diffusion, and an efficient system for reporting intellectual assets are also essential for the development of the business services sector.

This study follows on the footsteps of a significant body of work done at the OECD, which identified many policy areas of significant bearing on the efficiency of the business services sector. This includes, *inter alia*, issues related to the performance of labour markets, to education and training policies, and to measures to promote innovation and spread the benefits of ICT. The fact that these areas were not covered explicitly in this study does not mean to imply a judgement on their importance within a coherent strategy to increase the efficiency of the business services sector.

Looking ahead, further work is warranted to improve the basis for policy discussion in this area. Data issues are of essence, as statistics in the sector are still patchy. Further analysis of the role of intellectual assets in value creation would be particularly useful for our understanding of a sector like business services, where intangibles are often among the most valuable assets of firms. Finally, work on global value chains should contribute to the policy debate by clarifying what is at stake in the ongoing liberalisation efforts in the sector.

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