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Offshoring and U.S. Small Manufacturers

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Background

Small manufacturers are critical to the health and dynamism of U.S. manufacturing. In 2003, manufacturers with fewer than 500 employees accounted for 99 percent of all manufacturing firms and for 43 percent of all manufacturing jobs. Small manufacturers play key roles in value-chains as suppliers to larger companies, and are often the source of many product and process innovations. (For example, small firms produce 13 to 14 times more patents per employee than larger firms.) Among the many issues affecting small manufacturers, the outsourcing of manufacturing processes overseas has been one of the most widely debated, yet little researched. This paper represents a preliminary attempt at examining the role that small firms play in manufacturing and how they have been affected by trends in outsourcing of production activities.

While there are no generally accepted definitions, outsourcing refers broadly to a company's procurement of goods or services that it used to produce internally, from outside the firm. While often used interchangeably, the related term "offshoring" refers to a company's movement of such procurement to a foreign country either within or outside the firm. Offshoring is not a new phenomenon. In fact, a large fraction of the growth in world trade since the 1970s has taken the form of trade in intermediate inputs in general, and offshore outsourcing in particular. At the same time, the flip side of offshoring—the "insourcing" of activities to the United States from foreign companies—has also been increasing. Thus, it is fair to say that upon closer examination, the increasing complexity of world trade has led to a significant shift in production across industries and across the globe. This paper seeks to analyze how these trends have affected small business in the United States.

At present, little is known about the effects of outsourcing, insourcing, or offshoring on small business, or for that matter, what role small firms play in the phenomenon. This study employs two methodologies to address the issue of small business manufacturing in offshoring. First, an empirical investigation of the impact of offshoring on the performance of small manufacturers employs data on import and export activities and employment. Second, three industry case studies provide a closer and more qualitative look at how varied the impacts of offshoring can be across different industries.

Overall Findings

Offshoring, outsourcing, and insourcing do not follow any constant pattern across small firms, but rather vary greatly by industry, just as with larger firms. Results of empirical tests of changes in small firm employment do not yield significant results with respect to the effects of outsourcing, offshoring, or insourcing. The preliminary results in this paper should not be taken as the final word on how changes in the alignment of global production capacity have affected small American businesses. It would be more accurate to say that these results show that there is no simple answer to this difficult puzzle. Importantly this paper can at least lay to rest any claim that globalization is either universally detrimental or beneficial to small firms. It appears that a more accurate statement would be that both large and small firms located in the United States have benefited and suffered from outsourcing. The case studies in the second part of the paper drive home this fact.

Highlights

- While there was great variance in offshoring activity across small business industries, overall offshoring activity grew at a greater rate in the 1990–1997 period than in the 1998–2003 period.
- For the 1998–2003 period (the only one for which data was available), offshoring was seen as a strategic decision and not a general phenomenon. The authors determined this by noting that there was no correlation between an industry offshoring production of its product with the decisions of other industries to offshore supply of that same product as an input.
- The case studies highlight that the variance in impacts across firms and even firm size is significant with respect to outsourcing, offshoring, and insourcing. No clear patterns could be identified based on either industry or the fact that a firm was small.

Scope and Methodology

The first section of the paper presents empirical results from looking at changes in small business employment in key manufacturing sectors within two time periods, 1990–1997 (using SIC codes for industry identification) and 1998–2003 (using NAICS codes for industry identification). The regression analysis relates changes in the location of production capacity to employment in small firms. The second part of the paper is a case study of three industries: apparel, auto parts, and semiconductors. These industries are not meant to be representative of a larger cross-section of small firms, but rather serve as simple illustrative examples of how outsourcing affects different industries in vastly different ways.

This report was peer reviewed consistent with the Office of Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at *advocacy@sba.gov* or (202) 205-6533.

Ordering Information

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