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# Consulting, engineering and other business services

## Internationalisation of business services

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The last twenty-five years have been a time of deep structural change in developed economies. Three far-reaching trends have set the pace: first, progressive transition of post-Industrial Revolution societies to service and later increasingly knowledge-based societies; second, the deployment of a new globalisation wave in these economies; and finally, affecting and accelerating the other two trends, the emergence and rapid spread of new Information and Communication Technologies.



## Towards a new tertiarisation

There is no doubt that the 20th century was a long period characterised by deep change at the economic base of the most advanced societies. During that century, the structural change pattern in the most developed economies was characterised by steady growth of service to the detriment of agriculture and, from the 1960s and 1970s onwards, of what is usually called industrial activities.<sup>1</sup>

However, the tertiarisation process of industrial economies seems to have accelerated in the last three decades in terms of both employment growth and the contribution of this branch to gross added value (GAV) of economies. Besides the acceleration of this process, the nature of tertiarisation itself also seems to have changed.

### The tertiarisation process of industrial economies seems to have accelerated in the last three decades in terms of both employment growth and the contribution of this branch to gross added value.

First, service has played (and still plays) a crucial role in the transition of advanced economies to knowledge-based economies. In this respect, there is evidence that the service sector is the one contributing most to knowledge-intensive job creation, particularly activities encompassing most of business services.

Also, expansion of certain service activities has been the decisive factor in bringing about the two great moments in globalisation of modern economies.

The first globalisation wave in the late 19th century was facilitated by the technological revolution in transport (railway, steam ships and

later automobile and other means of transport based on the internal combustion engine) and to a lesser extent by the development of communications (first telegraph, later telephone).

In the second globalisation wave of market economies in the late 20th century, information and communication technologies (ICT) and services created and developed around them played a very important role.

As Lasuén<sup>2</sup> points out, the world's big economic areas – the United States and the European Union – were already service economies before the start of the second globalisation. This last globalisation phenomenon has been an internationalisation process of service markets rather than goods markets.

The main vectors of this globalisation are today professional and technical services (IT, financial, telecommunication expertise), knowledge-based services (R&D, knowledge-intensive business services, cultural and leisure services) and of course tourism.

### The second globalisation wave of market economies, in the late 20th century, has been an internationalisation process of service markets rather than goods markets.

Fruitful complementarity between knowledge-intensive (scientific, technological and organisational) activity in both industrial and many service sectors and ICT has unleashed very diverse and relevant effects on developed economies: progressive internationalisation of production processes and their impact on the organisation of companies, deep change in the nature and dynamics of markets and the strategy of companies, and growing interrelation between manufacturing and services within the company and the value chain of products as well as in their economic and technological interdependencies.

## Globalisation and business services

It is commonly accepted that the degree of internationalisation of the service sector (including business services) is quite poor.

As opposed to the manufacturing sector that often operates in global markets, most tertiary business had until recently markets of mainly national or even only local and regional scope. Yet this is only partly true.

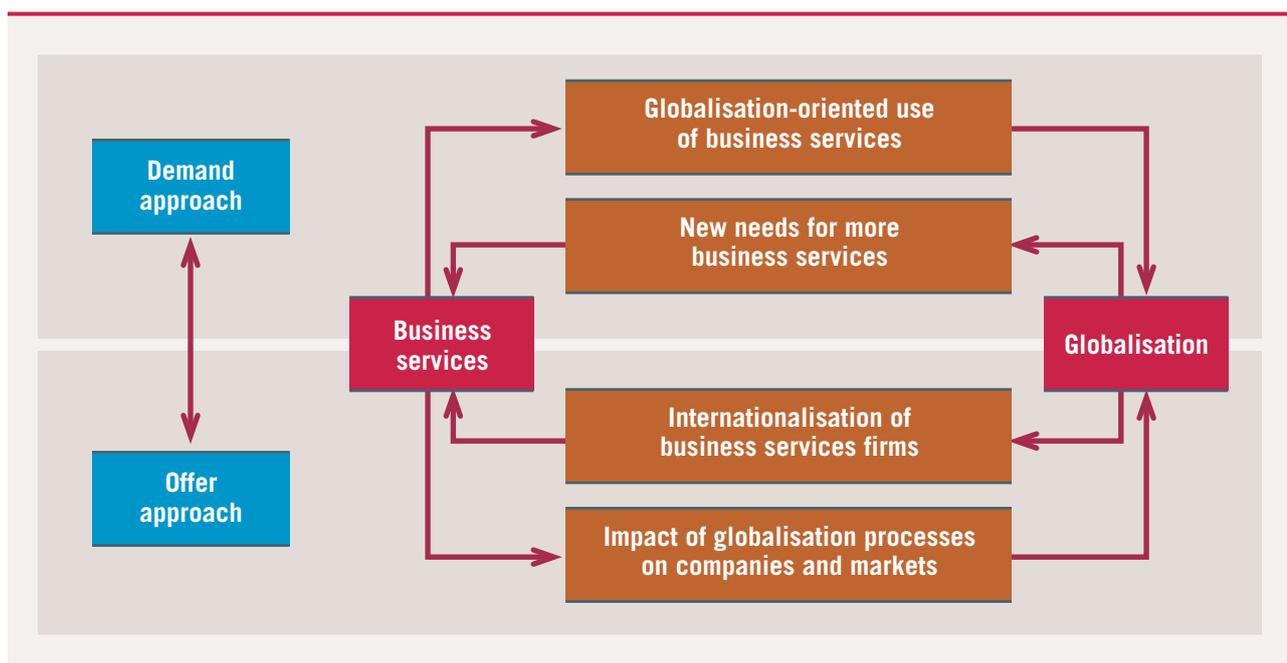
### A substantial and growing part of business service contributes to globalising customer firms.

As has been said before, services – and very especially business services – lie at the heart of the current economic globalisation wave (graph 1). Any modern firm of a given size is currently not competitive enough in the global

economy if it has not any support from a wide and sufficiently diversified base of advanced business services helping it to increase the variety and quality of its products and production processes and advising it in its internationalisation strategy and marketing.

Generally speaking, a substantial and growing part of business service is decisively based on globalising their customer firms through access to appropriate financing, human capital or skill sources and global knowledge management. They are also coached in their penetration of new markets, helping them to adapt globally conceived products to satisfy local needs or create new ones and assisting them in creating some reputation assets that are consistent enough to operate in foreign markets or by accordingly assimilated specific values of their new customer base. As Rubalcaba & Van Welsum<sup>3</sup> state, service provision to companies is determining in satisfying needs and opportunities of customer firms based on globalisation

**Graph 1. Relations between business services and globalisation**



Source: L. Rubalcaba (2007).

▲ Services lie at the heart of the current economic globalisation wave.

requirements, especially in relation with the global use of inputs required for adequate internationalisation of business activity and access to global product markets (chart 1).

The main contribution of business services to competitiveness of their customer firms in their international orientation lies essentially in the ability of these activities, together with their customers, in distinguishing what shall be global from what shall remain local. By doing this function, business services contribute to market integration at international level out of local diversity. In fact, this justifies the existence of many business services.

Business services are thus very important stakeholders in the current globalisation process. They are a relevant part of international service flows that contributed to transition from a simpler international economy –in which transactions were done between countries mainly on a cross-border basis– to a much more complex global economy –in which most inbound and outbound transactions are obtained and distributed around the world and many companies become global, with management also being international– where multilateral activities become increasingly important.<sup>4</sup>

### Chart 1. Relevance of services to companies in the globalisation process: their role in satisfying global needs

Needs of and opportunities for companies out of globalisation	
<b>Global use of inputs</b>	<ul style="list-style-type: none"> <li>▶ Global access to capital and production of doubly competitive technical innovation. (Financial services, technical and engineering services, technical and quality control service, research and development service [under contract], design)</li> <li>▶ Global access to the labour factor and use of new global skills in local markets. (Workforce selection and recruitment services, headhunting, vocational training, redeployment, temporary work)</li> <li>▶ Access to and management of global knowledge. (IT and information services, internet and intranet services, IT and knowledge management consulting)</li> <li>▶ Outsourcing and offshoring to lower-cost countries. (Information and communication services, auditing and accounting, operative services with low knowledge intensity, call centres)</li> <li>▶ Transport and communications between different locations. (Logistic and transport services, communication services)</li> </ul>
<b>Global product</b>	<ul style="list-style-type: none"> <li>▶ Access to new markets. (Management consulting, market prospection, export aid, trade fairs and exhibitions, legal services)</li> <li>▶ Adaptation of global products to local needs and the creation of new ones. (Advertising and direct marketing services, public relations and press offices, market research, commercial distribution services, internet-related services: B2B, B2C, websites)</li> <li>▶ Global reputation. (Commercial brands and corporate image, communication services, environmental services)</li> </ul>

By contributing to economic globalisation, service firms, especially those providing business services, also state their international orientation, albeit following quite a different pattern from manufacturing companies.

There is a set of circumstances that encouraged this process of service globalisation in the last two decades.

First, rapid technological progress in recent times, especially in areas of transport, IT and telecommunications (with the extraordinary dissemination of the internet and still incipient development of e-commerce), has allowed companies to have access to increasingly distant financial, commercial and information and knowledge resources and cater for farther and larger markets. However, unlike tangible goods, most services cannot be commercialised internationally by means of cross-border transactions. Many services need to be provided in the same place at the same time as they are consumed, so the main way of bringing these services to foreign markets is by establishing subsidiaries or any other sort of permanent commercial presence at the destination.

Secondly, liberalisation policies in many service activities and elimination of regulatory obstacles that hampered this business were initiated by most developed countries in the early 1990s. As is shown below, this has triggered strong growth of international service exchange in the shape of cross-border transactions (and service consumption in countries offering them) and especially foreign investment. This has been joined by the effect of intensive privatisation processes that affected heavily the public services sector in many countries in the last twenty years.

Finally, improvement in transport and communications and reduction of their cost as well as increasing relevance of transnational companies has facilitated cross-border movement of persons, either as independent service providers or as employees of service companies.

## Commercial flows and direct investment flows

An exponent of increasing internationalisation of services, particularly business services, is not growing evolution – though not as high as the relevance of the tertiary sector in the overall economy – of related commercial transactions but a strong increase in foreign direct investment flows into business services.

### Increasing internationalisation of services is due to a strong increase in foreign direct investment flows into business services.

It needs to be said that the trend in the evolution of foreign direct investment (FDI) at a global scale in the last decades has mostly gone into services. According to data from the United Nations Conference on Trade and Development (UNCTAD), the tertiary sector concentrated a quarter of cumulated global FDI in the early 1970s. By the early 1990s this figure had increased to almost half the total FDI, and by the middle of the current decade it was higher than 60%. In the same period, the share of manufacturing and the primary sector in cumulated global FDI had decreased significantly (8 and 3 percentage points respectively).

These results show that the globalisation pattern in services shows different features from the industry and agriculture. In the tertiary sector, the main way to internationalisation is permanent commercial presence in the area where service companies intend to do their business. Yet the relevance of cross-border trade is much lower in relative terms. Of course, this internationalisation pattern is under considerable influence of how services are provided, which demands presence of both service providers and users.

Beneficiary business of FDI flows into the tertiary sector have also changed in recent times.

Until fairly recently, such investment concentrated on trade and finance, which still took 47% of total cumulated FDI in services in 2004 (compared to 65% in 1990). Nevertheless, it was telecommunications, power, gas and water as well as business services where FDI doubled its rate in recent times, growing from 13% in 1990 to 26% in 2004. The box below provides some recent data on these commercial and foreign direct investment flows related to business services in Catalonia.

Beyond the impact of the very size of the tertiary sector, all this change is due to two main circumstances: a shift in the internationalisation pattern of these services aimed at companies and diversification of internationalisation modes within this business area.

FDI in the services sector used to be done by (mainly industrial) companies to support or add to their manufacturing activity abroad or commercialisation of their products. It was a

## Commercial transactions abroad and foreign direct investment flows in Catalonia

Chart A shows the rate of sales abroad by big business sectors in Catalonia during the 1987-2005 period according to data from input-output charts. It can be stated that in both years, the percentage of sales abroad in business services is considerably lower than the relevance of this sector in Catalonia.

However, it can be observed that the ratio increased significantly in that period (from 1.7% in 1987 to 7.0% in 2005), and so did sales to the rest of Spain and the rest of the world.

### Chart A. Distribution of sales abroad

*By big business sectors in Catalonia and within the business services sector, 1987 and 2005*

	1987			2005		
	Rest of Spain	Rest of the world	Total sales abroad	Rest of Spain	Rest of the world	Total sales abroad
Agriculture	1.3%	2.8%	1.7%	0.6%	1.4%	0.9%
Manufacturing and extraction industry	83.4%	88.4%	84.6%	69.2%	75.3%	71.8%
Building	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Production services	14.7%	8.8%	13.2%	28.5%	22.7%	26.0%
Business services	2.1%	0.3%	1.7%	7.3%	6.5%	7.0%
Consumption services	0.6%	0.0%	0.4%	1.8%	0.6%	1.3%
<b>Total economy</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: own, based on *Cambra Oficial de Comerç, Indústria i Navegació & Departament de Comerç, Consum i Turisme (1992): Taula input-output de Catalunya, 198*; *Institut d'Estadística de Catalunya (2009): Marc input-output de l'economia catalana, 2005*.

Chart B allows to visualise the percentage spread of foreign investment in Catalonia by big beneficiary sectors (among which business services). It can be stated that for the three analysed periods (1993-1997, 1998-2002 and 2003-2008) the proportion of foreign direct investment in business services grew progressively, from 6.8% to 8.9% of total investment.

### Chart B. Percentage distribution of foreign direct investment in Catalonia

By big economic sectors and within the business services sector

Percentage as of total	1993-1997	1998-2002	2003-2008
Agriculture	0.6%	0.5%	0.4%
Manufacturing and extraction industry	48.0%	33.0%	38.0%
Building	3.7%	4.1%	5.0%
Production services	40.9%	54.0%	47.7%
Business services	4.3%	6.3%	9.6%
Consumption services	6.8%	8.4%	8.9%
<b>Total</b>	<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>

Source: own, based on Dirección General de Comercio e Inversiones, Ministerio de Industria, Turismo y Comercio (2010).

However, as is shown on chart C (a) and (b) in detail, although Catalan investment abroad in business services increased in absolute terms during these three periods, it decreased in relative terms as of total investment done, from 8.0% to 1.6%.

### Chart C. Direct Catalan investment abroad

By big beneficiary sector and in the business services sector

(a) Absolute figures (thousands €)	1993-1997	1998-2002	2003-2008
Agriculture	753	44,791	4,224
Manufacturing and extraction industry	984,603	6,962,911	13,771,508
Building	69,261	136,648	943,539
Production services	1,291,657	9,330,761	15,814,883
Business services	197,085	418,069	506,608
Consumption services	119,831	925,706	1,524,655
<b>Total</b>	<b>2,466,105</b>	<b>17,400,817</b>	<b>32,058,809</b>

(b) Percentage as of total	1993-1997	1998-2002	2003-2008
Agriculture	0.0%	0.3%	0.0%
Manufacturing and extraction industry	39.9%	40.0%	43.0%
Building	2.8%	0.8%	2.9%
Production services	52.4%	53.6%	49.3%
Business services	8.0%	2.4%	1.6%
Consumption services	4.9%	5.3%	4.8%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

«follow-up» investment to facilitate penetration of manufactured products in new foreign markets. This direct investment concentrated thus on finance, insurance or transport. Although this pattern guiding FDI in the tertiary sector is still valid, there are quite clear indications that it is clearly changing. Foreign investment in service activities aimed at companies is now coming increasingly from service providers who do not intend to secure financial or commercial smoothness of other – mainly manufacturing – transactions but to directly supply new markets for their services and reinforce their own competitive advantage, often building or consolidating a brand or reputation at international level. Strong FDI increase in business services in the last decade lives up to this new internationalisation pattern.

**Foreign investment in service activities aimed at companies is coming from the same service providers intending to directly supply new markets for their services and reinforce their own competitive advantage, often building or consolidating a brand or reputation at international level.**

Diversification of the ways to internationalisation of service activities is another manifestation of this pattern shift. FDI in business services has gone progressively different ways.

First, there was a strong increase in cross-border mergers and acquisitions (CBMA) from the early 1990s, within which services have been the dominating sector. Services amounted to roughly 40% of CBMA in the late 1980s, whereas one decade later the rate had increased to over 60%. This has been a common way followed by transnational companies to enter a foreign market. However, CBMA have been more frequent in telecommunications and power, gas and water production and distribution.

Another way to internationalisation of service companies are arrangements not providing for any sort of shareholding such as franchises, management contracts or cooperation agreements. This agreement mode is appropriate for many service activities the competitive advantage of which is based on soft technologies, especially intangible knowledge-based assets rather than tangible assets and hard technologies. Transfer of this knowledge and skills can be sufficiently covered by agreements that do not require any shareholding. This sort of investment is frequent in the hotel and restaurant business, retailing, car rental and most business services (auditing, legal services and other professional services).

Finally, though still incipient, there is also development of integrated production systems at international level within the service sector. In spite of growth and progressive domination of FDI in services, these activities are still at a lower transnationalisation level than manufacturing.<sup>5</sup>

However, there are indications that international service production is developing into a similar direction as international production of goods. In the case of the United States, the import rate within one same company as compared to overall imports of other private services increased from 30% in 1986 to 49% in 2005. This seems to show growing dissemination of integrated production strategies even within the business services branch, a pattern going in parallel to the increase of the number of transnational companies in this sector.

## Conclusions

The business services sector has been the branch with the highest ongoing growth in the developed economies in the last 25 years. This is most probably one of the clearest signs of structural change occurred in these economies during this period, which can be termed as «new tertiarisation». The relatively low rate of commercial exchange abroad and foreign direct

investment, although to a lesser extent, in this sector fed the assumption that these were activities hardly prone to internationalisation. Most recent theoretical reflection and empirical evidence seem however to challenge this belief.

**Though still incipient, there is also development of integrated production systems at international level within the service sector.**

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## Notes

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5. The transnationalisation index is measured based on the rate of foreign subsidiaries in the added value, sales or employment in countries of destination. According to US data, transnational service companies have overall a transnationalisation rate close to 20%, much less than in manufacturing (ca. 40%).