

**ASTRALIAN
PROFESSIONAL
BUSINESS SERVICES:
IMPLICATIONS OF
GROWTH**

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AUSTRALIAN PROFESSIONAL BUSINESS SERVICES: IMPLICATIONS OF GROWTH

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Abstract

It seems to be commonly assumed that the growth of the professional services industries, here broadly defined as including both the Finance and Insurance sector and the Property and Business Services sector, has been grown largely as a result of outsourcing, particularly from manufacturing. The authors briefly explore this question using input-output data for a number of OECD countries, focusing on Australia to address the issue of changing sectoral use patterns of professional services. The implications of the findings are presented within an institutional framework that notes the historical bias against business service sectors.

The Australian business services sector

In the financial year 2000-2001 (ABS 2002) the Property and business services sector¹ of the Australian economy surpassed manufacturing, for the first time to become its largest recognised component² of value added. This received no obvious commentary³. The business services sector, despite its scale and growth, remains largely ignored by economists, academics and government. There are more than adequate institutional explanations as to why a rapidly developing area may not initially receive the attention it receives (Meyer and Rowan 1977; Zucker 1977; 1983, DiMaggio and Powell 1983; Meyer, Scott and Deal 1983; Tolbert and Zucker 1983). Saxenian (1985) observed these phenomena as Silicon Valley developed, and most famously Machiavelli (1992, p13) warned that the changes wrought by innovation encourages very few friends but many enemies. Later political economists, such as Putnam (1993) observe that institutionalised ways of going on (Giddens 1983) make it very difficult for economies to shift to new routines, even when the advantages may seem abundantly clear. Perhaps more to our point was the equally famous observation by Schumpeter (1975 pp 82-85) that early adopters of innovation reap super profits, until laggards realise they must disinvest and invest anew.

Australian institutions and industry policies are historically based around industries that produce tangibles such as mining, farming and manufacturing (Marceau, Manley, Sicklen 1997). This has led in directions that limit the strategic competitive advantages available to Australian firms in business services. The first limitation of these is a bias towards a focus on making and selling objects and not on services, which are seen as ethereal and somehow less valuable. Books such as *Manufacturing matters* (Cohen and Zysman 1987) and *In praise of hard industries* (Fingleton 1999) support this attitude. The second gives rise to insufficient attention being given to services and to the economic drivers of services growth because it views services only as important in so far as they have important interactions with the manufacturing sector that drive innovation, see Karaomerlioglu & Carlsson (1999) and Sheenan and Pappas (1998). Both approaches seem directed at supporting an agenda still based in 'hard industries'. There was of course the *fin de siecle* craze for the Internet economy, but this was a short-lived boom, which can be likened to the tulip economy of Holland in the sixteenth century. It did not change biases against services. It may have hardened some.

However, the old dichotomy of manufacturing and services is fraught with problems from a practical point of view given that manufacturing businesses often offer services alongside or incorporated with the tangible products (Marceau *et al.* 2002). Even so *business services* contribute significantly to the development of the economy generating enormous wealth, and out-performed the rest of the economy in employment and value added growth during the 1990s (see Marceau and Wixted 2002).

¹ This includes accounting, law, IT consulting, management consulting, marketing services and property services.

² The Australian Bureau of Statistics uses an industry classification based on the United Nations system and divides businesses by their primary activity. At the division level, some of the industry groups are 'agriculture, forestry and fishing', 'mining', 'manufacturing', 'construction', 'retail trade', 'finance and insurance' and 'property and business services'. The ABS figures reveal that in 2001-2002 manufacturing regained the top position by a small margin.

³ The ABS www.abs.gov.au did not put out a press release with the annual national accounts. Further, the Business Review Weekly, which might be expected to report on such developments relies upon IBISWorld data rather than the Australian Bureau of Statistics for its regular updates on the Australian economy and therefore does not feature official changes in the nature of the economy (see for example March 21-27 2002).

In this paper we analyse data on the domestic business markets for property and business services and also financial services⁴ (PB&FS) and show the opportunities that this provides for strategists and policymakers. The two sectors are considered jointly here because the sectors are both particularly focussed on serving the business community.

Growth segments

Data from the Organisation for Economic Development and Cooperation (1995) provides insight into the markets of the different sectors of economies by measuring their interactions (input-output matrices). These interactions are market transactions for goods and services between businesses. The data covers a twenty-year (1970-1990) period for nine countries⁵. The authors also had access to 1996-97 (ABS 2001b) data for Australia as original data, rather than repackaged for the OECD, which given the sectors in question should make no methodological difference to the results.

The particular interest of the current study is firstly to isolate the business services and financial services and second, to differentiate between the linkages between manufacturing and these services and intra-commercial services transactions.

The authors examined the interactions between the combination of business services and financial services vis à vis other sectors of the economies. The measure used was the intensity of PB&FS use as a share of that sector's total inputs. Thus the calculation of this is PB&FS inputs into manufacturing / total inputs into manufacturing *100. The change in this measure between the beginning and end period provides a percentage shift, either growth or decline in intensity of direct input usage. This approach tests for changes in dependence in contrast to approaches that measure the increase in the value of use as the sectors grow.

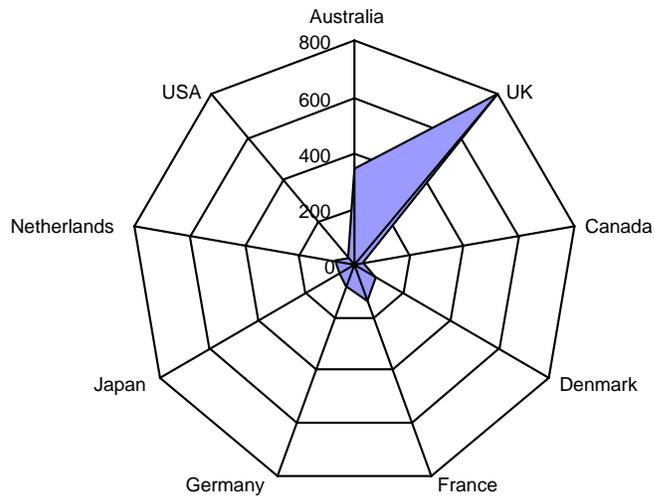
There is one important issue to watch for when using input-output data in the way conducted here. To construct national tables it is necessary for national statistical agencies to calculate the average use of various inputs in generating particular industrial output. Thus, if those agencies don't regularly re-survey businesses to recalculate these underlying coefficients then changes in the intensity of use of particular inputs will not be recorded across time. Although the changes reported here are, for most countries small, none are zero and most are based on comparisons across approximately twenty years, during which there has been substantial opportunity for statistical agency sampling. Therefore, it is reasonable to proceed with the approach proposed.

Figure One reveals that Australia's manufacturing sector increased its direct dependence on financial and business service firms at a rate second only to the UK. Even so, Australia's level of dependence is quite low. In 1989 only 6.8 per cent of all manufacturing inputs, were supplied by firms in the financial and business services sectors. This compared with an average of 12.7 for the countries presented. France had the highest degree of dependence at 22 percent.

⁴ Banks, insurance companies and superannuation funds etc.

⁵ Australia (1968 and 1989), Canada (1971 & 1990), Denmark (1972 & 1990), France (1972 & 1990), Germany (1978 & 1990), Japan (1970 & 1990), Netherlands (1972 & 1986), United Kingdom (1968 & 1990), United States (1972 & 1990).

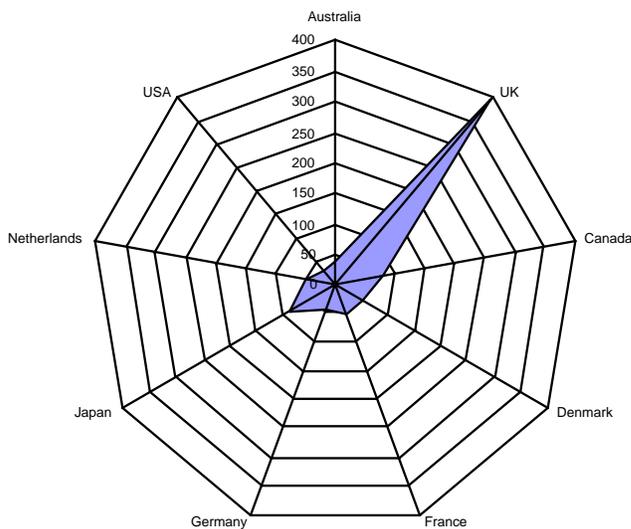
Figure 1: The use of PB&FS by manufacturing (% increase in the share of all inputs)



Source: Original data from OCED Input-Output Database 1995

Even when the Australian data for 1996-97 is utilised, the intensity only measures 10.1 per cent. Although this reveals a continuing trend in the growth of intensity of use by manufacturing of professional services, in Australia it is still below that of the OECD average for the late 1980s.

Figure 2: The use of PB&FS by other services (% increase in the share of all inputs)

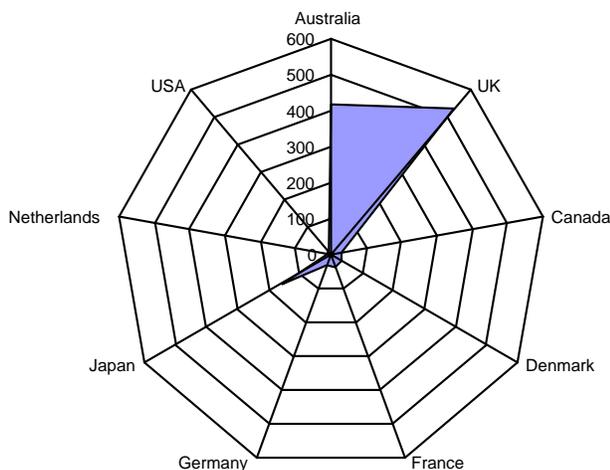


Source: Original data from OCED Input-Output Database 1996

Figure 2 reveals that apart from the UK the dependence of service sectors (other than professional services) changed relatively little during the 20 years. In Australia the degree of interdependence finished close to the average for the nine countries at 25.4 % against 26.1%.

The 1996-97 data for Australia reveals some further growth of intensity with the indicator at 30.7 per cent.

Figure 3: Intra sectoral use (% increase in the share of all inputs)



Source: Original data from the OECD Input-Output Database 1996

Finally, intra-sectoral dependence grew very rapidly in the UK and Australia. However, again this growth was a process of catch up in Australia. Around half of the inputs to the financial and property and business services sectors come from firms in those sectors. The average for the available OECD countries is about 55 percent.

By 1996-97, the intra-sectoral use of financial and property and business services sectors in Australia had jumped to 62.6 per cent. As a speculation, it is conceivable that this latest measure would be near or above the relevant average.

Implications and conclusions

The data reveals that the financial and business services sectors in the UK and Australia have expanded through an increasing reliance of manufacturing firms on external services. However, in the Australian case, this was more a process of moving towards a level of economic specialisation similar to most developed economies, than Australian manufacturing moving towards a much higher degree of outsourcing. Even the latest data positions Australia at the low end of outsourcing across the period rather than with high levels of manufacturing activities being externalised into market transactions.

The situation with the intra-sectoral use of financial and business services sectors is very similar for the comparable years. The UK and Australia both experienced high rates of growth in interdependence. But again, the UK started in a higher level of interaction and finished above the average whilst Australia was starting from well behind and finished near the average. However, by mid way through the 1990s Australia was clearly continuing to specialise in professional services.

The deepening of intra-sectoral interdependence is an outcome that would be expected from input-output studies as industries mature. However, the results can also be partially explained by Karpin's (1995) observation that Australia had hollowed out its corporate middle. The consequent shift towards greater specialisation and corporatisation created a market for externally provided services. The efficiency of these arrangements increased the diversity of market business services available.

Of course, more analysis of recent data⁶ is necessary but we do see several opportunities in these data. First, Australia has moved from a low base of reliance on financial and business services to an increasing reliance. Rogers (1967) and others show us that this type of trajectory predicts rapid increase. It did with the Australian wine industry (March and Shaw 2001). This seems to be confirmed by Allens Consulting (2001:1) on professional and business services, which shows that this sector is booming. The sector is probably in the first rapid growth burst of its cycle.

Strategically this presents an opportunity for policymakers, and firms to invest resources now and increase the rate of growth and return. Second, judged against most of the other economies there is much more opportunity for Australian managements to divest internal business services and purchase market business services. This too will accelerate growth. Third, current market business services are not doing as well as their UK counterparts in growing their sales of services to sectors that produce stuff, and this is an opportunity for

⁶ The OECD has released a later dataset based on the mid 1990s (2002) than the one used here covering 20 countries. As of early 2007, the OECD is working on a significant new database that covers 37 economies, including OECD and significant emerging economies (see Wixted, Yamano and Webb 2006 and Yamano and xxxx 2006). It is hoped that a later version of this paper will include analysis of these latter datasets.

increased growth, because Australian business services do not work at the same level of utilisation as UK firms. Fourth, the sector is so important that it deserves special study, and as Australian institutions have not yet switched attention, there is a strategic political advantage available to the politicians who shift their bureaucrats. Finally, and predictably there should be much more research addressed to this sector. Picking winners is never popular in policy circles, but picking business services seems the least popular.

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