



# International Journal of Academic Value Studies

ISSN : 2149 - 8598  
www.javstudies.com

(Yayınlanma Tarihi: 19/07/2016)

International Journal of Academic Value Studies, 2016 / 2 (4): 121-128.



## Does Exporting is Less Common Among Small Services Firms? Evidence From Turkey

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### Abstract

Two of the most salient, interesting trends in the post-1950 U.S. economy have been the upcoming importance of the service sector and the growth in the skill premium in wages despite a large expansion in the relative supply of high-skilled workers. The growth of the service sector and the relative demand for high-skilled workers have been well understood in independent literatures.

Key theoretical idea linking these two concepts based on structural characteristics differences between service and product firms. In detail, service firms tend to be having few separate boundary roles, much geographical dispersion, decentralized decision making, higher employee skill level, interpersonal skill emphasis and lower formalization. Whereas product/manufacturing firms tend to be having many separate boundary roles, little geographical dispersion, centralized decision making, lower employee skill level, technical skill emphasis and higher formalization.

In other words, according to deep analysis of organizational theory before writing this paper, it is seen that service firms tend to be organic while manufacturing firms tend to be mechanistic in nature... It should also be added that small service firms tend to be having smaller export rates.

Throughout this paper this will be analyzed within sections: at first section introduction will be given. In section 2, theoretical roots in other words literature review on the subject will be presented. Causes of general structure differences will be explained in detail.

In section 3, after explaining the historical development, service firms in Turkey will be brought up for discussion and comparison based on their structures and trading figures. Section 4 will include structure foresight, further research, discussion and conclusion. Besides giving insight about service firms for comparison purposes, the purpose of this paper is to provide information for the potential researchers about basic aspects of structure attitudes and behaviors, since it is so newly presented.

**Keywords:** Service, Manufacturing, Organization, Organizing.

**Jel Codes:** F23, J54

### 1. INTRODUCTION

Simply explained, services are a diverse group of economic activities not directly related with the manufacture of goods, mining or agriculture. They typically provide the provision of human value added in the form of labor, advice, managerial skill, entertainment, training, intermediation and the like. They differ from other types of economic activities in a number of ways. Many, for instance, cannot be inventoried and must be gathered at the point of production. This would include trips to the doctor, enjoying a meal at a restaurant, flying from Tokyo to Paris, or attending a concert. This is in totally contrast with manufactured products, whose tangible character allows them to be stored, distributed widely and consumed without direct interaction with the entity that produced the good.

Technological advances are, however, narrowing the differences between services and other economic activities. While it has not reached the point yet where someone can enjoy the

ambience of a good restaurant without physically going to one, information and communication technology (ICT) now provides people to participate in a growing number of service-related activities in real, or deferred, time, without having to be physically there. Copies of movies and most other performances can be recorded and mass-produced for future consumption, like manufactured products. Software is developed and boxed like any other manufactured product, and is thought, for all intents and purposes, a good – albeit with a high service-related content. In these instances services have, in a manner, taken on the characteristics of commodities – one provider is mass-producing a common product for most of the people.

The relative significance of manufacturing and services to economies, and the inter-relationship between the two have been the subject of much discussion through the years. Some have underlined that the decline in manufacturing and the corresponding shift to services is unprofitable in the long run, since services depend critically on manufacturing for their existence. In the absence of manufacturing, service sectors are seen as collapsing, at all. On the other hand, services have been providing a major driving force in economic growth. Rather than services following and supporting manufacturing, manufacturing is seen as flowing to those countries and areas where the services infrastructure is efficient and well structured.

The discussion on this point finally underscored the close and symbiotic relationship between services and manufacturing, and the blurring, sometimes arbitrary, distinction between the two extremes. Without demand for transportation, for example, the need for trucks, buses, ships and airplanes would not work. Similarly, without demand for information and entertainment, there would be no providence for printing presses, televisions and radios. The interrelationship between computers and software provides a good instance of the dynamic interplay between manufacturing and service activities, as software developments are pushing development of more powerful computers, and vice versa. In addition to interacting with one another, services are day by day being embodied in manufactured products. This is reflected in the innovative effort and expertise that is captured in the final value of products, as well as design, technical assistance and other "intangible" aspects. In some cases, the rising demand for products with a higher service-oriented content is having an impact on the ways that companies understand themselves.

## **2. LITERATURE REVIEW**

Service sector provides more than 70 percent of the GDP in many developed economies. According to the 1999 Statistical Yearbook service sector employment is more than 80% in United States and more than 70 percent in Canada, Japan, France, Israel, and Australia. There is no such thing as a service industry. There are only industries whose service components are greater or less than those of other industries. Everybody is in service. Many of the jobs in manufacturing are actually should be understood as service jobs.

The service sector is expanding very fast. The extraordinary growth of the service sector has focused attention on challenges of effective management of service organization and operations vastly different from the challenges faced in manufacturing settings. Due to rapid developments in information technology, globalization, changing customer needs/preferences, and the changes in relative wealth between the developed and newly developing economies, the effective management of service systems pointing out the productivity and quality issues will become even more crucial in the coming years.

Until recently, the concept of service productivity has been conceptually underestimated (Corsten, 2001). Simply transferring the traditional concept of productivity from manufacturing and producing material goods to services is bound to fail because of the immateriality and intangibility of services (Corsten, 2001). Immateriality refers to both the

intangibility of the output, as well as the heterogeneity of services. Furthermore, the integration and involvement of customers in the value creation processes is central to services (Lasshof, 2006). This means that the customer is inevitably a main factor for service providers, which must also somehow be integrated and counted for in the concept of services productivity. This is also somehow contrast to the classical concept of productivity, where the customer usually is not an integral part during value creation and the business processes often are a closed system (Grönroos and Ojasalo, 2004). This implies that the quality of both material products and business processes can neither be perceived nor be influenced by the customer during the value creation process.

Managing a service is varied from managing goods and materials (Rust and Chung, 2006). This is mostly due to the fundamental nature of a service – a service is immaterial and takes place on integrating customers' inputs. Essentially, services management is dealt with managing interactions of humans (Chase and Dasu, 2001).

Regarding the relationship between service productivity and service quality, some researchers are of the opinion that productivity and quality are indispensable (Grönroos and Ojasalo, 2004; Gummesson, 1998), whilst others argue that productivity should be independent from quality and should be used as an expression of qualitative yield that is detached from the quantitative result (Lasshof, 2006; Nachum, 1999). Nevertheless, all researchers agree that the customer determines the quality of a service (Lasshof, 2006; Grönroos and Ojasalo, 2004). To make the problem even more complicated, a large number of various factors exist that are supposed to have an impact on service productivity. Depending on the service process in focus, several different factors might be important to determine service productivity, ranging from the relationship between service providers and customers to service quality. Only a few of existing factors representing service productivity have so far been subjected to research and analysis.

Wright & Mechling [37], reported on the research to empirically determine which operations management problems are the most important to small service organizations. A survey was conducted to point out the relative significance of operations -related service problems. The authors asked managers of service organizations to rank a set of operations problems according to their relative importance using Q- methodology. Significant factors are analyzed, and explanations are offered for the ranking of the operations problems. Fifty-four service organizations responded to the survey, three responses were not usable. The results indicated that 'determining how utilize resources most effectively', 'monitoring and measuring quality of services', ' predicting future events, conditions, customer demand, price/cost levels', etc. are crucial operational issues for service organizations. However, the results also underlined that facility location and layout, waiting line systems, and distribution requirements planning were for the most unimportant to the respondent service organizations.

Singh & Deshmukh and Yassine dealt with quality issues in growing service sector. It was recognized that service quality is multifaceted and that it is ultimately evaluated in the minds of the customer [22, 28, and 33]. Service quality was defined as a measure of how well the service delivered matches the customer expectations Lewis [29]. Parasuraman et al. [33], established a service quality model where the service quality was shown to be a discrepancy between the expected service and the perceived service. The various gaps or the reasons due to which this discrepancy takes place were described. Effective measurement and analysis of service quality are a main first step in its improvement. Parasuraman et al. [32], explained the development of a 22-item instrument (called SERVQUAL) for assessing customer perceptions of service quality in service and retailing organizations. SERVQUAL is a concise multiple-item scale with good reliability and validity that service organizations can use to better understand the service expectations and perceptions of consumers and, as a result, improve service. Behara et al. [8], stressed the development of neural network models for service quality

measurements. "In this paper, it is demonstrated that neural networks have the potential to be a valuable approach to understanding customer evaluation of service quality and providing a promising approach to data mining in the domain of service quality".

Researchers in SOM [6, 19, and 30] realized that the challenges in service organizations are not adequate requirement of the same nature as manufacturing organizations. Services cannot be seen as merely goods with some odd characteristics. As a matter of fact, the characteristics of most service firms differ widely from those of manufacturing. The main features of a service, which distinguishes it from a product are; intangibility, heterogeneity, and inseparability of production and consumption [33]. However, some concepts and tools developed in the manufacturing domain can be altered to fit and benefit service organizations. Behara and Chase [7], have adapted the concept of quality function deployment (QFD) for service firms. Statistical process control [3], just in time [23], and quality circles [27] all originated in manufacturing and then were adopted by SOM researchers to fit service organizations [19]. Various researchers [19, 23, 27], are of the view that service industries can improve their operations by using techniques and tools similar to the ones took into account in manufacturing environments. Reichheld and Sasser conceptualized the concept of zero defections to services. According to them, service companies must gather what their manufacturing counterparts learned in the 1980s-which quality does not improve unless it is analyzed. Service companies have their own kind of scrap heap; customers who will not come back. That scrap heap too has a cost. So the concept of zero defections- keeping every customer the company can profitably serve, will increase the company's profits. Customers can tell you exactly what parts of the business you must improve. Zero defections culture can be developed by training the workforce and using defections as a primary performance measure. Everyone in the organization must understand that zero defections is the goal. It is crucial to make all employees understand the lifetime value of a customer. Managers must use defections as a vehicle for continuously improving the quality and value of the services. The winners will be those who lead the way in managing towards zero defections.

Chase and Gravin [14], has given importance to service part of manufacturing. The factory of the future is not a place where computers, robots, and flexible machines do the drudgework. The manufacturers that thrive into the next generation will have to deal with by bundling services with products, anticipating and responding to a truly comprehensive range of customer needs. To compete, it needs connection between factories and customers. It is the strategy not technology that connects. The managers of service factories have to work in an open system. They need connections to design, marketing, planning, and customers. Computer and telecommunications can help here to speed communication and breakdown functional barriers.

### **3. TURKISH SERVICE INDUSTRY: PARAMETRIC EVIDENCE FROM TURKEY**

The main data sources we used in this study are twofold: the Annual Industry and Service Statistics database and the Foreign Trade Statistics database in Turkey. "The Annual Industry and Service Statistics is based on surveys<sup>3</sup> covering the enterprises in the industry and services sector carried out by Turkish Statistical Institute (TURKSTAT). The survey is performed by using the full enumeration method for the enterprises having 20+ employees as well as some regularly followed smaller firms with 1-19 employees. TURKSTAT uses the sampling method for the rest of the small firms to cover the entire Turkish economy. When conducting the 2008 survey TURKSTAT visited 100,152 enterprises. "

Our sample covers the period 2003-2008. In our analysis, we used 330,680 observations and exclude small firms represented using the sampling method. The database contains information on employment, wages, investment, value added, sales, foreign ownership<sup>4</sup> and the number of domestic plants of the firms. Our data on services trade come from the same

database: firms were required to report whenever they export and/or import services. Therefore, our services trade data do not gather information regarding the magnitude of services trade but information about the services trade status of the firm. In other words, for any given firm we have information about the extensive but not the intensive margin in regards to services trade. The classification of economic activity used in the study is NACE Rev. 1.1.

The second database that we use in our study is the Foreign Trade Statistics database. "The main data source is customs declarations and made available by TURKSTAT. The data set includes goods flow, the reference period, customs, commodity code, partner country, the nationality of the means of transport at the frontier, mode of transport, customs procedure, statistical value (export f.o.b./import c.i.f.), net mass (kg), supplementary unit, delivery terms, nature of transaction and type of payment. The classification used for compiling Turkey's foreign trade statistics is the Harmonized System (HS) 12-digit. We merge these two datasets to obtain data on goods trade, services trade and firm characteristics. We group the firms as: goods-exporters, G\_E; service-exporters, S\_E; exporter of both goods and services, E-both."

The database we use in this study has several advantages. Firstly, it is the census data and gathers all firms with 20+ employees in the Turkish economy. Secondly, our trade data cover the entire universe of goods traders in Turkey. Thirdly, all the firms that engage in services trade are included in our dataset. In other meaning, the trade data in our analysis is comprehensive at the firm-level. The completeness and the consistency of our data are our main strengths here. Some of the previous studies use extensive data sampling. Some of them only cover goods and services exports above a certain threshold and thus do not point out the complete export behavior among the firms. Some of them use services trade data reported in conjunction with the goods trade. In other words, there is no record of a separate transaction for service trade.

Exports in the Turkish economy is no exception in this regard. Among all firms in Turkey only 21.8 percent of firms export goods and 1.7 percent engages in services exports in 2003-2008 period. On the other hand, 1.7 percent of firms export both goods and services.

Most of the goods exports take place in the manufacturing sector. Within sub-categories of the manufacturing sector, across the board more than 30 percent of the firms engage in goods trade. Within the services sector, on the other hand, the wholesale & retail sector has the highest share of firms that export goods with 17.6 percent.

Similar to the fact that goods trade occurs mainly in the manufacturing sector, the important bulk of services trade takes place in the services sector. The share of services exporters in transport (22.4 percent) and computers and R&D (16.8 percent) sectors are crucially higher than those in the rest of the services sectors. On the contrary, it is not only the firms in the services sector but also the firms in the manufacturing sectors engage in services trade. It is seen that high-tech firms in the manufacturing sectors (9.7 percent in total) tend to export services more. This fact is in line with the literature: Borchsenius, Malchow-Moller, Munch and Skaksen (2010) suggest that "while 80 percent of services imports and over 90 percent of services exports take place through firms in the services industries; the rest of services trade in the Danish economy takes place through the manufacturing firms."

Although the number of exporters is small, they are accounted for a important share of economic activity measured by sales. Although the share of exporters is only 25 percent, they account for 65 percent of the sales in the economy. The share of goods exporters in sales is 55 percent while the share of services exporters is only 2 percent. The striking result is the share of the firms that export both goods and services: Only 1.7 of the firms export both goods and services; however, they account for 8.6 percent of the sales in Turkish economy.

In the manufacturing sector, where most of the goods trade takes place, 40 percent of the firms engage in exporting. Moreover, the share of these exporters in sales is a stunning 83 percent. Similar figures exist for the services sector. While 14 percent of the firms in services sector engage in exports, more than %50 of the sales belong to these firms. The flashy figure in the services sector is the sales performance of the firms that export both goods and services: Although they constitute only 1.4 percent of the firms, they account more than 10 percent of the sales.

Sectoral decomposition of the manufacturing sector in terms of goods exporting intensity is homogeneous. Among the high-tech goods producers, more than %50 of the firms are exporters. Moreover, the exporting firms in these sectors account for more than 90 percent of the sales. Another fact about the high-tech goods producers is that the share of the firms that export goods and services is the highest and their share in sales is around 10 percent.

Exporting is less common and seen among services firms. The most open sectors are transport and computers & R&D with 25 percent of firms that engage in exports. The unbelievable figure in the transport sector is that the share of the firms that export both goods and services is 5 percent while their share in sales is almost 50 percent.

The size of the firms matters for exporting, as well. The larger the firm is, the more open it is to trade. While only 10 percent of the small firms with less than 20 employees engage in exports, this share increases to 72 percent for large firms with more than 500 employees. On the other hand, the share of services exporters does not rise with the size of the firm substantially.

There is a crucial difference between manufacturing firms and services firms. Although the share of the small firms with 1 to 19 employees that export is around 10 percent in the economy, the share of exporting firms in manufacturing firms increase to 85 percent when size increases. However, the share is limited to less than 50 percent in the services sector even for firms with more than 500 employees which creates the one of the main point of that study.

The facts are that the share of firms that engage in services exports and their corresponding share in sales are limited. However, this is not the case for goods exporters and both goods and services exporters. The shares of firms in these trading status increase with firm size and constitute an important part of the economic activity. Therefore, next we analyze the goods exporter sample which presents the share of goods and services exporters by product (in goods) variety. The implications of this Table are striking. When the exported product variety increases the share of the firms that export both goods and services increases. This is more obvious in the manufacturing sector. This descriptive analysis offers that when the variety of exported products increases the firms tend to export services as well. This may be seen as suggestive evidence for the complementarity of goods and services exports, confirming the previous results.

Finally, we explore the role of foreign involvement in the exporting decision of the firms. The trading current share of multinational enterprises (MNE) in Turkey. Compared to domestic firms, the share of exporting firms are much higher within MNEs. Nearly 30 percent of the foreign affiliated firms sell only to the domestic market. Among MNEs, 54 percent of the firms engage in goods exporting and 8 percent in services exporting. Furthermore, 9 percent of multinationals export both goods and services.

First, in Turkey firms that export both goods and services are larger than firms that only export goods or services. Second, multinational firms operating in Turkey are different than domestic firms: Goods exporters are larger in size compared to both goods and services exporters.

In the recent decades the world has seen striking rising services economies, which offer vast opportunities in a wide array of areas. Services provide essential inputs to other products and services. Services have important social function in areas such as health, education, energy, transport and telecommunications and indispensable in the expansion of global value chains.

The main objective of understanding services trade, in particular the services exporters from the manufacturing lines of business, is the main propellant of the current paper, which shows a firm-level analysis of services exports in Turkey in 2003-2008.

Our results show that services exporting is a rare activity. Not only services firms but also manufacturing firms export services. Moreover, exporters of both goods and services are consistently bigger than goods exporters or services exporters. However, goods exporting multinational firms in Turkey are larger than multinationals that export both goods and services.

"In our analysis of determinants of the decision to become a services exporter, we find that goods exporters with a larger size, higher labor productivity and wide spectrum of goods to export increases the odds in favor of becoming a services exporter."

#### **4. STRUCTURE FORESIGHT & DISCUSSION**

In this paper, we have worked on the services exports of goods exporters. However, the sectoral decomposition of goods and services exports can be significant in shaping the international trade policy of a country. Liberalization can be justified when this action causes welfare improvements, which surface as gains from exchange and gains from specialization. Therefore, whether liberalization causes specialization in high-wage/high-productivity services or low-wage/low-productivity services matter for the long term growth of a country and warrants further investigation. In Turkey, for example, among the exporters of both goods and services 46 percent of the firms come from the services sector while 54 percent from the manufacturing. Again, among these firms, the labor intensive manufacturing, the high-tech capital intensive manufacturing, wholesale/retail and transportation firms constitute 18 percent, 16 percent, 17 percent and 16 percent of goods and services exporters, respectively. Because of that, in which sector the service trade liberalization will happen, matters.

#### **5. FURTHER RESEARCH & CONCLUSION**

Service sector is growing and gaining importance day by day. Newer services are entering into market place. Customer is becoming more and more knowledgeable on services. Service organizations are looking for some innovative ways to improve their services. The techniques for effective service operations management are not fully developed as in manufacturing. It is

because the characteristics of most service firms differ widely from those of manufacturing. The main features of a service, which distinguishes it from a product are; intangibility, heterogeneity, and inseparability of production and consumption. It therefore becomes an area of future research to apply concepts and tools developed in manufacturing domain to fit and benefit service organizations.

Another crucial area of future research is the industry restructuring after services trade liberalization. The response of firms producing and exporting goods and services as a bundle for a better competitive position in international markets and the response of firms with unrelated lines of goods and services business to services liberalization can have various different repercussions for sectoral and country level productivity and growth patterns.

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