Clarification Memorandum No. 1

NAICS Sector 42 - Wholesale Trade
Scope and Implementation Guidelines for U.S. Statistical Agencies

Introduction - As with all sectors, NAICS defines the boundary and scope of the trade sectors using production terminology. For wholesale trade, the interpretation of this terminology and its implementation by U.S. statistical agencies has raised issues that the Economic Classification Policy Committee (ECPC) through the Administrative Subcommittee has seen fit to address. This document is a clarification of the scope of NAICS Sector 42, Wholesale Trade. It also presents approved implementation guidelines for classifying establishments to this sector.

The ECPC is aware that there will be a significant change to the content of wholesale trade (as presently constituted under the SIC rules) with NAICS implementation. Retail-like establishments primarily selling to business customers (classified as wholesale in the SIC) will move to retail trade. These shifts were discussed during the preparation of the manual. The ECPC is also aware that NAICS implementation for the 1997 economic census will not be complete because the forms as designed do not ask the right questions. This will be corrected for the 2002 Census.

NAICS Manual - According to the U.S. NAICS manual, “the Wholesale Trade sector comprises establishments engaged in wholesaling merchandise, generally without transformation, and rendering services incidental to the sale of merchandise.

The wholesaling process is an intermediate step in the distribution of merchandise. Wholesalers are organized to sell or arrange the purchase of (a) goods for resale (i.e., goods sold to other wholesalers or retailers), (b) capital or durable nonconsumer goods, and (c) raw and intermediate materials and supplies used in production.

Wholesalers sell merchandise to other businesses and normally operate from a warehouse or office. These warehouses and offices are characterized by having little or no display of merchandise. In addition, neither the design nor the location of the premises is intended to solicit walk-in traffic. Wholesalers do not normally use advertising directed to the general public. Customers are generally reached initially by telephone, in-person marketing, or by specialized advertising that may include Internet and other electronic means. Follow-up orders are either vendor-initiated or client-initiated, generally based on previous sales, and typically exhibit strong ties between sellers and buyers. In fact, transactions are often conducted between wholesalers and clients that have long-standing relationships......

Although, in general, wholesaling normally denotes sales in large volumes, durable nonconsumer goods may be sold in single units. Sales of capital or durable nonconsumer goods used in the production of goods and services, such as farm machinery, medium and heavy duty trucks, and industrial machinery, are always included in wholesale trade.” (NAICS United States 1997 page 375)

With regard to retail trade, the manual says: “The Retail Trade sector comprises establishments
engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise.

The retailing process is the final step in the distribution of merchandise; retailers are, therefore, organized to sell merchandise in small quantities to the general public. This sector comprises two main types of retailers: store and nonstore retailers.

Store retailers operate fixed point of sale locations, located and designed to attract a high volume of walk-in customers. In general, retail stores have extensive displays of merchandise and use mass-media advertising to attract customers. They typically sell merchandise to the general public for personal or household consumption, but some also serve businesses and institutional clients. These include establishments, such as office supply stores, computer and software stores, building materials dealers, plumbing supply stores, and electrical stores. Catalog showrooms, gasoline service stations, automotive dealers, and mobile home dealers are treated as store retailers.

In addition to retailing merchandise, some types of store retailers are also engaged in the provision of after-sale services, such as repair and installation. For example, new automobile dealers, electronic and appliance stores, and musical instrument and supply stores often provide repair services. As a general rule, establishments engaged in retailing merchandise and providing after-sale services are classified in this sector.....

The buying of goods for resale is a characteristic of retail trade establishments that particularly distinguishes them from establishments in the agriculture, manufacturing, and construction industries....” (NAICS United States 1997, page 411)

“Wholesalers also engage in the buying of goods for resale, but they are usually not organized to serve the general public. They typically operate from a warehouse or office and neither the design nor the location of these premises is intended to solicit a high volume of walk-in traffic.” (NAICS United States 1997, page 412)

Criteria for Classification - Once an establishment has been classified as primarily engaged in retailing or wholesaling merchandise, it must be determined if it is in retail or wholesale trade.

Although there were concerns expressed about the length of the descriptions, the ECPC agrees that the following wording will meet the conceptual criteria for splitting wholesale trade as defined in the SIC and NAICS.

For the wholesale portion of an industry in SIC major groups 50 and 51:

Selling [insert appropriate description] using facilities not open to the general public. These establishments typically require commercial accounts, proof of business license or tax ID, or similar qualifications for sales; generally price their goods for resale rather than final use; and typically do not cater to or allow walk-in customers from the general public. Include establishments selling to retailers, and brokers, agents, import/export agents or brokers, and manufacturers’ representatives. DO NOT INCLUDE warehouse clubs, membership buyers
clubs, or stores and sales areas selling to the general public.

For the retail portion of an industry in SIC major groups 50 and 51:

Selling [insert appropriate description] using facilities open to the general public. These establishments can be in shopping centers, industrial parks, or in similar areas where they are open to the general public. “General public” means walk-in customers typically served with counter sales, displayed merchandise, cash registers or credit card equipment. Include membership buyers clubs, warehouse clubs, and stores and sales areas selling to business or commercial customers and the general public.

Exceptions: Agents, brokers, exporters, importers, manufacturer's sales representatives, and grain elevators are wholesale even if their facilities are open to the general public.

Furthermore: sellers primarily selling farm machinery; construction and mining machinery; and manufacturing, oil well, and warehouse machinery are wholesale even if they sell using facilities open to the general public.

Facilities were designated in these questions because activities may occur in a store or nonstore environment. The definition of nonstore in both wholesale and retail trade will be further refined during NAICS 2002 completion work. As a general example, nonstore activities could include catalog sales, Internet sales, and similar activities that do not take place in a traditional wholesale or retail environment. Attachment 1 provides a list of some of the characteristics that were not accepted as exclusive criteria for classification and the shortcomings associated with each.

Implementation - Before the NAICS manual was completed the Census Bureau prepared a set of questions to be used for the classification for the economic census. Subsequently, they found that there were numerous problems with their questions. These problems prompted the Administrative Subcommittee and the ECPC to review this area in terms of both definition and implementation. For statistical comparability, consistency in classifying trade establishments is essential. The Census Bureau will not fully implement NAICS until the 2002 Economic Census.

Impact - NAICS, as a system, defines industries based on the production function of establishments. Often establishments have multiple production functions. A trade establishment may have a small storefront and sell to the general public and also have a warehouse and sell to businesses. These activities are separate and distinct production functions. The first is retail; the second is wholesale. Similar situations occur in manufacturing. We often see establishments that cast iron, machine the rough castings, and assemble a final product.

In general, NAICS classifies combined activities (or vertically integrated operations) based on the final step of production. Thus the manufacturing establishment would be classified to the industry of the final assembled good. Likewise the combined presence of the wholesale trade and retail trade production functions at the establishment level, would classify the establishment to retail trade, since retail trade is the “final step in the distribution of merchandise.”

The ECPC realizes that there will be significant changes to the content of Wholesale Trade with
NAICS implementation. Many retail-like establishments that primarily sell to business customers were classified to Wholesale trade in the SIC and will move to Retail Trade in NAICS. There will not be a corresponding move from Retail Trade. Attachment 2 identifies the SIC areas that will not be impacted by this decision.
Attachment 1: Production Characteristics That Are Not To Be Used to Classify Establishments to Wholesale and Retail

The U.S. NAICS manual description goes into detail providing information on particular production characteristics used to attract the general public and specifying particular products that are sold, but these are representative of the classification criteria, which for wholesale is selling goods using facilities not open to the general public. These characteristics are not the criteria and should not be confused with the criteria. Aspects of these establishments mentioned in the NAICS materials for illustrative purposes and to highlight the change from the SIC, but not distinguishing a clear classification principle include references to:

**Products** - The products sold cannot be the key indicator for determining sector classification. For NAICS, it is how merchandise is sold not what is sold or how it is used. Putting the focus on products will only cause future problems for the classification system. It was a product focus in the SIC system that put office supply stores in wholesale and that put truck dealers in wholesale. However the NAICS agreement did make specific mention of capital or durable nonconsumer goods used in the production of goods and services, and stated that establishments primarily selling these would be in wholesale trade. The specific exceptions that the ECPC designated were limited to farm machinery, construction machinery, mining machinery, manufacturing machinery, oil well machinery, and warehouse machinery.

**Particular Selling Characteristics** - Selling methods (e.g. advertising, displays) vary based on the product sold, the availability of space, the cost of space, the need to advertise, tastes of the customer, environment, economic conditions, and other factors. These characteristics are helpful for understanding the classification concept; however, to focus on any one of these characteristics to define the whole sector is inadequate. No one characteristic applies to all establishments.

**Storefront** - For a store retailer or a store wholesaler, the storefront distinction would be applicable. It could be viewed as a proxy for open to the general public. However the term storefront is subject to interpretation. The U.S. NAICS manual does not mention storefront in the sector level description at all. Furthermore, such a focus still does not define the distinction between total wholesale and total retail and it seems to imply that there is no one distinction between the sectors but that multiple distinctions exist.

**Class of Customer** - Selling to the general public is not a class of customer distinction but rather implies how the establishment is set-up to do business. For example, if it sells to the general public, it must have the facilities to handle cash transactions. The general public should not be equated with households or personal consumption expenditures. The general public being dealt with may be in business, however this fact is not pertinent for classifying the activity. NAICS rightfully eliminated the use of class of customer (e.g., contractor, farmer, nonprofit institution) for determining the classification distinction between retail and wholesale sectors. In the past, this distinction necessitated exceptions and caused confusion.

**Primary Activity** - Both wholesalers and retailers sell merchandise as their primary activity. Between these two sectors, the chief distinction for NAICS is on whether the facilities are open
to the general public or not. It cannot be a primarily retail versus primarily wholesale distinction. Since facilities open to the general public requires the establishment as a whole to have the necessary capital, labor, and intermediate expenses for this operation, an establishment cannot be part retail. It either is or it isn’t. Thus a primary distinction between the two sectors is not warranted. An example of this is a small, independent office supply establishment. The front part of the building is a storefront area, designed to attract walk-in customers. The rear part of the building is a warehouse and office that takes phone orders, and delivers goods to businesses in a wholesale manner. If a primary activity criterion were applied to this establishment, the classification would change depending on the relative success of each part of the operation in a given year. In some years, the establishment would be classified in wholesale trade, in other years the establishment would be classified in retail trade. Its selling characteristics however have not changed.

The level of receipts cannot be used to classify the trade establishment between sectors. Almost all wholesalers have some small amount of sales to walk-in final consumers. However, these establishments are set up, designed, and operated as wholesale establishments. They do not have displayed merchandise, cash registers, credit card and check processing equipment, and similar things that a retail store, open to the general public, must have. The human capital is different. Wholesalers have warehouse workers, order takers, billing and accounts receivable personnel, office managers, sales representatives, etc. Retailers have clerks, counter persons, store managers, etc.

**Selling for Resale** - Wholesalers are often described as “selling goods for resale” and this is true. Wholesalers usually sell goods to other wholesalers or to retailers. However, you cannot determine an establishment’s classification based on the classification of the establishments that they sell to. For NAICS, who you sell to is not the critical principle for classification and of even less relevance is how the customer uses the goods that they purchase.

**Bulk versus Small Quantities** - Products sold and selling operations in today’s economy negates the applicability of a bulk versus small quantities criteria for differentiating wholesale from retail. Household consumers buy in bulk from warehouse clubs; and some large equipment items (like farm machinery) is sold in single units.
Establishments in SIC industries not listed below will be classified to wholesale trade or retail trade based exclusively on the selling characteristics of the establishment (i.e. selling using facilities open to the general public). In general, the application of this rule is not expected to change the content of SICs 5048, 5051, 5052, 5093, 5153, 5154, 5159, 5169, 5172, and 5198 because the interpretation of these industries is such that there is no retail activity present. The additional industries listed contain establishments that are exceptions to the rule.

**Automobiles and Other Motor Vehicles (SIC 5012)** wholesale distribution. This industry does not include Automobile dealers. Automobile dealers are included in retail trade when they sell passenger cars and light trucks. The distribution of heavy trucks and other commercial-type vehicles will be considered wholesale trade in NAICS, even if the distribution takes place in an establishment that could be classified as retail based on operating characteristics. Heavy Trucks and other commercial-type vehicles are specific exceptions in NAICS.

**Photographic Equipment and Supplies (SIC 5043)** wholesale distribution. Much of the equipment used to develop film is nonconsumer durable equipment. This includes commercial equipment, such as, identity recorders for checks and fingerprints; motion picture cameras, equipment and supplies; commercial photographic developing equipment; commercial photographic printing equipment; motion picture projection equipment; and similar commercial photographic equipment. Darkroom equipment for home use is generally sold by “camera stores” and is not included in this exception.

**Commercial Equipment, Not Elsewhere Classified (SIC 5046)** wholesale distribution. This includes nonconsumer durable equipment, such as vending machines, commercial cooking equipment, soda fountain fixtures, and mannequins. If equipment receipts are the primary receipts, these would be in wholesale even if the distribution takes place in an establishment that could be classified as retail based on operating characteristics. This is a specific exception in NAICS.

**Warm Air Heating and Air-Conditioning Equipment and Supplies (SIC 5075)** wholesale distribution. This would be limited to commercial equipment and those establishments supplying consumer equipment to retailers or installation contractors and would be exclusively wholesale trade regardless of the selling characteristics of the establishment. Consumer type equipment is either sold in a retail environment (such as a home center) or sold and installed by contractors in the construction sector. There is no retail sale of household-type heating and air-conditioning equipment included in SIC 5075.

**Refrigeration Equipment and Supplies (SIC 5078)** wholesale distribution. Commercial refrigeration equipment is classified in Wholesale Trade regardless of the selling characteristics of the establishment.

**Construction and Mining (except Petroleum) Machinery and Equipment (SIC 5082)** wholesale distribution. This is defined as capital equipment and is treated as Wholesale Trade, regardless of the selling characteristics of the establishment.
Farm and Garden Machinery and Equipment (SIC 5083) wholesale distribution. Farm and agricultural equipment are capital equipment and are treated as Wholesale Trade, regardless of the selling characteristics of the establishment. Lawn and Garden equipment being sold in a retail like manner will be moved to Retail Trade.

Industrial Machinery and Equipment (SIC 5084) wholesale distribution. Industrial Machinery and Equipment is capital or nonconsumer durable equipment and will be classified in Wholesale Trade regardless of the selling characteristics of the establishment.

Transportation Equipment and Supplies, Except Motor Vehicles (SIC 5088) wholesale distribution. The goods listed in this industry are nonconsumer durable goods and will be treated as Wholesale Trade, regardless of the selling characteristics of the establishment.