



Philippine Institute for Development Studies  
*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

## Sustaining Philippine Advantage in Business Process Outsourcing

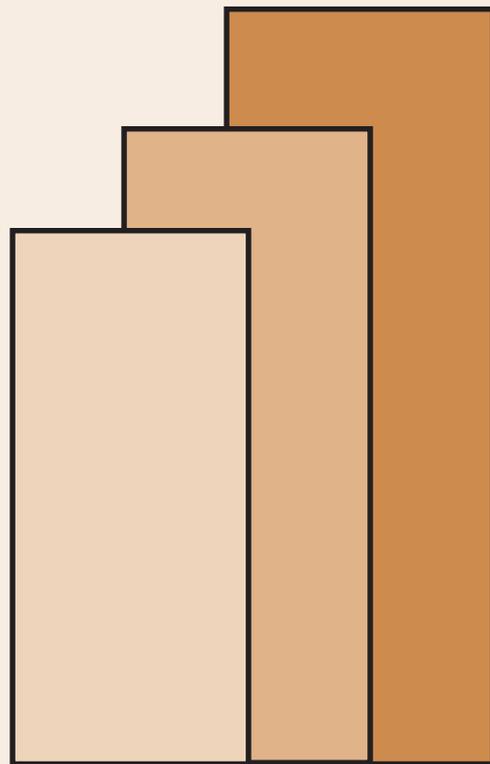
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**Final Draft**

**SUSTAINING PHILIPPINE ADVANTAGE IN  
BUSINESS PROCESS OUTSOURCING**

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## **ABSTRACT**

This study looked at the sustainability of the growth and development of business process outsourcing (BPO) in the Philippines. It was prompted by the sector's spectacular growth in several of its subsectors, mainly contact call centers, medical transcription, animation, and software development. Doubts about the sustainability of this hypergrowth situation are increasingly being felt, as the industry experiences difficulties in meeting the demands of the market—specifically, the country's ability to supply the skilled workforce. In addressing sustainability, the government will have to grapple with several important issues, such as the main drivers of the BPO phenomenon, the size of the global BPO market, and the competitiveness of the Philippines as a BPO location. These questions were directly addressed by the study. Only after these issues have been addressed can policymakers provide broader and longer term directions for the industry, specifically on: (1) whether the present level of priority given to BPOs is appropriate and consistent with national economic goals or should the government instead prioritize other sectors, and (2) whether the country's educational system should be aligned with the goals of enhancing the competitiveness of the BPO industry, and the consequences of this educational thrust on other strategic sectors of the economy.

This study will look at the sustainability of the growth and development of Business Process Outsourcing (BPO) in the Philippines. It was prompted by the spectacular growth in several of BPO sub-sectors, including contact call centers, medical transcription, animation, and software development. Doubts about the sustainability of this hyper-growth situation are however increasingly being felt, as the industry experiences difficulties in meeting the demands of the market—specifically, the country’s ability to supply the needed qualified skilled workforce.

In addressing this issue, however, the government will have to grapple with several important questions:

- (1) What is the BPO phenomenon?
- (2) What are its main drivers?
- (3) How big is the global market for BPOs?
- (4) Is its growth expected to be sustained?
- (5) Is the Philippines attractive as a BPO location?
- (6) How can the country enhance its competitiveness as a BPO location?

These are the questions which will be directly addressed by this study. Only after these issues have been addressed can policymakers seek to provide broader and more long-term directions for the industry, specifically on the following questions:

- (1) Is the country’s present level of priority given to BPOs appropriate and consistent with national economic goals? Or should the government instead prioritize other sectors?
- (2) Should the country’s educational system be aligned with the goals of enhancing the competitiveness of the BPO industry? What are the consequences of this educational thrust on the other strategic sectors of the economy?

While the latter issues will not be the focus of this research, the study's objective of providing inputs for policy makers makes it different from previous researches on BPOs that sought to primarily to promote the sector to private investors.

## I. INTRODUCTION: THE CONTEXT

The lowering of tariff barriers, together with rapid technological developments, has been continuously pushing the world to become a single market place. As a result, domestic companies are subjected to ever-increasing levels of competition. This has prompted organizations to look for various ways by which they can enhance their competitiveness—both in terms of lower costs or improved service and product quality.

### A. Outsourcing

In this context, “outsourcing” has been one of the most publicized responses of organizations. Initially, firms looked at outsourcing exclusively from the perspective of cost-reduction. The World Bank defines “outsourcing” as *“the contracting of a service provider to completely manage, deliver and operate one or more of a client’s functions (e.g. data centres, networks, desktop computing and software applications)”*. (World Bank E-Commerce Development Report, 2003)

#### Box 1. Sample Definitions of Outsourcing

- **Accenture** - “contracting with an external organization to take primary responsibility for providing a business process or function” (Linder JC and Cantrells 2002).
- **PricewaterhouseCoopers** - “is the long-term contracting out of non-core business processes to an outside provider to help achieve increased shareholder value.”
- **Gartner** - “the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected processes based on defined and measurable performance metrics” (2003).

(E-Commerce Development Report, 2003)

Outsourcing is discussed in economic literature under the concept of vertical integration—or more popularly, “make or buy” decisions. In delivering a product or a service, a firm actually has a choice of which portion(s) of its value-chain of activities (i.e., raw material sourcing,

transformation or production, marketing and delivery, after-sales service, and support activities such as logistics, business administration, etc.) it will perform internally—make—or source from the market—buy.

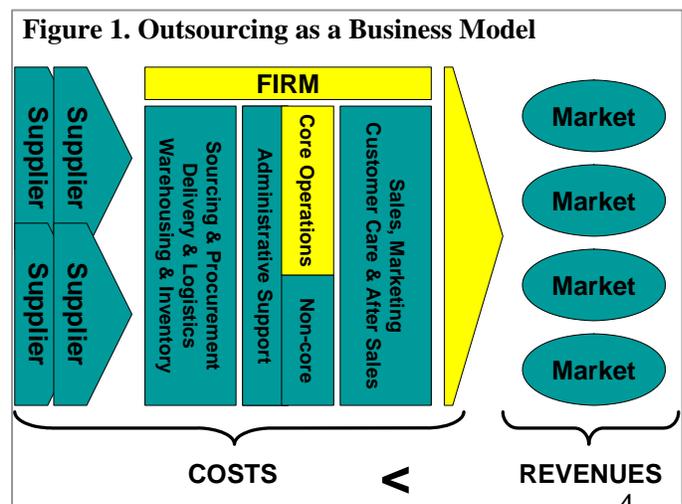
The choice of whether to “make” or to “buy” depends on the firm’s appreciation of the benefits and costs involved. Based on economic theory, the arguments for “internally-undertaking” an activity (make) are as follows (Besanko, 2003):

- Coordination of production flows through the vertical chain may be compromised when an activity is purchased from an independent market rather than performed in-house
- Private information may be leaked when an activity is performed by an independent market firm
- There may be costs of transacting with independent firms that can be avoided by performing the activity in-house

On the other hand, the arguments for outsourcing an activity (buy) are as follows:

- Market firms can achieve economies of scale that in-house departments producing for only their needs cannot attain.
- Market firms are subject to the discipline of the market and must be efficient and innovative to survive. Overall corporate success may hide the inefficiencies and lack of innovativeness of in-house departments.

Outsourcing—as a business strategy—is not actually new. Especially in the manufacturing sector, companies have long practiced “sub-contracting.” In fact, starting from domestic sub-contracting, complex international supply-chains are now driving highly-globalized industries such as garments, electronics and automotive parts and



components. Production activities are routinely outsourced to least-cost, country-locations.

However, it must be noted that migration of production activities to other countries, primarily developing countries, did not come in the form exclusively of “outsourcing.” Foreign direct investments, which were undertaken both for cost and market access considerations—to get around tariff barriers—is also a common business strategy.

## **B. Nuances of Service Transactions**

Until recently, unlike in the goods sector, outsourcing of services has been quite limited. This was due to the very nature of services and of service transactions. Services, are “economic output of intangible commodities that may be produced, transferred and consumed at the same time.”<sup>1</sup> (emphasis supplied) They cover the following major industries: transport, travel, communications, construction, financial, and insurance services. Unlike goods, and largely because of their intangible nature, it is hard to disassociate the production and consumption of services. Thus, most service transactions require the physical proximity of both the provider and the buyer of services. For example, a patient will have to “see” a doctor for the diagnosis of his/her medical condition (i.e., health service).

However, the information and communication technology (ICT) revolution has made it physically possible for certain service transactions to overcome space and time limitations. Activities and services that can be digitized and transmitted over the internet became technically feasible to be outsourced. The phenomenon is clearly explained by the United Nations Conference on Trade and Development (UNCTAD):

“The use of ICT allows knowledge to be codified, standardized and digitized, which in turn allows the production of more services to be split up, or “fragmented”, into smaller components that can be located elsewhere to take advantage of cost, quality, economies of scale or other factors. This makes it possible to produce certain services in one location and consume them (or use them in further production) in another—either simultaneously

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<sup>1</sup> Definition based on the Balance of Payments Manual of the International Monetary Fund (IMF)

(e.g. information provided via call centres) or at a different time (e.g. data entry, software development).” (UNCTAD World Investment Report, 2004)

### **C. Offshore Outsourcing**

Starting initially as a domestic phenomenon, services outsourcing rapidly evolved into offshore outsourcing. Developments in ICT made services more transportable and fragmented and simplified the tasks involved, thereby allowing them to be relocated more easily.<sup>2</sup>

A variety of service products were affected by this trend—from simple low-value data encoding to high-value processes such as architectural design, analysis of x-ray films, and software development. Initially, lower-cost “in-shore” or domestic locations were explored; followed by “near-shore” countries (e.g., Ireland, in the case of the United States).

However, outsourcing eventually took the path of “off-shoring”—or locating to low-wage countries. Typically, these countries are less developed economies with a large base of educated workforce. Low-wage skilled workers and professionals, coupled with efficient and cost-effective telecoms infrastructure, were the main value proposition of lower-income countries. International telecoms costs declined in a number of developing countries as they liberalized their telecoms sectors and consciously offered incentives to attract outsourced service activities.

### **D. Shifts in Cross-border Service Transactions**

The emerging trend on offshore services outsourcing resulted in a noticeable shift in the structure of cross-border services transactions. This shift can be understood more clearly if framed within the context of the General Agreement on Trade in Services’ (GATS) different modes by which services are supplied in cross-border transactions. These modes are commonly referred to as:

Mode 1: Cross-border Supply

Mode 2: Consumption Abroad

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<sup>2</sup> UNCTAD World Investment Report, 2004

Mode 3: Commercial Presence

Mode 4: Movement of Natural Persons

Table 1 and Figure 2 provide illustrations on these different modes of supplying services.

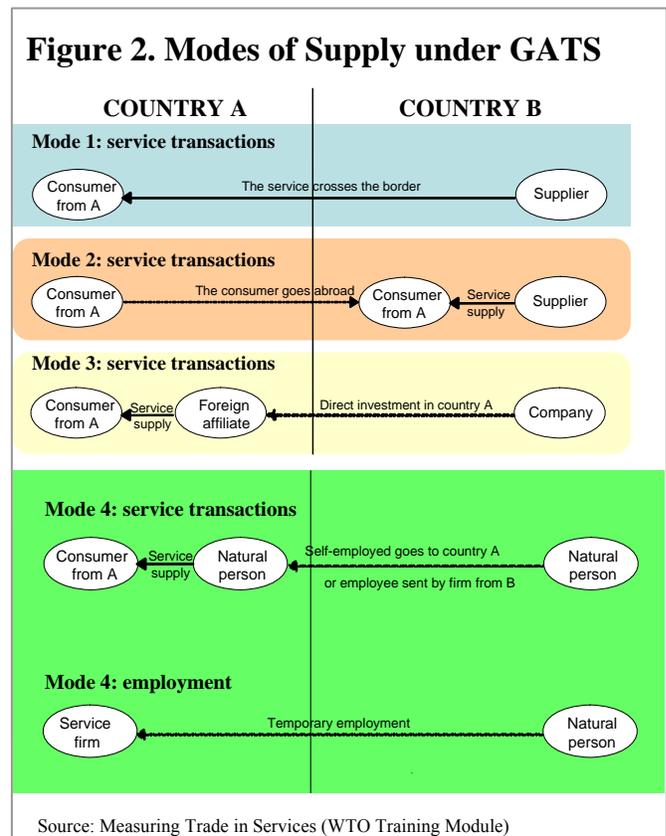
**Table 1. Modes of Supplying Services for Cross-border Transactions**

Modes of Supply	Description	Illustration
Mode 1	Cross-border Supply	Digitized and processed information crosses the border through telecoms or postal infrastructure (e.g., consulting or market research reports, tele-medicine and distance learning)
Mode 2	Consumption Abroad	Consumer crosses the border to consume the service (e.g., travel, hotel, health or training services given to non-residents)
Mode 3	Commercial Presence	Supplier of the service is a locally-established affiliate, subsidiary or representative office of a non-resident supplier (e.g., foreign direct investments)
Mode 4	Movement of natural persons	Supplier of the service is in the country on a temporary basis and remains a non-resident (e.g., service suppliers, health workers, consultants)

Source: WTO Website

In the past, because of physical constraints on the manner by which services can be supplied, trade in services typically involved the cross-border movement of either the buyer or the provider of the service. For example, a tourist travels to the country of destination (Mode 2) or a professional service organization (e.g., an accounting firm) establishes an affiliate office in another country (mode 3), or an engineer goes abroad to work on a construction project (Mode 4).

As mentioned earlier, the ICT revolution and declining telecoms costs have drastically improved the viability of supplying services across borders (Mode 1). Thus, whereas trade



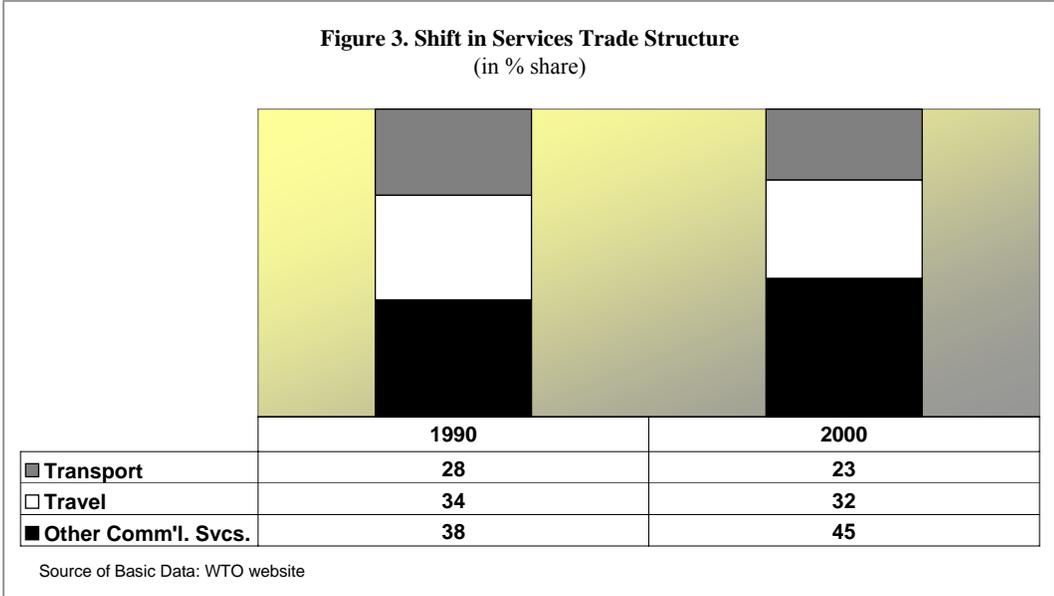
in services was previously carried-out mostly under Modes 2, 3, and 4, the ICT revolution had increasingly made Mode 1 transactions both more technically feasible and financially viable. With ICT providing a real-time link, service providers and buyers—for certain transactions—no longer needed to be physically proximate to each other.

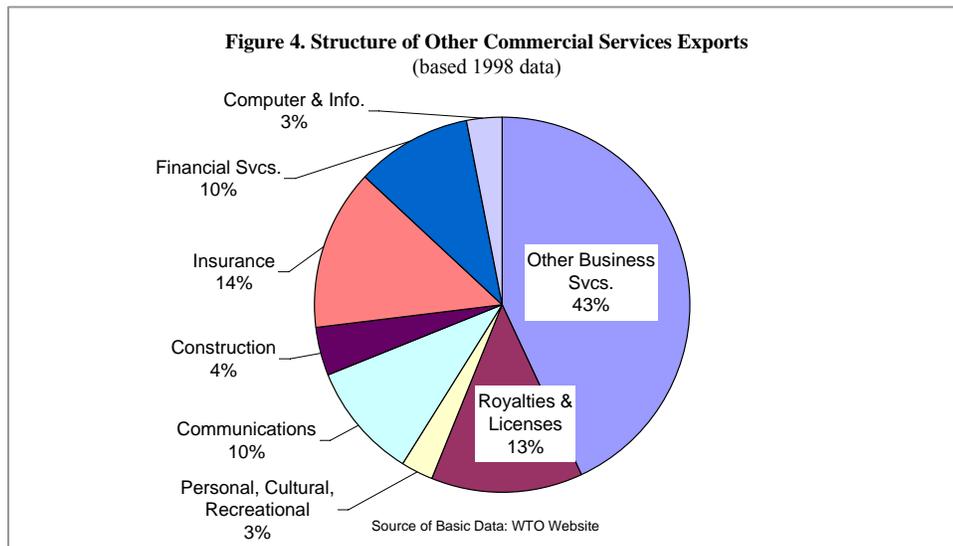
As a result, the structure of services trade shifted: “Other Commercial Services,” provided mainly under Mode 1, increased its share of the total value of trade in services. This item increased its share from 38% (of total value of services trade) in 1990 to about 45% a decade later.

The extent of offshore outsourcing can be gleaned more clearly from the large share of “Other Business Services” in the total value of “Other Commercial Services” exports. The “Other Business Services” category covers service processes which are typically outsourced, e.g. legal services; accounting, auditing; business and management consulting, etc.

This trend started with the outsourcing of lower-value adding service activities, such as data encoding and processing, jumping to marketing support activities (call centers), and at present is evolving to encompass even strategic activities, such as Research & Development.

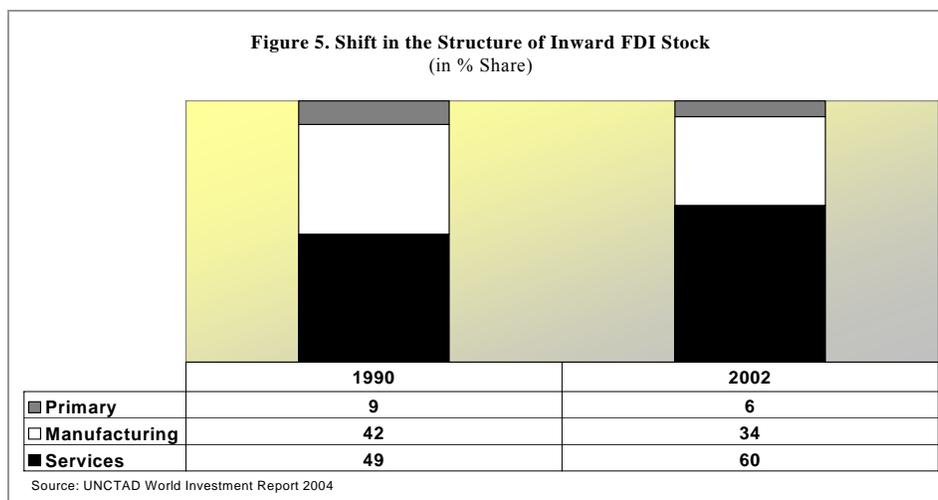
For instance, in health services, outsourcing began with Medical Transcription but now covers routine medical diagnosis—e.g., analysis of digital X-ray plates.





## E. Trends in Foreign Investments in Services

The same structural shift in services trade can be seen in Foreign Direct Investments (FDI): the share of services to inward FDI stock increased relative to the share of the primary and manufacturing sectors. From less than half of inward FDI stock in 1990, the share of Services increased to 60% in 2002.



The shift is more pronounced in certain service sectors, e.g. Business Activities (this category includes: legal services; accounting and auditing; business and management consulting; etc.). In 1990, the share of “Business Activities” in total inward FDI stock stood only at 13%; by 2002, its share doubled as it increased to 26%. More importantly, the structure of FDI flows to developing countries shifted: in 1990, “Financial Services” accounted for more than half of total FDIs; by 2002, “Business Activities” attracted the largest share of FDI inflows (40%).

	<b>1990</b>			<b>2002</b>			
	<b>Developed Countries</b>	<b>Developing Economies</b>	<b>World</b>	<b>Developed Countries</b>	<b>Developing Economies</b>	<b>Centrl &amp; East. Europe</b>	<b>World</b>
Elect., Gas, Water	1	2	1	3	4	6	3
Construction	2	3	2	1	3	5	2
Trade	27	15	25	20	14	21	18
Hotels, Restaurants	3	2	3	2	2	2	2
Transportation	2	8	3	11	10	24	11
Finance	37	57	40	31	22	29	29
<b>Business Activities</b>	<b>15</b>	<b>5</b>	<b>13</b>	<b>23</b>	<b>40</b>	<b>10</b>	<b>26</b>
Others	13	8	13	9	5	3	9
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: UNCTAD World Investment Report 2004

Likewise, the greater importance of service industries can also be noticed with changes in the profile of the biggest transnational companies (TNCs) in the world. In 1995, only 12 of the 100 largest TNCs in the world were in the Service sector; after seven years, in 2002, Service sector TNCs numbered 31.

## II. BUSINESS PROCESS OUTSOURCING: A DEFINITION

The previous chapter highlighted the need to precisely define the scope of any study on Business Process Outsourcing (BPO). As illustrated, outsourcing can cover the whole spectrum of a firm's value chain: from logistics, to manufacturing, to marketing, and to after-sales service. Moreover, there has been some confusion between two overlapping terms: **outsourcing** and **off-shoring**.

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**Table 3. List of Typical BPO Services**

### **Banking Services**

- Account opening services
- Account information capture
- Customer queries
- Check clearing
- Check payment reconciliation
- Statement processing
- ATM reconciliation
- Investment account management
- Management reporting
- Loan administration
- Credit debits card services
- Check processing
- Collections
- Customer Account Management

### **Mortgage Services**

- Application verification and processing
- Disbursals and collections
- Payment reconciliation
- Account information updates
- Mortgage Loan Servicing

### **Finance Services**

- Document management
- Billing
- Shareholder services
- Claims processing
- Accounts Receivable
- Accounts Payable
- General ledger
- Accounting services

- Treasury Operations Management

### **Credit Card Services**

- Applications screening and card issuance
- Customer account management
- Collections and customer follow-up
- Account queries and limit enhancements
- Accounting and payment reconciliation

### **Insurance Services**

- Policy Owner services
- Claims processing
- Transaction & Re-insurance Accounting
- Statutory reporting
- Annuities Processing
- Benefit Administration
- Customer information capture
- Risk assessment and premium computation
- Policy processing and account monitoring
- Claims management
- Payment reconciliation

### **Asset management Services**

- Account creation
- Account maintenance
- Transfers and additions
- Dividend payments

- Brokerage payment
- MIS reporting
- Customer service

### **Health Care**

- Medical Transcription Services

### **Customer Care**

- Customer service
- Customer analysis
- Call centers
- Consumer information services
- Customer Relationship Mgt

### **Human Resources Services**

- Payroll and benefits processing
- Training and development
- Retirement investment and benefits management
- Hiring and staffing
- Recruitment screening,
- Administration and relocation services
- Payroll processing
- Compensation administration
- Benefits planning
- Administration and regulating compliance

### **Sales and Marketing Services**

- Telemarketing Services

- Direct Marketing and Sales campaigns

**Con't . . . Table 3**

**Web-related Services**

- Website designing
- Website management
- Site personalization
- Site marketing
- Search Engine, Directory Optimization and

- Positioning Services
- Catalog / content management
- Web analytics
- Database Design
- Web security services and integration with
- CRM
- Back-office systems for inventory management
- Web enablement of legacy applications

- Electronic bill presentment and payment services
- Graphics/Animation
- Web-based Email Processing
- Web-based Help Desk
- Web-based Chat Support
- e-Learning :Web based online education services 4
- e-publishing

Source: World Bank 2003 E-commerce and Development Report, p. 141

**A. BPO Definition**

This study will look at BPOs, as defined by the Information Communication and Technology (ICT) Division of the Board of Investments (BOI) of the Department of Trade and Industry (DTI). The DTI is the lead agency charged with promoting BPOs in the country.

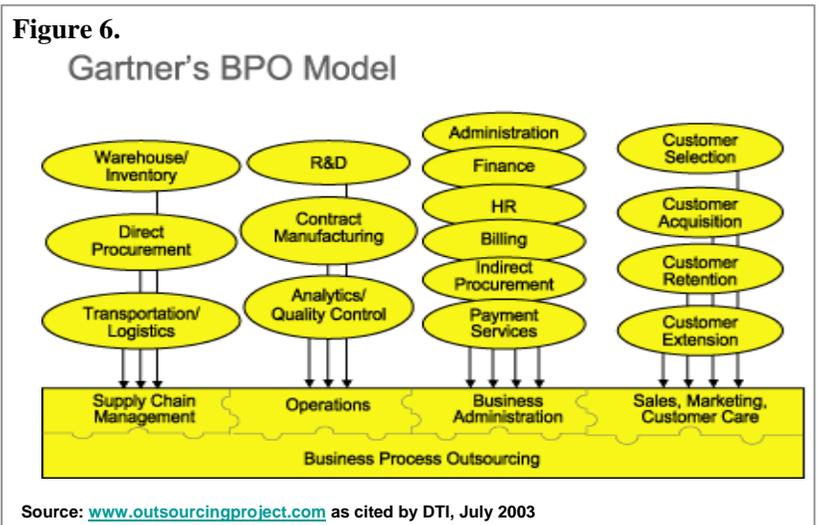
The DTI defines BPOs as: “the delegation of service-type business processes to a third-party service provider.” (“Business Process

Outsourcing Roadmap: Positioning RP as Global BPO Hub,” BOI-DTI Presentation, July 2003).

This was derived from Gartner Dataquest’ definition of BPOs as:

“the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected process or processes based on defined and measurable performance metrics.” (downloaded from

<http://www.dti.gov.ph/contentment/9/16/119/422.jsp>, December 2004)



Accordingly, BPO service offerings are categorized into four:

**Supply chain management** - includes activities such as transportation and logistics, direct procurement, and warehouse and inventory management

**Operations** - include activities such as research and development and contract manufacturing, which accounts for over 50% of the BPO market today

**Business administration** - includes activities such as finance and accounting, human resource, billing and payment services, indirect procurement, and administration services such as claims and policy processing

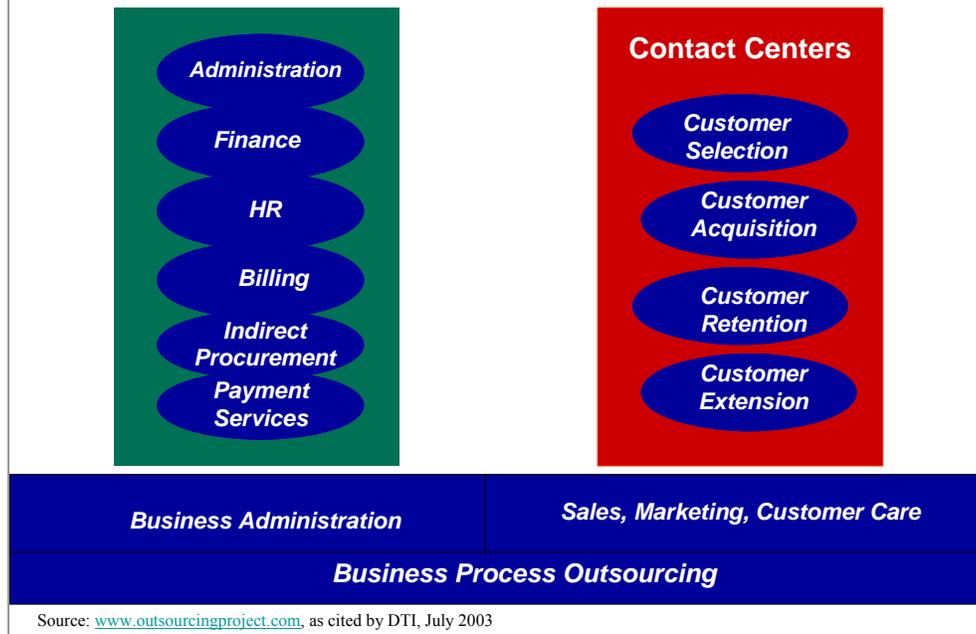
**Sales, marketing and customer care** - includes activities such as customer selection, acquisition, retention and extension

Of these four, the latter two (i.e., business administration and sales, marketing and customer care) follow more closely the DTI's definition of BPO activities. There are three key elements of this definition of BPOs:

- First, it is limited to service-type activities, specifically business support services and sales-related functions;
- Second, these activities should be IT-intensive; and,
- Third, these activities should be outsourced.

Specifically, therefore, BPOs—as defined by the DTI, includes: the outsourcing of the following IT-intensive activities: Business Administration (e.g., administration, finance, HR, billing, indirect procurement, and payment services) and Sales, Marketing and Customer Care (e.g., contact centers, customer selection, acquisition, retention and extension).

**Figure 7: Limiting BPO Definition: Services-oriented and IT-enabled**



## B. Outsourcing and Off-shoring

As domestic outsourcing developed into off-shoring, the overlap has created confusion—especially with their many derivative terms (e.g., in-sourcing, right-sourcing, near-shoring, etc.). A large reason for the confusion can be traced to the observation that domestic outsourcing eventually also leads to off-shore outsourcing.

### Box 2. Defining Offshoring

Many people are confused by the terms offshoring and outsourcing. In a nutshell, outsourcing is hiring another company to do some of your work. Offshoring is moving some of your work to another country with cheaper labor. The two ideas often overlap – for example, when outsourcing work to a supplier located offshore – but they aren’t the same. In the early days of offshoring, most companies chose to outsource because it was fast and easy. But according to our recent research, more and more companies are electing to retain control and ownership by establishing their own wholly owned offshore subsidiaries. In addition more of the benefits fall to the bottom-line. Things are even more confusing in the United States where some offshoring proponents have attempted to divert public criticism by substituting terms like *global sourcing*, *inter-sourcing*, *blended sourcing* and *rightsourcing*. But beneath the smart word-smithing, it’s still offshoring. (Report of Deloitte-Touche-Tomatsu, 2004)

On the other hand, in the search for cost-savings, not all business processes that migrate to least-cost countries are outsourced. Companies can choose to still do these service activities internally—i.e. assign it to an affiliate. This is variously referred to as

offshoring, intra-firm (captive) offshoring, captive shared service centers, etc.

What is emerging therefore is a mix of choices open to companies: to outsource or to perform the activities internally and to either do it in their home countries or locate these activities abroad.

**Table 4. Offshoring and Outsourcing – some definitions**

		Internalized or Externalized Service Production	
		Internalized	Externalized (Outsourced)
Location of Service Production	Home Country	Production kept in-house at home	A computer company contracts a call center company to handle its technical support. Call center is located in Minnesota.
	Foreign Country (Offshore)	Company consolidates all HR-related data encoding functions of affiliates worldwide in the Philippines. Example, P&G & Maersk shared service centers in Manila.	Emerson (a US industrial company) contracts SYKES (a call center firm) to handle its technical support. Call center is based in Pasig City, Philippines.

Adapted from UNCTAD World Investment Report 2004

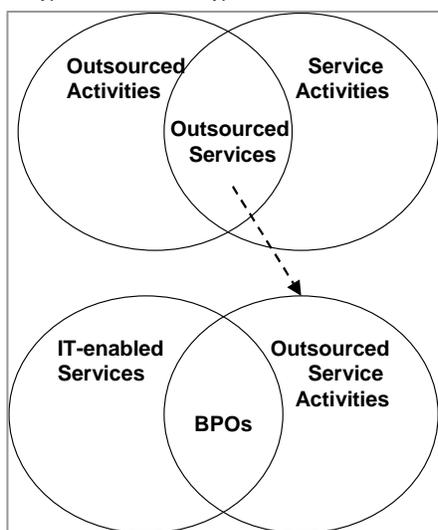
The UNCTAD illustrates these options clearly in Table 4. The Philippine Government is promoting the country as a destination not just for outsourced or third-party BPOs, but also for captive shared service companies. Examples of internalized offshoring in the country

include the shared service centers / regional headquarters of Proctor & Gamble, of Maersk, of Flour Daniels (their design and engineering center). On the other hand, the primary example for outsourced off-shore operations are, in general, the call centers.

### III. GROWTH OF BPO WORLDWIDE

Figure 8 illustrates the definitional problems discussed in the previous sections, as they apply to estimating market size. Outsourced activities cover not only services; in fact, as mentioned earlier, outsourcing started in the manufacturing sector. Moreover, another problem is that not all service activities are outsourced; as discussed earlier, service activities can be done in-house—right in the domestic premises of a particular company or in the facilities of an overseas affiliate (e.g., under the captured concept or shared services concept).

**Figure 8. Locating BPO Definition**



As result of this definitional problem,<sup>3</sup> it is difficult to pinpoint exactly the size of the global (or even domestic) BPO market. Several other reasons account for this, including:

- First, service activities—being generally intangible products—are difficult to track (compared with goods);
- Second, there is still no central source of information for services trade; and,
- Third, especially for global BPOs, services can be delivered through various modes—cross-border supply, consumption abroad, investments, or movement of natural persons.

Moreover, it must be noted that available estimates of BPO market size and growth currently originate from consultancy firms with specialty IT-related research product offerings. These include Gartner Dataquest, International Data Corporation (IDC), and McKinsey. IT-related magazines and publications, such as ComputerWorld, also monitor BPOs. In the absence of centrally-reported secondary information and given the ambiguity that still surrounds BPO definition, available numbers on BPOs are generated mainly through surveys. Since most reports of consultancy companies are proprietary in nature, the reports—including sections detailing methodology—are not fully available for public scrutiny. Thus, in using currently available estimates, readers should be conscious that these generally originated from consultancy companies which have products and services that also promote BPOs.

Moreover, these monitoring activities follow a demand-driven calendar. These are rather expensive exercises and sponsoring institutions recover their investments by market-based mechanisms.

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<sup>3</sup> For a full discussion of these issues, please see Manual on Statistics of International Trade in Services, prepared by the Department of Economic and Social Affairs, Statistics Division of the United Nations (Statistical Papers Series M No. 86 (2002)).

## A. Market Size and Projected Growth

### 1. Market for Outsourcing

Gartner Dataquest—as cited by the ITECC—estimated the global market for Outsourcing at around US\$495B. This figure includes both manufacturing and service activities—both those which are IT-enabled and those which are not.

Those which are generally considered excluded from IT-enabled services are: manufacturing services (\$495B) and distribution and logistics (\$60B). On the other hand, service activities that can be fully-enabled by IT total about \$200B, including (a) Administration, Finance, Accounting and HR; (b) Payment Services; (c) Manufacturing Services; (d) Distribution and Logistics; and (e) Sales, Marketing and Customer Care.

**Table 5.**  
**Estimated Market for BPOs**

<b>Service Line</b>	<b>US\$ Bn</b>
Admin/Finance/Acctg/HR	130
Payment Services	40
Mnufacturing Services	235
Distribution/Logistics	60
Sales/Mktg/Customer Care	30
<b>Total</b>	<b>495</b>

Source: Author's estimates based on graphs cited by the ITECC from Gartner Dataquest research

The same report further highlighted the following:

- Demand for outsourced services will have more than doubled, from \$208B in 1999 to \$543B in 2004; and,
- The biggest markets are the US, followed by Europe, the Asia-Pacific region, and then Japan.

## 2. Market for IT-enabled Services

Expectedly, to date, the Indian umbrella organization of IT and IT-related industries—better known by its initials, NASSCOM—has been the most active source information about IT-enabled Services, including BPOs. NASSCOM has jointly conducted major studies on IT and IT-enabled services with a number of consulting organizations, most notably McKinsey. Two of these studies are among the most commonly quoted in literatures about BPOs: the 1999 study on “The Indian IT Industry” and the follow-up 2003 study “India IT Strategies.”

Citing the 1999 NASSCOM-McKinsey study, the DTI placed the global market for IT-enabled services at around US\$141.2 billion (B).<sup>4</sup> The biggest segment is Data Search, Integration and Management; followed by Customer Interaction; Remote Education; Network Consulting; and Finance and Accounting.

<b>Service Line</b>	<b>US\$ bn</b>
Customer Interaction Services	33.0
Finance & Accounting Services	15.0
Translation, Transcription & Localization	2.0
Engineering & Design	1.2
HR Services	5.0
Data Search, Integration & Management	44.0
Remote Education	18.0
Networking Consulting & Management	15.0
Website Services	5.0
Market Research	3.0
<b>Total</b>	<b>141.2</b>

Source: NASSCOM McKinsey Study - India IT Strategies, as cited by DTI (2003)

However, by 2002, in the follow-up report of NASSCOM-McKinsey, the global market for IT-enabled services was projected to reach between \$325B to \$375B in 2005.

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<sup>4</sup> 2002 market size, as projected by the 1999 McKinsey Study

**Table 7.**  
**IT-Enabled Services**  
 Projected 2005 Market (US\$ bn)

<b>Service Line</b>	<b>low</b>	<b>high</b>
Inbound call centers	70	75
Engineering and design	65	70
Credit/debit card services	45	50
Payroll services	30	35
Web sales and marketing	30	35
Benefits administration	25	30
Telesales/telemarketing	20	25
Billing services	15	20
Database marketing / customer analysis	15	20
Claims processing	10	15
<b>TOTAL</b>	<b>325</b>	<b>375</b>

Source: NASSCOM-McKinsey Report 2002

In its studies, McKinsey follows industry convention and defines the segments of BPOs or IT-enabled services as:

- HR – human resource services, payroll
- Customer Care – call centers, remote maintenance, support centers
- Payment Services – back-office operations
- Content Development and Others – digital content development, engineering and design, GIS, web site services)
- Administration – data processing, medical transcription, insurance claims processing
- Finance – revenue accounting

(Source: McKinsey 2002)

### 3. Market for BPOs

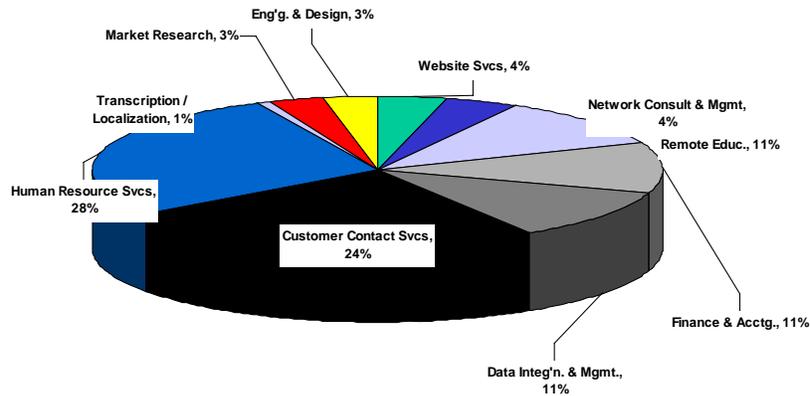
BPOs are, strictly speaking, that subset of IT-enabled services which are outsourced (i.e., as compared to captive IT-enabled services or shared services). McKinsey & Co. projects that the global BPO market will reach US\$ 180 billion by 2010<sup>5</sup>.

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<sup>5</sup> DTI Website, downloaded November 2004.

Figure 9.

## Global BPO Market by 2010



Source: McKinsey & Co., as cited by DTI & San Agustin (UA&P, 2004)

### 4. Summary of Global Market Sizes

Regardless of how BPOs are defined or on how the size of the market was estimated, all the reports consistently point to a growing market for BPOs. Thus, from a policy perspective, assuming there are no regulatory changes in other countries,<sup>6</sup> the Philippines can expect a continually growing global demand for BPOs. This is especially considering that even at the low-side estimate of a \$180B global BPO market by 2010, the country's present BPO size of about \$1.7B<sup>7</sup> is still less than a percent of this projected market size.

Based on publicly available information, Table 8 presents a summary of the market size of outsourcing, IT-enabled services, and BPOs as reported by various consulting companies.

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<sup>6</sup> For example, in the United States, legislative bills have already been filed against outsourcing of federally-funded projects.

<sup>7</sup> Excludes accounting, finance and administration (including HR) and shared services

**Table 8. Summary of IT-enabled and BPO Market Size**

	<b>Gartner Dataquest*</b>	<b>McKinsey**</b>
Outsourcing	\$208B in 1999; \$495B in 2004	
IT-enabled Services	\$200B in 2004***	\$141.2B in 2002; \$325B to \$375B by 2005
BPOs (Outsourced IT-enabled Services)		\$180B by 2010

\* as cited in various reports of the DTI and of the ITECC

\*\* based on original reports and as cited by the DTI and ITECC

\*\*\* includes the following: (a) Administration, Finance, Accounting and HR; (b) Payment Services; and (c) Sales, Marketing and Customer Care

### 5. Market for Offshored BPO

It is important to note, however, that while the total global demand for outsourcing, for IT-enabled services and for BPOs is without a doubt large, only a portion of this is off-shored. As reported by in the 2003 UN E-commerce Development Report (EDR) of the United Nations (UN), the following are some estimates of BPO off-shoring:

- Only 1-2% of all BPOs were off-shored in 2001;
- Global service exports totaled \$32B in 2001; with Ireland accounting for over ¼

In terms of FDI projects (2002-2003) in export-oriented services, on the other hand, 90% originated from developed countries.<sup>8</sup> However, most of these investments—more than half—went also to developed countries, with Ireland and Canada as primary destinations.

All these indicate that there is still room for growth in international off-shoring in services, especially to less developed countries. For example, even among the 1,000 largest firms in the world, only 30% have so far off-shored service activities to low-cost countries. Many of the remaining 70% however have plans to follow suit.

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<sup>8</sup> Firms from the United States dominated, with two-thirds of all export-oriented information and telecommunication service projects, 60% of call center projects and 55% of shared-service projects.

Moreover, although those that took advantage of cost-savings from off-shoring are mainly US-based companies. However, European companies—especially those from the United Kingdom—are starting to be receptive to the idea. In a 2004 study jointly undertaken by the UNCTAD and by Roland Berger Strategy Consultants, about 83% of large European companies with off-shoring activities were found to have been satisfied with the experience, only 3% were dissatisfied, and 44% of the companies interviewed planned further off-shoring in the coming years. This will most likely push other firms to look into off-shoring as a competitive strategy.

The UNCTAD expects fastest growth to be in the off-shoring of IT-enabled services, which is forecasted to expand from \$1 billion in 2002 to \$24 billion in 2007. (UN EDR, 2003)

The over-all general conclusion is that off-shoring is still far from its mature stage; its still too early to predict its pattern of growth and favored country-locations. One of the earliest studies on the phenomenon (of off-shoring) was undertaken by the World Bank in mid-1990s. The research suggested that between 1% to 5% of total jobs in G-7 countries could be affected by off-shoring.<sup>9</sup> In more recent estimates done by business research groups, the following points were arrived at: (UN EDR, 2003)

- About 3.4 million service jobs may shift from the United States to low-income countries by 2015;
- Another study said that 2 million off-shored jobs could be created in the financial services industry alone, and that the total number of jobs affected for all industries could be in the area of 4 million.<sup>10</sup>

## **B. Main Drivers for Growth**

Many companies have decided to outsource for a number of reasons, including: (DTI 2003)

- to improve speed-to-market and competitiveness;

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<sup>9</sup> which they defined as activities in which long-distance provision is technically feasible and for which cost savings of up to 30-40% is possible.

<sup>10</sup> While this figure may seem large, it should be compared with an average turnover of 4 million jobs every month in the United States.

- to focus on core competencies;
- to access intellectual capital, scarce skills and resources with no long-term investment; and,
- to have more disciplined processes, shared risks and partnerships in the transformation to e-business.

However, the main driver for off-shore outsourcing remains to be cost-related considerations. In a survey done in the US by Computerworld, companies were asked on why they outsource to non-U.S. locations<sup>11</sup>. The results were:

- (1) to reduce/control costs (44%)
- (2) to free up internal resources (20%)
- (3) to gain access to world-class capabilities (13%)
- (4) to increase revenue potential (13%)
- (5) to reduce time to market (11%)
- (6) to increase process efficiencies (11%)
- (7) to follow company philosophy of outsourcing noncore activities (11%) and
- (8) to compensate for lack of appropriate skills (8%)

Estimates by analysts (e.g., Neo IT) and by the UN EDR (2003) point to cost savings of up to 40% for off-shoring service activities. However, not all service activities can be off-shored.

There are several reasons cited by the UN EDR for this, including:

- For certain services, proximity to markets, interaction with customers, trust and confidence outweigh the possible benefits of an international division of labour.
- Technological limitations cannot be discounted as it is not possible for all service functions to be digitized and/or separated from related activities.

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<sup>11</sup> Based on a survey of 252 corporate IT managers in the U.S.; respondents were asked to select the three most important reasons. Source: Computerworld and InterUnity Group Inc., Concord, Mass., April and May 2003.

- Some businesses will continue to need localized services or person-to-person contact for exchanging highly confidential information or for adapting to rapidly changing customer needs.
- Regulations and legal requirements (e.g. regarding privacy) may also raise transactions costs and limit international trade in services. Certain services, such as insurance and banking, are required by law in some countries to be provided by companies established locally.
- The lack of international recognition of professional qualifications is another obstacle, as is the lack of globally agreed privacy rules.
- Some international locations also lack the capacity to host off-shored service activities. These include the supply of reliable telecom infrastructure, appropriately educated workers, rising wage costs and high levels of attrition in the fastest growing destinations, all giving rise to shortage risks, at least in the short run.
- TNCs too have different perceptions of the risks and benefits of off-shoring services and some are reluctant to do so.

#### **IV. PHILIPPINE BPO INDUSTRY**

##### **A. Main Segments**

The Philippine Government has identified 10 export-oriented product groups that it will actively promote and assist (10 Priority Revenue Streams). BPOs are lumped together under the sector IT-enabled Services. The Government, through the DTI, is actively pushing for the following specific sub-sectors:

- **Contact Centers** - A physical location where calls are placed or received in high volume for the purposes of sales, customer service, technical support, research, and others.
- **Medical Transcription** - Process of interpreting/ encoding electronically the oral dictation of health professionals regarding patient assessment, therapeutic procedures, diagnosis, and so forth.

- **Animation** - The process of giving the illusion of movement to cinematographic drawings, models or inanimate objects thru 2D, 3D, etc.
- **Shared Financial and Accounting Services** - System of centralization/distribution where an independent business unit is dedicated to providing process- or knowledge-based financial services to other business units.
- **Software Development Services** - Analysis and Design, Prototyping, Programming and Testing, Customization, Reengineering and Conversion, Installation & Maintenance, Education & Training of Systems software, Middleware and Application Software<sup>12</sup>

In as much as these IT-enabled services can also be outsourced, these coincide with the sectors promoted under BPOs. For the Philippines, what is critical is that these are off-shored service activities—regardless of whether these are captive (in-sourced or shared services) or the third-party (outsourced) type.

The distinction may however be critical in certain policy decisions—i.e., the policy instruments used to attract shared service BPOs may be different from those for third-party BPOs. Captive off-shore service activities can be attracted to the Philippines through investment policies (Mode 3: Commercial Supply); while promoting third-party off-shore outsourcing will be through service export policies (Mode 1: Cross-border Supply).

## **B. Market Size and Structure**

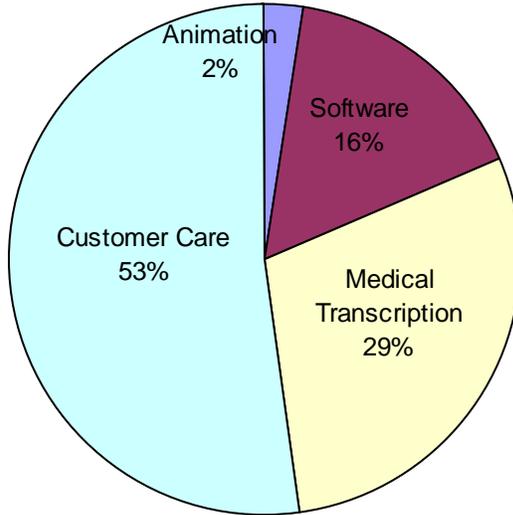
According to the DTI, the Philippine BPO sector reached a size of about \$1.655B in 2004, up from just about \$350M in 2001. It grew by an annual average of about 160%. The biggest sub-sector is Customer Care (Call Centers) at \$864M in 2004; followed by Medical Transcription at \$483M; Software Development at \$268M; and Animation, \$40M.

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<sup>12</sup> In recognition of the country's advantage, the DTI is also keenly promoting the Engineering Design Services sector (i.e., separately from Software Development or from Shared Services).

**Figure 10.**

**RP BPO Industry Structure**  
2004, \$1.6B (Total Size)



All of the BPO sectors registered cumulative growth rates of above 25% from 2001 to 2004, with Medical Transcription the growing fastest at 130%; followed by Call Centers with 50%; Software Development Services at 30%; and Animation at 25%.

**Table 9. Summary of Philippine BPO Segments**

		Contact Centers	Medical Transcription	Animation	Shared Financial & Acctg Services	Software Development Services
RP	'01	US\$ 173 M	US\$ 40 M	US\$ 21M	No data	US\$ 115 M
	'04	US \$ 864 M	US\$ 483 M	US\$ 40 M		US\$ 268 M
	Growth	50% (CAGR)	130%	25%		30%
Trends		"The Philippines is set to be among the largest markets for contact centers in Asia Pacific in the next 5-7 years."	\$10-\$16B industry, growing at a cumulative annual average of 20%. In the US, only 47% of the market is outsourced, the rest is in-house. Anticipated surge as there are hospitals which have yet to convert records as required by law.	Global animation revenues projected from US\$16B to US\$50B by 2004-2005 (~25% p.a.); new China market for education, design, and marketing services.	Consolidation of backroom operations on a regional level.	India moving out of legacy systems; e-business, mobile applications.

<b>Current Players</b>	37 Firms	Approximately 16 firms	Approximately 22 firms, including 11 direct exporters	Approximately 5 - 6 Finance & Administration centers today + other backroom operations	Approximately 52 BOI-registered firms and 24 PEZA-registered firms
<b>RP Value Proposition</b>	Service ethic/attitude (vis India); cost, turnover (vis Australia); language (vis China).	Familiarity with medical standards, terminology and practices of the USA; pool of health-related skilled workers.	We are considered a competency center for intangibles such as artistry, creativity (vis India), ability to interpret cultural nuances (vis China, Korea, Taiwan).	"Among the best accountants in the world"; Ranked 16/49 for "International Business Experience" by the World Competitiveness Report 2001 (India is no. 38) ; 80,000-100,000 BA / Comm graduates; cost savings of 20% - 40%	
<b>Existing Market</b>	United States, United Kingdom	United States	a. Entertainment – US, Japan & Australia / Canada / France; b. Education / business - Malaysia, China, Korea, Thailand	Regional HQs – in HK/Singapore; Financial Community (East Coast, Brussels)	USA/India (as locators/sellers), Corporate USA (as buyers), Singapore (as partner for India/China and US)

Source: DTI

### 1. Call Centers

The Philippines is widely recognized as the emerging best location for call centers, serving as a credible challenge to India and to Australia. Its call center industry size, measured in terms of number of seats, is projected to have jumped by 100% from the 20,000 in 2003 to about 40,000 in 2004. This placed the Philippines directly behind Australia, India and China in terms of call center industry size.

**Table 10. Comparative Call Center Industry Sizes**  
(Asia, in no. of Seats)

Country	2003	2004f	Growth
Australia	135,000	146,000	8%
India	96,000	158,000	65%
China	38,000	54,000	42%
Philippines	20,000	40,000	100%
New Zealand	12,000	13,500	13%
Thailand	11,000	13,000	18%
Singapore	10,000	10,100	1%
Hong Kong	10,000	10,700	7%
<b>TOTAL</b>	<b>332,000</b>	<b>445,300</b>	<b>34%</b>

Source: [www.callcenter.com](http://www.callcenter.com), as cited in Agustin (2004)

The external market opportunities for the country, in terms of the call center industry, remains strong as off-shoring gains momentum and as off-shored call centers from more costly countries, such as Ireland and Canada, are attracted to the Philippines.

## 2. Medical Transcription

The surge in the growth of Medical Transcription is however mainly due to a unique opportunity offered by federal regulation in the US that required hospitals to store digital copies of patients' records. While demand will stabilize in the medium-term, the Philippines' share of about \$483M is still very small compared with the potential market size estimated by DTI at about \$10B to \$16B. Moreover, as the US' health care system discover the benefits of off-shoring and outsource other administrative aspects of their operations (i.e., aside from patient records), the potential market will expand.

The main advantage of the Philippines is again its telecoms infrastructure, labor, and reasonable office rental fees. For labor, the Philippines is especially attractive because of its global reputation for health professionals. A basic knowledge of medical terms is critical for medical transcription.

On the downside, the technological trend is towards the development of automatic voice recording systems that may make human intervention in certain portions of the transcription

process unnecessary. However, these technologies may still take several years before they can be fully applied in the context of medical transcription.

### 3. Others: Animation, Shared Services and Software Development

Call centers and medical transcription alone account for more than 80% of total IT-enabled services / BPO revenues. The other 20% is shared by animation, shared services and software development.

The country's creative talents are recognized globally and are well-suited for computer animation. However, the industry is still at the level of 2D (two dimensional) computer animation; while India is already at the level of 3D animation. The biggest stumbling block is the high cost of computer hardware and, also, of the software. Based on an interview, it is estimated that a computer seat—hardware plus software—for 3D animation will cost between \$3,000 to \$6,000. Aside from India, Canada is also a major player in computer animation.

However, the country can exploit a particular niche in computer animation—content development for educational purposes. There is a growing market for English-based educational content materials for Asian countries such as China, Taiwan and Korea.

The Philippines has tremendous potential as a location for shared service operations in the area of Finance and Administration. A key reason is the educated workforce. An example is in the area of Accounting, where the Philippines has been a constant source of accountants for overseas assignments.

The country is already host to certain shared services functions for such companies as Citibank (call center operation, systems development and support), Proctor and Gamble (finance and administration, IT), Maersk (finance and administration), Caltex (finance and accounting), and Fluor Corp. (engineering design).

**Table 11. Representative Foreign Companies with IT-enabled Activities in RP****U.S. Companies**

<b>Company</b>	<b>Activity</b>	<b>Market</b>
America Online (AOL)	Customer Relationship Management/ Customer Contact Center	North America
Accenture	Management consultancy, market technology solutions	Worldwide
Barnes & Noble	Inventory management; on-line purchasing	North America, France
Caltex	Finance & accounting shared services	Southeast Asia
Citibank	Systems development and support	Asia-Pacific & Eastern Block Asia
Fluor Corp. (Fluor Daniel Phils.)	Regional engineering design work for EPC	100% export to Japan
James Martin (Headstrong Phils.)	Global research & applications development center (finance, supply chain management, etc.)	80% exported Worldwide
SYKES	Customer Contact Center	North America & Asia-Pacific

**European Firms**

<b>Company</b>	<b>Activity</b>	<b>Market</b>
Alitalia	Business process outsourcing	Asia, Middle East, North & South America
International Red Cross	Business process outsourcing	Worldwide

**Japanese Firms**

<b>Company</b>	<b>Activity</b>
Sumitomo Group	Machinery design & software for Sumitomo Heavy Industries
Mitsubishi Heavy Industries	Power plant & ship-building design (MHI Technical Services Corp.)
JGC Philippines, Inc.	EPC (engineering, procurement & construction)
NEC Telecom	Network software & telecom management systems development
Fujitsu (Software)	Application software & middleware; micro-coding for ICs
Tsukiden Group	Computer software development, LSI design, R&D

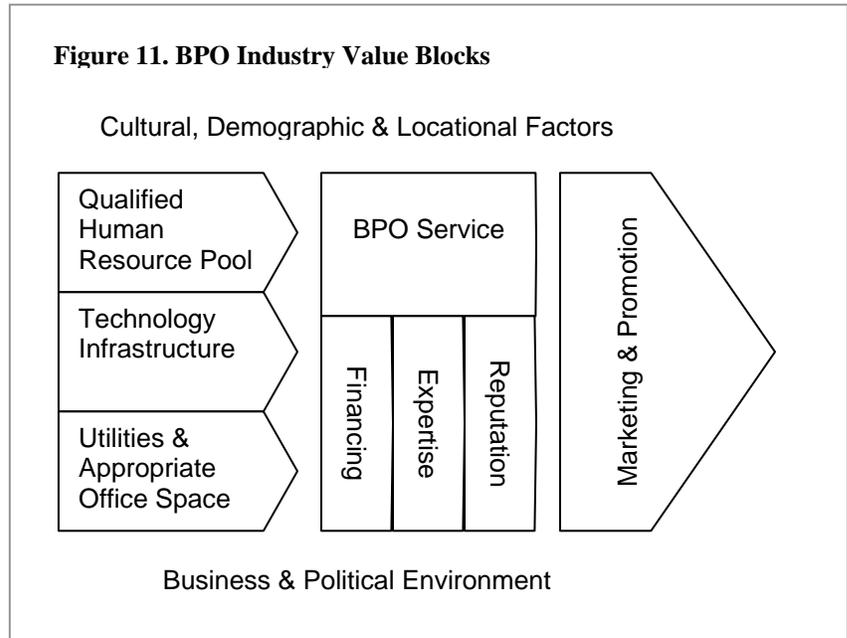
Source: DTI

## V. RP ATTRACTIVENESS AS A BPO LOCATION: INDUSTRY VALUE-CHAIN

### A. Basic Value-chain blocks

Based on interviews and on past studies done on BPOs, the starting-point of any viable BPO industry chain, from a national perspective, are:

- a sizeable pool of qualified human resource
- an efficient and cost-effective telecoms infrastructure



- adequate supply of building space equipped with the required IT, telecoms and power infrastructure

In selecting a BPO location, prospective investors place paramount importance in these industry value blocks—representing the three biggest cost-items of any BPO operation.

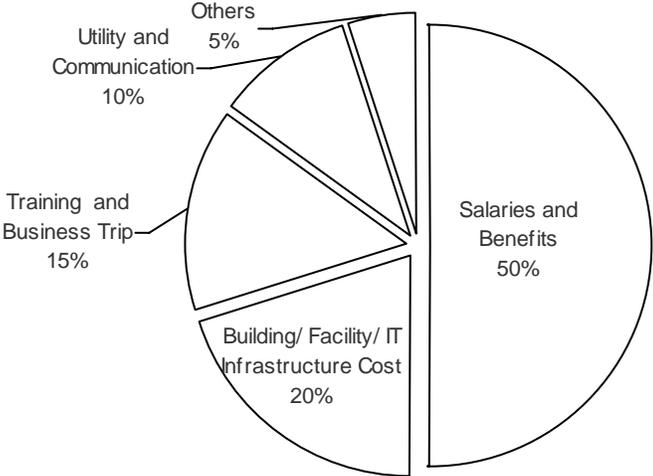
**Table 12. Structure of BPO Costs, per Interviews & Financial Statements**

Cost Items	Share to Total Costs
Salaries and Wages	40% to 60%
Rent	10% to 18%
Telecoms	10% to 25%

Source: Interviews and Selected Financial Statements

The DTI reports a similar cost structure: Salaries and Benefits taking 50%; Building & Infrastructure, about 20%; and Utilities and Communications, 10%. Training and Business Trips were also cited by the DTI as significant cost items for BPOs.

**Figure 12. Structure of BPO Costs, per DTI Report**



Source: DTI

In addition to these industry building blocks, the general environment must likewise be conducive to the operation of BPO companies (i.e., to foster the development of the needed building blocks). Critical considerations are:

- cultural affinity to the target market
- continually growing educated workforce
- geographic location yielding advantages to client company operations (e.g. different and complementary time zones)
- stable political and social conditions (e.g., political stability and physical security).

Lastly, as demonstrated by the Indian experience (i.e., through NASSCOM), a strong, well-communicated country positioning strategy is essential in capturing international BPO projects.

These industry pre-requisites (i.e., human resource pool, telecoms infrastructure, and utilities) and enabling environmental conditions (i.e., socio-economic and political environment) attract locators to consider a country as a BPO site.

In turn, the success of any BPO company, as an individual organization, depends on the presence of critical entrepreneurial resources. Most critical among these are: (1) access to financing, (2) industry expertise, and (3) proven track record (i.e., a good reputation among client companies).

## **B. The Philippine Advantage**

The sustainability of BPO growth in the Philippines can thus be looked at in three levels:

- (1) Broad Environment - the environmental conditions that will enable the enhanced development of the industry
- (2) Support Industries - the presence of key industries and infrastructure that will support the BPO industry
- (3) Organizational Resources – a specific BPO company’s access to entrepreneurial resources that will allow it to succeed.

It must be emphasized that these three levels are dynamically inter-acting with each other. For instance, the ability of BPO companies to access entrepreneurial resources will be a function of the enabling conditions that foster the development of the industry.

### 1. Broad Environmental Conditions

The broad environmental conditions facing any organization may be generalized into two: social and political. While the Philippines enjoys advantage in the social aspect; it is least-attractive from the political perspective.

## **Social Environment**

The key advantages of the Philippines, in terms of the social environment, are (1) its cultural affinity with the major market, the United States, and (2) its large population base and healthy demographic structure.

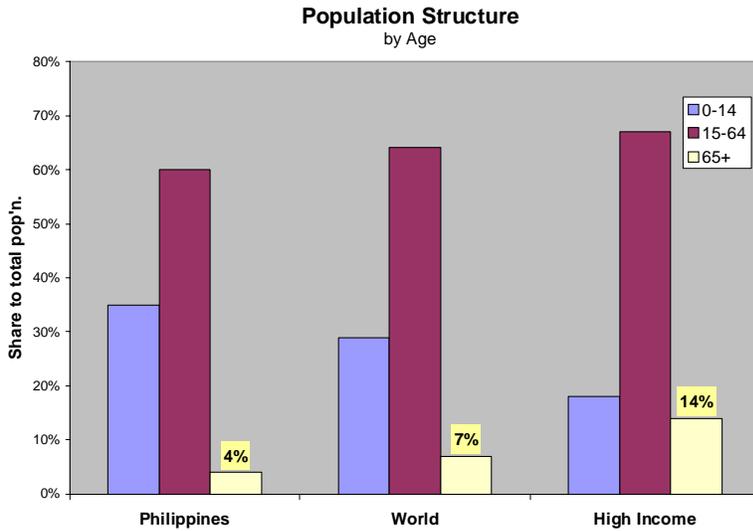
The main legacy of the Philippines' almost 50 years of being under the US is the country's public education system. This has been the single biggest reason why (1) literacy rate in the Philippines has historically been higher than its neighbors, (2) most Filipinos have a functional-level of English-speaking skill and (3) Filipinos are familiar and immersed in Western culture. Until recently, English was also the main medium of instruction in Philippine schools.

In the Philippines, the illiteracy rate, according to 2002 estimates by the World Bank is about 5% of population above 15 years of age. This is significantly lower than the average for all economies in East Asia and the Pacific (13%) and for all lower-middle income countries (13%). The country is also home to the 3<sup>rd</sup> largest English-speaking population in the world (next to the US and the United Kingdom).

On the other hand, the most important asset in any service-related industry is "people." In this context, the emerging major BPO locations are those countries with large population base—India, the Philippines and China. Should Indonesia and Vietnam eventually pursue focused programs to promote the use of English, these two countries can also attract serious attention as BPO locations.

However, not only is the Philippines enjoying a robust population growth and level, its demographic structure also ensure the continued flow of workers into the labor force pool. For instance, while only 4% of Filipinos are above 65 years old, roughly 7% of total global population is at this age range. The situation is far-worse for high-income countries, typically the source of BPO projects, where about 14% of their population belongs to 65 years and above age group.

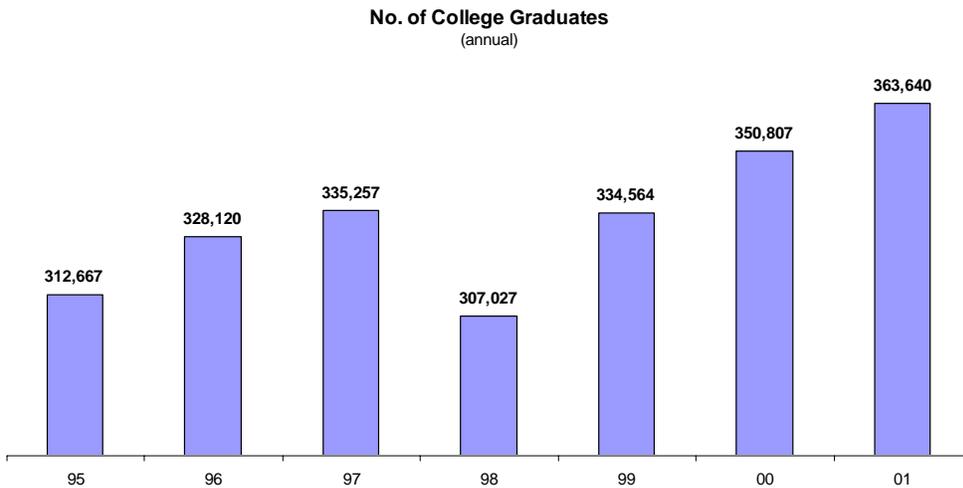
**Figure 13.**



Source of Basic Data: World Bank

A large population base, while a necessary condition for BPO development, should be complemented by a strong educational system. The Philippine public and private university system combined produces about 360,000 graduates per year.

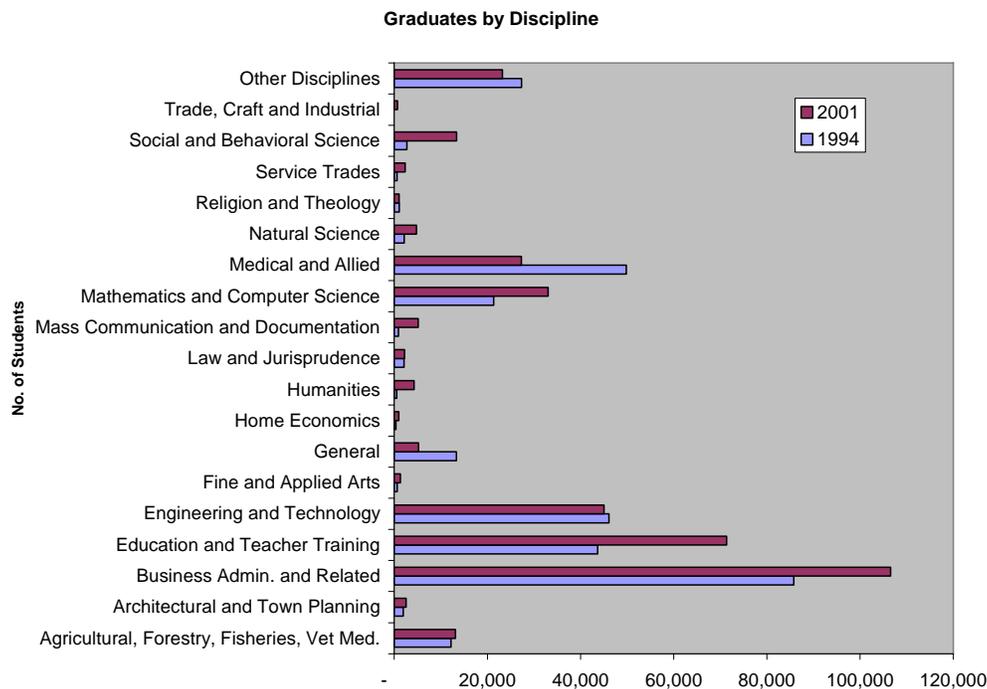
**Figure 14.**



Source: Commission on Higher Education (CHED)

Among these graduates, an estimated 30,000 to 50,000 are technically-proficient workers—getting degrees in computer science and programming. Another 50% percent of the total graduates are knowledgeable in fields commonly required in BPO operations, such as: business administration, mass communication and other related courses.

**Figure 15.**



**Table 13. Philippine Labor Pool Statistics**

<b>Total Number of Graduates (approximate, 2002-2003)</b>	<b>363,640 University Graduates/year</b>
Business Administration and Related Courses	106,559
Engineering and Technology	45,041
Math & Computer Science	33,059
Mass Communication & Documentation	5,140

Source: CHED

While the pool of university graduates remains stable, there are alarming indications that the quality of graduates have been declining. This, as will be discussed later, has already been affecting BPO companies in terms of the difficulty in getting qualified applicants. What is more

worrisome is that the declining trend will most likely persist, further eroding the competitive advantage of the Philippines.

For instance, in key disciplines such as Math and Science, the Philippines has been consistently placing near the bottom of international benchmark studies. The results of the “Trends in International Mathematics and Science Study” (TIMSS) of the Boston College serve as a good indicator. The TIMSS is a competitive examination to test the general level of Math and Science knowledge of specific grade-levels of students. In the test for 8<sup>th</sup> grade students, for example, the benchmark indicators show the Philippines near the bottom.

**Table 14.**  
**Trends in International Mathematics &  
 Science Study (Grade 8)**  
 2003 and 1999

	1999		2003	
	Math	Science	Math	Science
	<i>Rank out of 38 countries</i>		<i>Rank out of 45 countries</i>	
<b>RP</b>	<b>36</b>	<b>36</b>	<b>41</b>	<b>42</b>
Singapore	1	2	1	1
Korea	2	5	2	3
Taiwan	3	1	4	2
HK	4	15	3	4
Japan	5	4	5	6
Malaysia	16	22	10	20
Russia	12	16	12	17
US	19	18	15	9
<b>RP Score</b>	<b>345</b>	<b>345</b>	<b>378</b>	<b>377</b>
<b>Int'l. Ave.</b>	<b>487</b>	<b>488</b>	<b>467</b>	<b>474</b>

Source: Trends in International Mathematics and Science Study,  
 Boston College (2004)

In 1999, among Grade 8 pupils, the country ranked 36<sup>th</sup> out of 38 for both Math and Science. In the latest study, conducted in 2003 and released in December 2004, out of 45 countries, the Philippines placed 41<sup>st</sup> for Math and 42<sup>nd</sup> for Science. On the other hand, neighbors like Taiwan, Korea, Singapore and Japan have consistently topped the TIMSS.

It is interesting to note also that Eastern European countries, in addition to Russia (ranked 12<sup>th</sup> for Math and 17<sup>th</sup> for Science), are also getting high scores. For example, in 2003, for

Mathematics achievement, Belgium placed 6<sup>th</sup>; Estonia, 8<sup>th</sup>; Hungary, 9<sup>th</sup>; Latvia, 11<sup>th</sup>; Slovak Republic 13<sup>th</sup>; and Lithuania, 16<sup>th</sup>; to name a few. The same can be said of the Science exams: Estonia placed 5<sup>th</sup>; Hungary, 7<sup>th</sup>; Slovenia, 12<sup>th</sup>; Lithuania, 14<sup>th</sup>; Slovak Republic, 15<sup>th</sup>; Belgium, 16<sup>th</sup>; and Latvia, 18<sup>th</sup>.

These Eastern European countries will provide competition to the Philippines, especially in the higher-end BPO segments, considering that the next wave of BPO growth will most likely come from Western European countries. Eastern Europe will surely take advantage of its increasing integration into the European Community.

### **Political Environment**

While the Philippines can still cope with the negative impacts of its deteriorating educational system, the impact of its very fluid political environment is more immediate. Potential investors, including those in BPO services, are worried about the political problems in the country: (1) extent of graft and corruption, (2) criminality, and (3) threats to physical security.

For instance, again drawing on the Global Competitiveness Report, the Philippines ranked 102<sup>nd</sup> for “business cost of terrorism” (out of 104 countries); 83<sup>rd</sup> for “business cost of crime and violence”; and 96<sup>th</sup> for “business cost of corruption.”

**Table 15. Ranking of the Philippines in Political Factors**

	<b>Business Cost of Terrorism</b>	<b>Business Cost of Crime &amp; Violence</b>	<b>Business Cost of Corruption</b>
<b>(Rank out of 104 countries)</b>			
US	97	21	18
China	45	51	66
Canada	68	27	20
India	71	22	54
Australia	55	19	4
Russia	92	70	100
Indonesia	88	65	72
Hong Kong	20	4	11
Ireland	13	40	17
Thailand	85	33	48
Israel	103	13	8
Malaysia	73	23	38
Singapore	76	5	10
Czech Rep.	43	59	82
Hungary	14	47	63
<b>Philippines</b>	<b>102</b>	<b>83</b>	<b>96</b>
New Zealand	16	18	2
Romania	38	54	95
Vietnam	58	43	73
Source: 2004-2005 Global Competitiveness Report			

## 2. Support Industries

As mentioned, the key support industries for BPO services are telecoms, office space development and utilities.

### **Telecommunication**<sup>13</sup>

The Philippines is considered to have a relatively good telecommunication infrastructure, for both voice and data, as compared to other countries in the Asia Pacific region. There is redundant international connectivity, including fiber optic cable and satellite communication. As a result, a significant amount of trans-Pacific data communication bandwidth is easily available.

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<sup>13</sup> Discussions on telecommunications and real estate were adapted primarily from DTI documents

There is high-quality, low-cost bandwidth that is expanding the domestic telecommunication network. Currently, six platforms are available:

- Fixed line
- Cellular
- Cable TV
- Over the Air TV
- Radio
- The Very Small Aperture Terminal (VSAT) System

The bandwidth cost has declined by 70 percent during the past four years, according to local IT service and contact center providers (as cited by DTI). In addition, there are a number of international carriers for telecommunication services, a solid competitive landscape for buyers.

The Philippine telecoms market, compared with India, offers lower prices (by 30-50%), shorter procurement times (3 weeks as opposed to 3 months) and less transmission delay.

**Table 16. Competitiveness of Philippine IT Infrastructure  
Results of WB ICT Survey (2002, latest)**

	<b>Broadband Internet Access</b>	<b>Specialized IT Services</b>	<b>Competition in ISPs</b>	<b>Gov't. on-line services</b>	<b>Laws on ICT</b>	<b>Gov't. priority on ICT</b>
RP	3.6	4.6	4.4	2.3	4.1	4.6
India	3.2	5.8	4.5	3.9	4.3	5.6
China	2.9	4.3	3.7	3.5	3.5	5.3
Singapore	5.8	5.2	5.3	6.4	5.4	6.2
HK	5.3	6.0	6.1	5.7	4.7	5.3
Thailand	3.9	3.9	4.9	3.2	3.5	5.1
Indonesia	3.4	4.0	4.2	2.0	2.8	3.7
Vietnam	2.7	3.4	2.7	2.2	2.8	4.7
Japan	3.3	5.7	4.8	3.2	4.2	5.3
US	5.7	6.6	5.9	5.4	5.4	5.3

Source: World Bank Development Data Group

**Table 17. Key ICT Indicators: Philippines vs. India and the US**

(2001, latest)	RP	India	US
<b>ICT Infrastructure &amp; Access</b>			
Tel. lines per 1,000 people			
Country	42	38	667
In largest city	265	136	--
Waiting list (in '000)	--	1,649	--
Revenue per line (\$)	721	198	1,566
Cost of local call (\$ per 3min.)	--	0.02	0.09
Mobile phones per 1,000 people	150	6	451
Int'l. telecoms			
Outgoing traffic (min. per subscriber)	49	14	156
Cost of call (\$ per 3min.)	4.8	3.2	--
<b>Computers &amp; the Internet</b>			
Personal Computers			
Per '000 people	21.7	5.8	625.0
Installed in schools ('000)	77	239	16,322
Internet			
Users ('000)	2,000	7,000	142,823
Monthly off-peak access charge			
Service provider charge (\$)	23.9	10.0	5.5
Telephone usage charge (\$)	--	0.2	3.5
<b>ICT Expenditures</b>			
Total ICT (\$ million)	3,131	19,662	812,635
ICT as % of GDP	4.2	3.9	7.9
ICT per capita (\$)	40.5	19.0	2,923.8

Source: ICT at a Glance, by WB Development Data Group

## Real Estate

The Philippines has readily available locations and infrastructure to support the IT-enabled services industry. The primary physical locations where enterprises would most likely site operations are focused in and around the capital city of Manila. The options are primarily focused in five physical locations:

- Metro Manila, specifically the central business district of Makati and the business districts of Ortigas, Filinvest Alabang, and Fort Bonifacio.
- Technology parks located within the Metro Manila area (i.e., predominantly suburban locations just outside Manila)

- Two re-purposed military bases located two or three hours outside Manila (Subic and Clark)
- Established regional growth centers, especially Cebu in the Visayas; and Davao in Mindanao.
- Geographic centers of academic activity, such as (in addition to the locations mentioned so far) Baguio, Naga and Dumaguete.

“Ready-to-occupy” locations are available, especially in Metro Manila. Due to the Asian economic crisis of 1997, the Philippines has an over capacity of real-estate space. As a result, the price of commercial real estate is quite low compared to equivalent options in India, specifically Bombay. All other destinations compare favorably with the Philippines.

## **Utilities**

The Philippines, however, has one of the highest tariffs for electricity rates in Asia. Though not often cited, the high power rates is a source of disadvantage for BPO companies that must continuously operate all day, seven days a week, at climate-controlled environment (i.e., air conditioned). With power rates accounting for roughly 10% of total operating BPO cost, any improvement in this area will lead to additional cost advantages for Philippine BPOs. Possible measures, in the short-term, could include “peak-load” pricing for electricity consumption. This will mean lower electricity bill for BPOs at night—coinciding with the complementary time zones of the Philippine and the US.

### 3. Organizational Resources

Ultimately, the success of any BPO company will depend on the firm’s access to financial and human resources.

## **Financial Resources**

Investing in a BPO project requires considerable amount of capital. For instance, a call center project would need about US\$10,000 per seat. Thus, a modest 100-seat call center will require an investment of about US\$1 million (M). At an exchange rate of US\$1:Php55, this means that a start-up call center will need Php55M. Payback can however be very attractive, with some estimating that a call center seat can earn anywhere from US\$1,000 to US\$2,000 per month (net income).

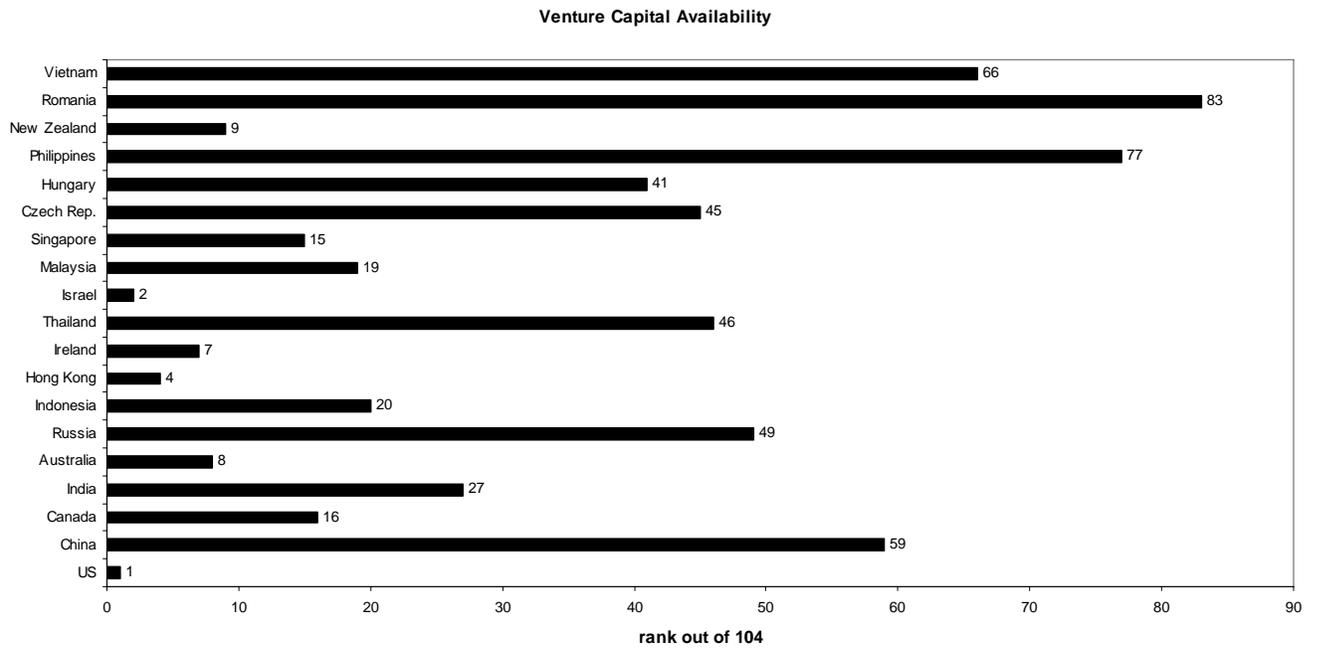
Investments for other BPO services are much higher. Animation companies, for example, need to invest as much as US\$3,000 to US\$6,000 per seat—covering both hardware and software components needed for intricate 3D designs.

Given the high investment-levels and risky nature of BPO projects, financing come only from any of following:

- Foreign-based BPO companies wanting to establish service-base in the Philippines (e.g., e-Telecare, SYKES, etc.)
- Global companies that want to consolidate service activities in a regional office (e.g., Citybank, Maersk, etc.)
- Venture Capitalists

For a Filipino company that wants to open a BPO business, venture capitalists will just about be the only source of financing. However, access to venture capital is quite difficult in the country. In contrast, India already has a number of indigenous BPO companies (e.g., Daksh was an Indian-owned company before it was bought by IBM). Entrepreneurial financing for these companies were primarily from Indian technology professionals, who migrated to the US but who came back to India to jumpstart the country's entry into IT-related ventures.

**Figure 17.**



Source of Basic Data: 2004-2005 Global Competitiveness Report. World Economic Forum (WEF)

## **Human Resources**

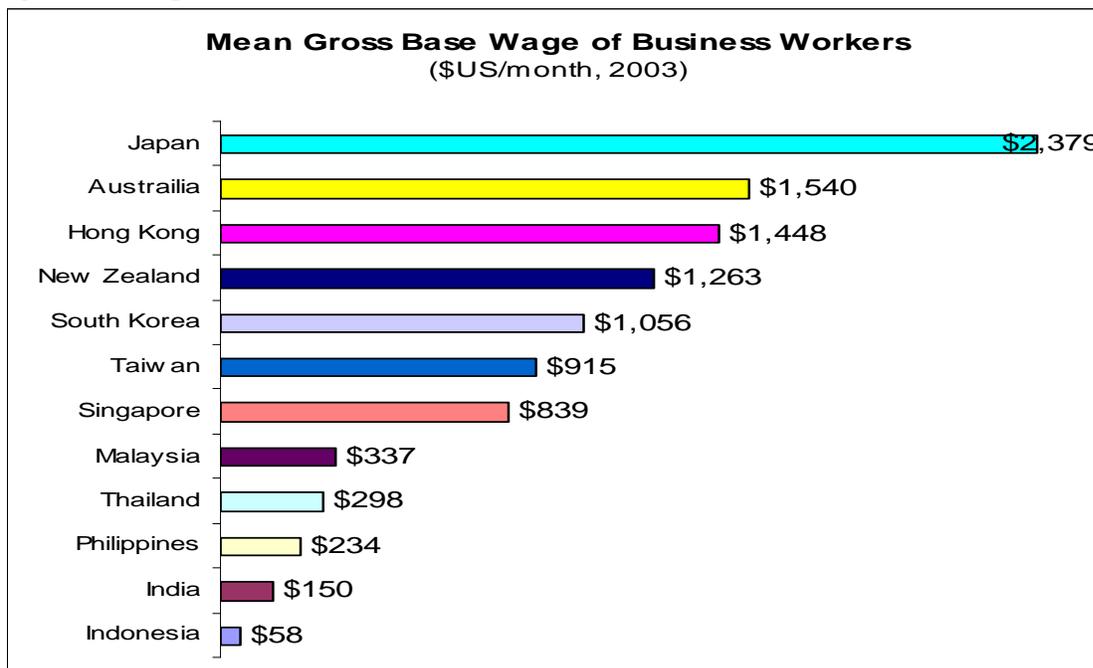
The competitiveness of the Philippines in attracting BPO projects rests in its proposition of lower-cost BPO professionals armed with University degrees. In fact, a call center agent's salary (entry-level), is one of the lowest in the region, bested only by India and matched by China.

**Table 18.**

<b>Average Salary of Call Center Agents</b> (annual, in US\$)		
	<b>Salary</b>	<b>% of US</b>
US*	25,000	1.00
RP	2,828	0.11
India	1,689	0.07
China	2,804	0.11
HK	16,438	0.66
Malaysia	3,960	0.16
Singapore	11,748	0.47
Thailand	3,949	0.16
* estimates, average of entry-level agent & w ith experience		
Source: 2003 Callcentre Benchmarking Study, as cited by F. Huang		

Philippine wages are competitive not only for call center operations but for BPOs in general. In 2003, for example, among business workers, the average base wage for the Philippines is about \$234 per month—the third lowest in Asia; but, India is still more competitive at \$150 per month. With salaries and wages taking anywhere from 40% to 60% of total BPO costs, savings in salaries of BPO agents are very attractive to foreign companies.

**Figure 18. Comparative Labor Costs**



Source: DTI

**Table 19. Philippine Wage Rate Statistics**  
(2003, Estimates)

Wage Rate for Contact Center Agent	\$200-\$300 per month (i.e., entry level) \$300-\$380 per month (i.e., with some type of vertical expertise)
Wage Rate Accountant	\$300-\$500 per month
Wage Rate for Accounting clerk	\$150-\$200 per month

Source: BOI and CFP

The Philippines' competitiveness rests not only on cost considerations. Overall, Philippine labor force cost and quality compare favorably with China; but is at a disadvantage with India—especially for the higher value-adding IT skills. San Agustin (UA&P, 2004) summarized research results of three different business consulting companies: NeoIT, PERC and CCW. The only advantage of the Philippines over India is its cultural affinity with the United States, currently the biggest BPO market. Thus, overall, the Philippines would be more suited for BPO activities that require customer interaction; while India will be more suitable for backroom operations.

**Table 20. Overall Comparison of Labor Force Attractiveness**

Overall Labor Force Quality		India	RP	China
		Highly Suitable	Highly Suitable	Unsuitable but Qlty is improving
<b>a. Skill</b>	NeoIT*	Good	Fair	Poor
	PERC**	Good	Fair	Fair
	CCW***	Good	Good	Fair
<b>b. English-proficiency</b>	NeoIT	Good	Good	Poor
	PERC	Good	Good	Poor
	CCW	Good	Good	Poor
<b>c. Cultural affinity</b>	NeoIT	Fair	Good	Poor
	CCW	N/A	Good	Poor

\*NeoIT is a BPO consultancy company

\*\*Political Economic Risk Consultants

\*\*\*CCW is a management consulting company

Source: as cited in San Agustin (2004)

However, the main factor that attracts BPO projects into the country is the very same one that defines the industry's critical limits. The most pressing problem of BPO companies today is their

ability to attract and retain qualified BPO professionals—from call center agents, to computer animation artists, to transcribers, etc. This is a common concern for the whole industry.

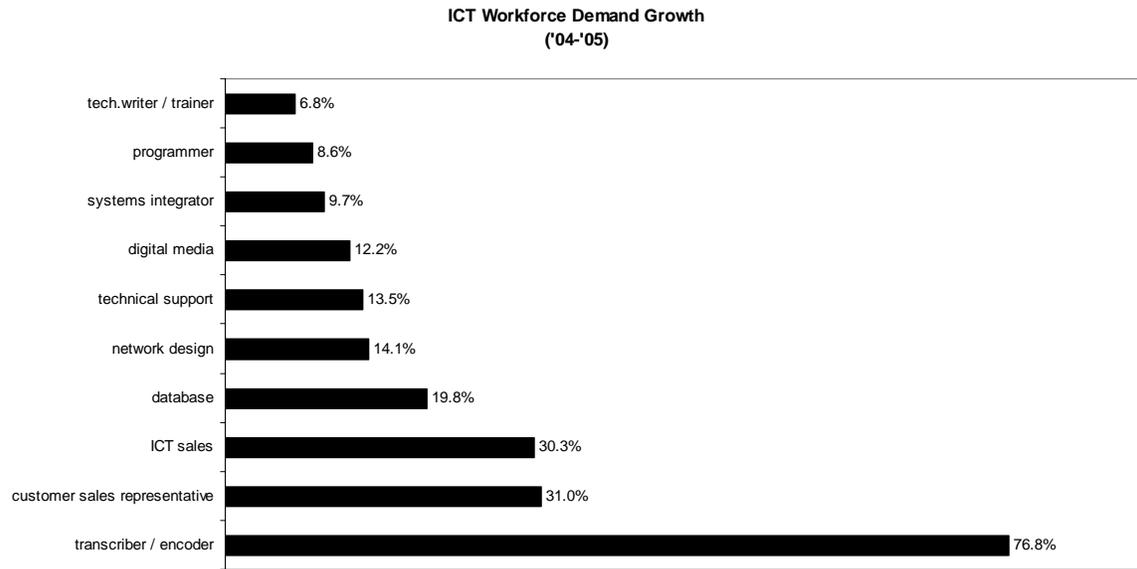
This situation was brought about by the rapid growth of the industry, leading to supply-side bottlenecks. The demand for ICT-enabled workers, where BPO professionals belong to, had grown by 87% from 2003 to 2004; for 2005, it is projected to increase by another 47%.

**Table 21.**

	<b>Workforce Demand for IT Workers</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
(no. of workers)			
ICT-enabled	41,800	78,351	115,324
ICT Providers & non-ICT entities	70,165	82,565	92,072
<b>TOTAL</b>	<b>111,965</b>	<b>160,916</b>	<b>207,396</b>
(growth rate)			
ICT-enabled		87%	47%
ICT Providers & non-ICT entities		18%	12%
<b>TOTAL</b>		<b>44%</b>	<b>29%</b>
Source: Information Technology Association of the Phils. (2004)			

Consistent with industry market growth, demand has been strongest for transcribers (including medical transcriptionists), followed by call center agents.

**Figure 19.**



Source: ITAP Study 2004

The problem, however, is that the growth in demand for BPO professionals cannot be matched by the available supply of qualified applicants. In 2003, based on a 2004 study undertaken by the Information Technology Association of the Philippines (ITAP), the acceptance rate among applicants for BPO positions ranged from 2.0% (for software development) to 17.3% (animation). These relatively low acceptance rates were aggravated by high turnover rates—ranging from 7% (call centers) to 19.4% (animation).

**Table 22.**

<b>Average Acceptance &amp; Turnover Rate</b>		
<b>(by Industry, 2003)</b>		
	<b>Rate in %</b>	
	<b>Acceptance</b>	<b>Turnover</b>
Animation	17.3	19.4
Manufacturing (ICT)	1.8	17.6
Real estate, business services		15.0
Software development	2.0	13.5
Telecoms, media & entertainment	8.9	12.1
BPO		11.7
Systems integration	6.1	11.4
Wholesale, retail trade	11.5	10.3
Data transcription / conversion	9.5	9.0
Trade services (ICT)	6.6	9.0
Financial services	10.1	7.8
Contact Center	3.3	7.0
Others (non-ICT)	3.8	7.0
Education (non-ICT)	13.8	5.5
Manufacturing (non-ICT)	8.5	4.3
Education (ICT)	5.4	2.3
Government	24.8	1.2

Source: Information Technology Association of the Phils. (2004)

More recent estimates of acceptance and turnover rates, however, paint a graver situation for BPOs—particularly for call centers. The main challenge to the Philippines’ emergence as a regional leader in call center operations is the shortage of qualified agents. From the 7% acceptance rate reported by the ITAP study, early 2004 estimates point to just 2% acceptance rate. Towards the end of 2004, however, some of the biggest call centers were reporting an acceptance rate of just about 1.6%.

A key weakness of applicants for call center positions is English-language proficiency. The development of software-aided language training programs can help those at the “high-failure” level (or among those who failed, they are the ones considered relatively easier to train).

Employee turnover is also becoming a problem for call centers, with some experiencing attrition rates of 2% per month. Latest estimates (1<sup>st</sup> Quarter, 2005) show that big call centers experience annual turnover rates of above 40%. It must be noted, however, that even among call centers, attrition can vary greatly depending on the type of client-accounts being serviced by the agents. For example, retailing companies (e.g., K-mart) and credit card accounts are high-tension assignments where agents have to deal with difficult customer complaints. In these key accounts, attrition can be higher.

The main factors that cause higher labor costs are the increasing costs of: recruitment, selection, hiring, and equally critical, retention of qualified employees. With low acceptance rates and high turnover rates, competition among call centers for new employees, as well as those with experience, has been bidding up industry salary and wage levels.

As a result, call centers are resorting to:

- Wage premiums for “international call center experience”
- Signing bonuses
- Multiple locations<sup>14</sup>
- In-house pre-employment training
- More benefits, e.g. educational opportunities

#### 4. Summary of RP Attractiveness as a BPO Location

Based on interviews and a review of past researches done on BPOs in the Philippines, the main criteria used to evaluate the competitiveness of the country as a BPO off-shore location are: quality and availability of human resource, cost of doing business, infrastructure and utilities, and the business environment (DTI 2003). Another study, specifically for call centers, added “International Awareness” as a factor (Knowledge Institute, 2003). Still, other studies (McKinsey, 2002) used only two major factors: Country Attractiveness and People Attractiveness.

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<sup>14</sup> Having multiple locations increases the chance of recruiting qualified candidate-applicants from the catchment area.

**Table 23. DTI's Factors for Philippine BPO Competitiveness**

<b>Factor</b>	<b>Determinants</b>
Quality of Human Resource	<ul style="list-style-type: none"> <li>■ Availability of qualified and educated staff</li> <li>■ Access to multilingual skills: English and other regional languages</li> <li>■ Flexibility of labor (labor laws, workforce attitude)</li> </ul>
Cost of Doing Business	<ul style="list-style-type: none"> <li>■ Labor cost</li> <li>■ Property and telecommunication costs</li> </ul>
Infrastructure and Utilities	<ul style="list-style-type: none"> <li>■ Availability and reliability (telecommunication)</li> <li>■ Office space or building with back-up power supply</li> <li>■ Easy access (local and international)</li> </ul>
Business Environment	<ul style="list-style-type: none"> <li>■ Support services (recruitment, setting up, telecommunication)</li> <li>■ Stability, reliability, etc.</li> <li>■ Data Protection</li> <li>■ Bureaucracy</li> </ul>

Source: DTI 2003

**Table 24. SGV's (Knowledge Institute) Factors for Philippine BPO (Call Center) Competitiveness**

<b>Factor</b>	<b>Determinants</b>
People	<ul style="list-style-type: none"> <li>■ Education level</li> <li>■ Size / depth of labor pool</li> <li>■ English literacy / accents</li> <li>■ Retention levels</li> </ul>
Cost	<ul style="list-style-type: none"> <li>■ Cost of labor</li> <li>■ Cost of infrastructure</li> <li>■ Real Estate</li> <li>■ Telco Facilities</li> <li>■ Government incentives</li> </ul>
Environment	<ul style="list-style-type: none"> <li>■ Country risk (peace &amp; order)</li> <li>■ Cultural compatibility</li> <li>■ Friendliness to expats</li> </ul>
International Awareness	<ul style="list-style-type: none"> <li>■ Trade Missions / Institutional Marketing</li> <li>■ Presence of Industry Groups</li> <li>■ Track record</li> </ul>

Source: F. Huang, SGV (2003)

There is convergence in the assessment of analysts in terms of the relative advantage and disadvantage of the Philippines, compared with the leading BPO destination—India. Two assessments will be presented here—one done by a local consulting company, and the other, by an international consulting company.

The Knowledge Institute presents the Philippines’ main attraction as its more developed telecoms infrastructure, owing to earlier government efforts at liberalizing the industry. In terms of labor, on the other hand, due to its bigger population base, India has the cost advantage over the Philippines. Key technical skills—e.g., software skills—are also more developed among Indian BPO professionals. Filipinos, on the other hand, have the edge in soft- or people-skills, e.g. cultural compatibility and English adaptability (i.e., for the US market).

**Table 25. SGV’s (Knowledge Institute) Factors for Philippine BPO (Call Center) Competitiveness**

<b>Factor</b>	<b>RP</b>	<b>India</b>
<b>Overall Cost Advantage</b>	<b>High</b>	<b>Very High</b>
- Labor Cost	High	Very High
- Size of labor Pool	High	Very High
- Gov’t Support	Medium	Very High
- Telecoms Infrastructure	Very High	Medium
<b>Quality (US market)</b>	<b>Very High</b>	<b>High</b>
- Cultural Compatibility	Very High	Medium
- English Adaptability	Very High	Medium
- Availability of Software Skills	Medium	Very High
<b>Overall Awareness</b>	<b>Medium</b>	<b>Very High</b>

Source: adapted from F. Huang (Knowledge Institute, 2003)

A broadly similar assessment was arrived at by AT Kearney, a globally-recognized BPO consultancy-research firm. It cited the Philippines as very strong—next to India—in Financial Structure. Again, this can be traced to relatively lower wages and cost-effective telecoms infrastructure. The size and skill of available manpower were however rated much lower than India. But by far the biggest drawback of the country is its unstable business environment—broadly defined by AT Kearney to include the political situation in the country. In this particular measure, the only countries that scored lower than the Philippines were Russia (0.51), Vietnam (0.70) and Turkey (0.73).

**Table 26. Overall Attractiveness of the Philippines**

AT Kearney 2004 Offshore Location Attractiveness Index				
Overall	Financial Structure 40%	Business environment 30%	People skills & availability 30%	Total
Scale of	1 to 4	1 to 3	1 to 3	
India	3.72	1.31	2.09	7.12
China	3.32	0.93	1.36	5.61
Malaysia	3.09	1.77	0.73	5.59
Czech republic	2.64	2.02	0.92	5.58
Singapore	1.47	2.63	1.36	5.46
<b>Philippines</b>	<b>3.59</b>	<b>0.92</b>	<b>0.94</b>	<b>5.45</b>
Brazil	3.17	1.41	0.86	5.44
Canada	1.00	2.48	1.94	5.42
Chile	2.99	1.68	0.70	5.37
Poland	2.88	1.57	0.88	5.33

Source: AT Kearney website

Over-all the Philippines is attractive because of:

- Competitive wages; slightly higher than India's but much lower than the US'
- Generally skilled (business-related and people skills) labor force, with strong cultural affinity with the US (main market)
- Advanced development of its telecoms infrastructure, owing to deregulation and liberalization in the 1990s
- Availability of suitable locations for BPO office space, but pressure for upward rate adjustments are building-up

On the other hand, its main drawbacks are the following:

- Increasing difficulty of finding qualified employees (especially for call centers)
- Level/quality of education for higher level IT skills
- Political and regulatory environment, especially the unstable political situation, graft and corruption and threats to physical security.
- High power rates—among the highest in the region

### **C. Government Initiatives**

In spite of resource limitations, the government has been actively trying to address impediments to BPO sector development by way of partnerships with the business sector and with the academe. At the forefront of these efforts is the Department of Trade and Industry (DTI), through its brand management approach to export development.<sup>15</sup> The DTI has been the lead national government agency supporting private sector initiatives in addressing the two primary constraints for BPOs—(1) the international promotion of the Philippines as an off-shore BPO location and (2) the enhancement of critical BPO skills among college students.

The DTI, primarily through its brand manager for IT-enabled services and through the Center for International Trade Expositions and Missions (CITEM) has been assisting BPO industry associations in promoting the Philippines as a preferred off-shore location for services.

In addition, it has been instrumental in generating awareness among other government institutions—both at the national and local levels—about the importance and potential of BPOs. In particular, it has been active in promoting partnerships between BPOs and the academe in the development of courses that would introduce university students to the opportunities provided by BPOs and, at the same time, enhance critical skill-sets related to BPO operations. At present several universities are already offering academic subjects related to enhancing BPO-related skills, in partnership with private BPO companies. Other agencies actively trying to address the looming shortage of qualified BPO professionals include the Technical Education Skills Development Authority (TESDA) and the Commission on Higher Education (CHED).

Local government units (LGUs) have also taken a primary role in preparing their constituencies take advantage of the employment opportunities offered by BPOs. Some have already initiated computer literacy and advance language courses. These LGUs include the Cities of Pasig, Manila, and Dumaguete.

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<sup>15</sup> The government, through the DTI, has identified 10 Priority Export Sectors, including IT-enabled Services. As defined, IT-enabled services cover BPOs.

In the area of infrastructure development, the country continues to benefit from the deregulation of the telecommunications industry in the 1990s. As technology continues to evolve and converge, government response must however keep pace. Regulation of telecommunications in the country is within the mandate of the National Telecommunications Commission (NTC). The NTC is severely undermanned and lacking in resources to keep abreast with new developments in the sector. However, its recent decisions have indicated that it foresees the critical role of technology infrastructure in the development of user-sectors. These include its policy decision on the Voice over the Internet Protocol (VoIP), seen as a way to break the hold of bigger telecoms players on business applications—including certain BPO activities.

The policy framework for the infrastructure side of IT-related businesses is expected to be developed once the Commission on Information and Communications Technology (CICT) is elevated into a full-blown government department. A legislative bill has already been filed in Congress to this effect, but is not given sufficient prioritization due to resource constraints (i.e., in creating a new department) and due to the fluid environment caused by the unstable political situation.

## **VI. POLICY RECOMMENDATIONS**

### **A. Revisiting the Industry Value-chain Blocks**

Setting the country's strengths and weaknesses in terms of the BPO Industry Value Blocks, the Philippines is strongest in Cultural, Demographic and Technological factors; while weakest in Political Environment, Human Resource Skills, Entrepreneurial Access to Financing and Expertise, and International Marketing and Promotions.

**Table 27. Overall Assessment of Philippine BPO Value Chain**

<b>Value Block Elements</b>	<b>Assessment of Philippine Advantage vs. Main Competitor</b>
<b>Cultural and Demographic Factors</b>	<ul style="list-style-type: none"> <li>• Stronger affinity to western culture</li> </ul>
<b>Business and Political Environment</b>	<ul style="list-style-type: none"> <li>• Unstable political environment; threats to peace and order</li> </ul>
<b>Qualified Human Resource Pool</b>	<ul style="list-style-type: none"> <li>• Significantly lower wages than US but slightly higher than India;</li> <li>• Stronger in soft-skills; Weaker in technical (IT) skills</li> </ul>
<b>Technology Infrastructure</b>	<ul style="list-style-type: none"> <li>• Well-developed, reliable and cost-effective</li> </ul>
<b>Utilities and Office Space</b>	<ul style="list-style-type: none"> <li>• Available IT buildings</li> <li>• Higher power rates</li> </ul>
<b>Entrepreneurial Access to Financing and Expertise</b>	<ul style="list-style-type: none"> <li>• Limited access to venture capitalists; India has advantage owing to Indian IT Professionals who migrated to US</li> </ul>
<b>International Marketing and Promotion</b>	<ul style="list-style-type: none"> <li>• RP just starting with industry-wide efforts at country branding; Indian NASSCOM is a benchmark organization.</li> </ul>

## **B. Policy Recommendations**

Policy recommendations should therefore enhance the strong points in the value chain and address the weaknesses.

- Cultural and Demographic Factors – a large population base that is oriented towards the Western culture has been a key consideration of companies—not only of BPOs—that locate in the Philippines. However, this is also an advantage that in the future may not be easy to sustain given the globalization of culture, brought about by the advances in mass media and communications. What should be emphasized and further developed, however, are the more unique Filipino traits—rather than mimic the Western cultural orientations.

These traits include customer service orientation and having a good work ethic. These are qualities that overseas Filipino professionals and workers have been known for. While

enhancement of these cultural factors is actually not policy-actionable, they can be emphasized during marketing and promotional campaigns.

- Business and Political Environment – though this is a general country-weakness that is not peculiar to the BPO sector, it nevertheless has to be addressed as it is the main impediment to attracting BPO projects. While fully solving this problem will necessarily require a longer time frame, efforts at insulating the BPO sector (from investment promotion, to business registration, to actual operation) are currently being undertaken via active government front-offices dedicated exclusively to BPOs (e.g., ITECC, the DTI’s brand management approach, etc.).

Convinced of the potential offered by BPOs, local government units are also increasingly being involved: from promotion of possible locations outside of Metro Manila, to the development telecoms and IT infrastructure in their localities, to enhancing the quality of their work force (e.g., mandating English as the medium of instruction in local educational institutions, supporting the introduction of IT courses in public schools, etc.), to ensuring the safety of BPO professionals—especially those working during the night shift. Compared with national government initiatives, local government involvement is more direct and, hopefully, will yield a more immediate impact.

- Qualified Human Resource Pool – BPOs, especially call centers, have started to engage higher educational institutions in partnership programs that aim to provide critical skills to prospective BPO professionals while they are still in college. This is important as it develops a ready-pool of trained, BPO workers. However, these initiatives will not be able to stem the tide of the steadily declining quality of education in the Philippines, especially for critical subjects such as Math and Science. Government will have to provide the general direction.

First, budgetary priority should be given by the Government to education, as mandated under the constitution. Second, the Government should diagnose the poor performance of school children in Math and Science. Third, the Government should review the

pedagogical basis for shifting to Pilipino as the language of instruction in schools. While from the perspective of call centers, there are obvious benefits of going back to English as language of instruction, there must have been a reason why it was changed previously. Partly, the advocates of Pilipino were claiming that concepts are better learned by students when taught in their native language. If this is indeed the case, then there are strong considerations to retain Pilipino.

The issue of which language of instruction to use should also be considered within the context of which is more effective in terms of developing higher-level technical skills. This is critical if the Philippines wants to move-up the BPO value chain. Currently, the country's main area of advantage is in terms of the soft-skills; while India is dominant in the technical skills. This allows India to concentrate on backroom operations—where there is also potential for higher value addition; while the Philippines focuses on BPO activities with greater customer interface (e.g., call centers).

The 2004 Information Technology Association of the Philippines (ITAP) Philippine ICT Workforce Demand Study provides the following recommendations:

- a. Improve primary and secondary education
  - b. Have an IT certification exam to ensure the quality of graduates
  - c. Improve the quality of teachers
  - d. Make education more affordable
  - e. Teach critical thinking, instead of memorization
  - f. Greater industry-academe linkage, e.g. through value-adding internships / on-the-job training and industry collaboration in designing ICT curricula.
- Technology Infrastructure – while this is the strongest advantage of the Philippines, India is fast catching-up. Thus, there is a need for the country to consider further policy changes in the telecoms industry. These include possibly the removal of the cap on foreign ownership of telecoms companies (presently at 40%), to further introduce competition in the industry's various segments. Another consideration is to further clarify telecoms policies, especially as they converge with ISP (Internet Service Providers). For

instance, a more liberal policy on Voice over the Internet Protocol (VoIP) could provide an alternative, less costly (though currently, less reliable) platform for BPO operations.

- Utilities and Office Space – the 24/7 nature of BPO operations, together with the technical requirements of their equipment, require intensive power use. Thus, efforts by the government to lower electricity rates in the country will benefit BPO companies. In the short-term, however, “peak-load” pricing mechanisms could be a way to enhance the attractiveness of the Philippines, especially for BPO services that take advantage of time zone differences with the US.
- Entrepreneurial Access to Financing and Technical / Market Expertise – As Filipino executives become more exposed to BPO operations of global companies, opportunities will develop for local professionals to set-up their own BPO companies. In the meantime, special programs can be explored to provide incentives to successful foreign-based Filipino IT professionals to return to the Philippines in order to jumpstart entrepreneurial activity in strategic BPO areas.
- International Marketing and Promotion – industry and government have started collaborative efforts at promoting the Philippines as a regional hub for BPO operations. Key players here include the Department of Trade and Industry, the ITECC, and industry associations. However, India’s NASSCOM remains to be the model.

## **VII. AREAS FOR FURTHER STUDY**

### **A. On BPOs and the National Statistical System**

There is a need to formally study the contribution of BPOs to the Philippine economy. Due to the problematic nature of national statistical classification systems as they apply to BPOs, there is a real possibility that the impact and importance of BPOs are currently grossly underestimated.

BPOs are currently classified under “Private Business Services” and “Other Business Services.” Based on the Philippine Standard Industrial Classification (PSIC, '94 as amended), it is considered under:

- Division 74 (Miscellaneous business activity),
- Group 749 (Business activities, nec)
- Class 7499 (Other business activities, nec)
- SubClass 74999 (Misc. business activities, nec)

The National Statistical Coordination Board has recently (2002) formalized a new classification system—the Philippine Centralized Product Classification (PCPC) that is also consistent with the new international system proposed by the United Nations. Under the PCPC, BPOs and its various sub-segments, will be more clearly be captured. For instance, call centers will be under:

- Division 85 (Support Services)
- Group 859 (Other Support Services)
- Class 8593 (Telephone-based Support Services)
  - 859310 (Telephone call center services, including taking orders for clients by telephone, soliciting contribution or providing information for clients by telephone, telemarketing)

Though the PCPC has already been adopted, it is not yet being used by the Government. There is a need to urgently implement its use and conduct studies on the actual impact of BPOs.

Another problematic area for BPO research is the estimation of “Trade in Services.” Measuring IT-related BPOs is quite difficult because the concept of gross value added is more difficult to apply in Services, since it is not represented by a tangible product. For example, as illustrated by the WTO, E-commerce covers a range of Service activities:

- customer sits down at computer - computer services
- logs onto Internet - communication services
- orders products - distribution services

- pays for it - financial services
- downloads the product or has it mailed to home address - delivery services

There are also other items in international trade measurements and methodologies that capture IT-related business services. These include:

- Royalties and license fees (computer related services that are delivered to foreign markets thru cross-border software licensing agreements)
- Other Industries - Software bundled with Computer hardware, and
- Services that can be delivered both electronically and via physically via optical disks

The end result of all these data classification and estimation problems, given the Philippine System of Accounts and the nature of BPO activities, BPOs' contribution to the economy is ambiguously captured. Most likely, its contribution is understated and its total contribution is dispersed or credited to other industries.

## **B. On Population and the Philippine Educational System**

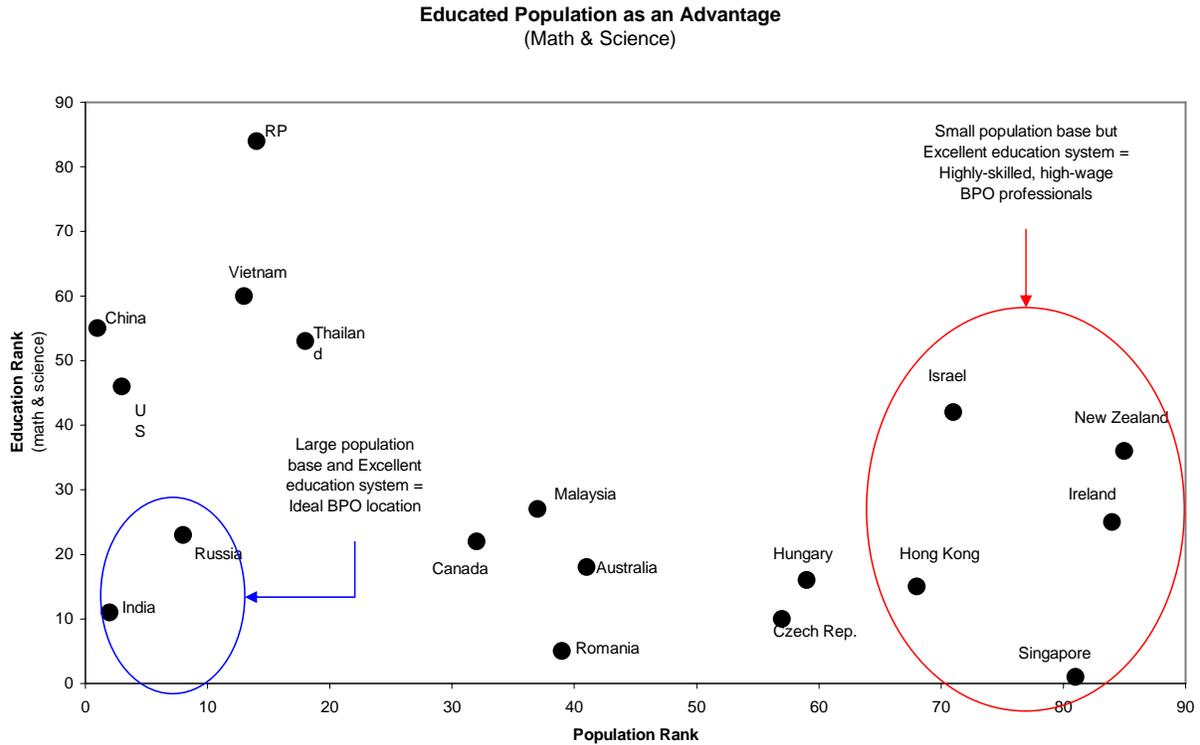
All other things equal, a large population base will improve the attractiveness of a country as a BPO location. However, having a strong educational sector is also an important pre-requisite. These two are the emerging important drivers for BPO competitiveness.

India and Russia fit this description. For example, in the latest (2004-2005) Global Competitiveness Report of the World Economic Forum, India was ranked 2<sup>nd</sup> most populous country and 11<sup>th</sup> in terms of the quality of its educational system; Russia, on the other hand, landed 8<sup>th</sup> in population and 23<sup>rd</sup> in education. On the other hand, Australia, Canada and Malaysia have very advanced educational systems, with small-to-medium population base.

The Philippines is grouped together with China and Thailand—countries with large population base but inadequate educational systems. Thus, if the Philippines wants to eventually graduate to the higher value-added BPOs, significant attention must be devoted to improving the quality of

our educational system—especially in the area of math and science. Incidentally, these are the very same disciplines where some of the country’s biggest competitors (current and emerging) are quite good at.

**Figure 20.**



Source of Basic Data: 2004-2005 Global Competitiveness Report. World Economic Forum (WEF)

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