

Business Process Outsourcing in the Philippines

Lee Kuan Yew School of Public Policy - Microsoft Case Studies
Series on Information Technology, Public Policy and Society

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Case Title:
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Contents	Pages
I. Introduction	5
II. Country Background	5
III. Origins and Drivers	7
IV. The Industry Today and it's Economic Impact	13
V. The Rise of Next Wave Cities	15
VI. Future challenges	17
Exhibits 1-6	19
Notes and References	27

Authors and information about the case:

Alvin Lee, Zsuzsanna Vári-Kovács, Stevenson Q Yu (Researchers) and **Ashish Lall** (Associate Professor), LKY School of Public Policy, National University of Singapore wrote this case study. It is based on the existing literature and on in-person interviews with **Mr. Marvin Bandibas** (former Operations Manager, Sutherland Global Services and Accenture), **Mr. Bert Barriga** (Executive Vice President, ICT Davao), **Mr. John Garcia Bongat** (Mayor, Naga City), **Mr. Raul Cortez** (Legal and Corporate Affairs Director, Microsoft Philippines), **Ms. Eliza Magno** (President and Founder, Illumedia Outsourcing), **Mr. Oscar S. Moreno** (Mayor, Cagayan de Oro City), **Ms. Hermie Paraiso** (BPO worker, Focusinc, Davao City), and **Mr. Monico Puentevella**, (Mayor, Bacolod City). October 2014.

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Layout by **James Lee**
Front Illustration by **Paul Lachine**



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“Our people are our greatest asset. Their combination of skill, work ethic, eagerness to learn, creativity and loyalty is a major part of what makes this nation competitive. The IT-BPO industry has been capitalizing on these qualities, and they have done that while offering opportunities in-country, rather than out of our country—keeping our talent here, and arresting the social costs of working abroad.”

Benigno S. Aquino III
President of the Philippines¹

I. Introduction

In July 2014, World Bank president Jim Yong Kim visited Manila and praised President Benigno Aquino’s efforts to move the Philippines towards inclusive growth, transparent governance and less corrupt public life. He also commented on the high economic growth of the country by answering his own rhetorical question: “Can the Philippines be the next Asian miracle? [After] coming here, I think there is no question that is the case.”² The Philippines has indeed emerged as a resilient economy amongst its Southeast Asian peers in the wake of the global financial crisis of 2008. The relatively stable economy since the start of President Benigno Aquino’s administration in June 2010 has been helped by limited exposure to toxic international financial products, relatively stable domestic demand and remittances from more than 2 million Filipinos working abroad.³

Thriving on the country’s supply of well-educated English speakers and generous tax incentives offered by the government, the business process outsourcing (BPO) industry has been an important contributor to the country’s economy and government has branded BPO as a “sunshine industry”. It has become the fastest growing industry in the Philippines, with USD revenues growing at a compound annual rate (CAGR) of 25.3% between 2007 and 2012.⁴ Metro Manila ranked second after Bangalore, India and Cebu ranked eighth after Pune, India in the 2014 Tholons Top 100 Outsourcing Destinations rankings. Six Indian cities appeared in the top ten and four Chinese cities were ranked between tenth and fifteenth. The “Next Wave” Filipino cities have lower ranks, with Davao in sixty-ninth position and Santa Rosa Laguna (Metro Laguna), Bacolod, Iloilo and Baguio in the bottom twenty.⁵

This case study examines the origins and drivers of the BPO industry in the Philippines and its significance to the Filipino economy today. Section II provides a brief country background. Section III traces the inception of the industry in the US and its origins in the Philippines. It also discusses at some length, the driving factors such as the labour force and the role of both government and trade associations in promoting the growth of the industry. Section IV provides a snapshot of the industry today and its contribution to the Philippine economy. “Next Wave Cities”, particularly Davao, are discussed in section V and section VI concludes the case, identifying challenges for the future.

II. Country Background

The Republic of the Philippines is an archipelago with 7,107 islands and a population of 107.6 million. The country’s capital is the City of Manila which is located in the National Capital Region (NCR or Metropolitan Manila) and home to about 11.8 million

people. Around half the Filipino population lives in urban areas - some key cities are Davao, with a population of 1.56 million and Cebu, with about 855,000 inhabitants. The country has two official languages: English and Filipino, as well as eight major dialects. Due to centuries of colonisation by Spain, 80.9% of the population is Roman Catholic, with 11.6% belonging to various home-grown Christian sects and Protestant denominations. Muslims comprise 5% of the population.⁶

The Philippines has a long colonial history. First colonised by the Spanish in the 16th century, the country was ceded to the US in 1898 following the Spanish-American War. A period of Japanese occupation ensued during World War II, after which the Philippines attained independence in 1946. Today it is governed as a republic, with an elected president as head of state and a bicameral congress modelled after the US system.⁷

The Philippines has a young population with a median age of 23.5 years; a total fertility rate of 3.06 children per woman and an annual population growth rate of 1.81% in 2014.⁸ The labour force expanded by 938,000 to 41.2 million in 2012 and the unemployment rate stood at 7%. The country's consumption-based Gini index of 0.43 indicates high income inequality, and 19% of the population lived on less than USD 1.25 per day (at purchasing power parity or PPP exchange rates) in 2012. The country's Gross Domestic Product (GDP) per capita was USD 6,110 (PPP) in 2012 and real GDP growth averaged 5.3% annually between 2007 and 2013. Due to the 2008 financial crisis, the GDP growth rate declined to 1.1% in 2009, but stabilised by 2011 at a higher level than the regional average (exhibit 1). Household consumption accounted for 74% of nominal GDP in 2012 and has historically been the primary driver of GDP growth. The inward flow of foreign direct investment was USD 3.8 billion in 2013, or about 1.4% of nominal GDP. Remittances by overseas foreign workers reached USD 26.6 billion in 2013, representing 9.8% of nominal GDP.⁹

Between 1960 and 2012, the Philippines experienced a steady decline in the share of agriculture in total output and employment. In other developing countries the decline in the share of agriculture is typically picked up by the industrial sector. In the case of Philippines, this was picked up by the services sector. In 2012, services accounted for 57.1% of GDP, compared to 31.1% for industry and 11.8% for agriculture. In the same year, 52.5% of the labour force was employed in services, 15.4% in industry, and 32.2% in agriculture (exhibit 2).¹⁰ The importance of the services sector is also reflected in the external (balance of payments) accounts of the Philippines (exhibit 1) which reflect a deficit on the trade in goods account and a surplus on the trade in services account.

Despite strong growth since the financial crisis, the business environment remains challenging, with the Philippines ranked 108th out of 189 economies in the World Bank *Doing Business* report 2014. Starting a business and paying taxes is particularly difficult, but the country is also lagging behind in facilitating property

registration and protecting the interests of investors.¹¹ The Executive Opinion survey conducted annually by the World Economic Forum considered corruption as the most severe impediment to business in the country (17.6% of respondents), followed by inadequate infrastructure supply (15.9%), tax regulations (13.3%) and inefficient government bureaucracy (12.6%).

III. Origins and Drivers

The first modern outsourcing industry emerged in Mexico in the late sixties, when US firms engaged Mexican maquiladoras (manufacturing operations in a free trade zone) to assemble their products.¹³ Since then, increased competition in the West pushed firms to seek efficiency improvements and potential for cost reduction abroad, giving rise to a global offshore outsourcing industry. Technological advancements in telecommunications and logistics in the mid-eighties made outsourcing feasible on a larger scale. Outsourcing in the IT services sector started with Eastman Kodak's 1989 decision to outsource its information technology systems to IBM.¹⁴ The company was followed mainly by American and British companies such as General Electric, British Airways and American Express, which relocated their non-core functions to English speaking countries; primarily to India.¹⁵ Eventually, Western outsourcing firms such as Accenture, EDS and IBM also shifted more of their outsourcing business to offshore destinations.¹⁶

There are several ways in which a company may outsource to an offshore location, based on the nature of the job being outsourced and the service provider. Two of the most common forms of offshoring are either through a Global In-house Centre (GIC) – where a firm sets up a subsidiary unit in an offshore location; or fee-for-service – where a firm hires a local or international firm with an offshore presence and outsources their work. Although firms initially began outsourcing as a means to reduce costs, managers gradually realised that the benefits of relocating part of the business process to an offshore location also included a potential increase in quality, allowing firms to move up the value chain, as simpler and more labour-intensive processes were carried out by vendors from countries with lower labour costs. The vendor landscape, access to market, risk profile, business environment, quality of infrastructure and intellectual property rights were increasingly important in choosing an appropriate destination to outsource, along with crime rates, political stability, government support and distance from headquarters.¹⁷ Thus, what initially began as a cost reduction strategy for manufacturing and back-end customer support soon expanded to include services such as medical transcription, data analysis and animation. A 2005 McKinsey study estimated that 11% of worldwide service employment could, in theory, be performed remotely by 2008, but the extent of outsourcing and ability of any particular company to outsource depended on the number of its customer-facing functions. The study identified engineering, generalist and support staff services to be most amenable to offshore employment.¹⁸

Many governments and multilateral institutions assert that the exact size and growth of the outsourcing phenomenon is difficult to measure because of definitional complexities in the use of the terms outsourcing, offshoring, near-shoring, right-sourcing, and others. In the context of information technology, BPO has been defined as “the delegation or handing over to a third party (external supplier) mediated via a contractual agreement, all or part of the technical, process and human resources, including management responsibility for transferred staff.” The Information Technology & Business Process Association of the Philippines (IBPAP) estimated the global BPO market size to be USD 134 billion in 2012 (measured by total revenue), which was expected to grow to USD 200-250 billion by 2015. The Philippines’ share of the global market has grown from 6% in 2007 to 10% in 2012 – a position the country seeks to sustain (exhibit 3).¹⁹

Origins of BPO in the Philippines

Offshoring and third-party outsourcing services first came to the Philippines in the 1980s through SPI Global, which offered data-entry services to Fortune 500 companies like Boeing and Sony.²⁰ Animation outsourcing followed with the establishment of Burbank Animation Inc. in 1983. The Australian-owned firm was later joined by locally-owned Optiflex Animation, and 1988 saw the establishment of Fil-Cartoons; a fully-owned subsidiary of Hanna-Barbera.²¹

The late 1980s and early 1990s were considered the “Golden Age of Philippine Animation,” with some animators earning a monthly salary higher than that of a general manager or a senior vice-president.²² During this era, the Philippines was known as the animation capital of the world and accounted for 90% of all outsourced animation work, with customers coming primarily from Japan and the United States.²³ However, the industry declined due to the migration of talented animators who were lured away by foreign studios offering higher pay, and increasingly stiff competition from China, South Korea and India.²⁴

Andersen Consulting (now Accenture) established the first captive centre in the Philippines in 1985.²⁵ The operation began as a systems and application software development centre that catered to internal business requirements. In the span of three decades, Accenture Philippines expanded operations to Technology and Operations Delivery Centres in Manila and Cebu employing over 32,500 professionals.²⁶ Foreign investment in outsourcing facilities accelerated after PEZA was established in 1995 to oversee and operate export-promotion zones in the country. Call centre services in the Philippines began only after the telecommunications industry was deregulated in 1995 and the protected monopoly previously enjoyed by the Philippine Long Distance Telephone Company (PLDT) was dismantled. In 1997, Sykes Enterprises acquired the Scotland-based McQueen Group and set up the first call centre in the Philippines. America Online (AOL) was another pioneer, which established an e-mail based helpdesk facility in the Clark Special Economic Zone in 1998.²⁷

The number of business process outsourcers, particularly call centres, increased rapidly after 2000. This was largely due to government and industry promotion. In the same year, a nationwide marketing thrust was initiated to position the country as the E-Services Hub of Asia, with then-President Estrada leading a trade mission to the United States.²⁸ The Department of Trade and Industry’s (DTI) promotion arm, the Center for International Trade Expositions and Missions (CITEM), launched the annual e-Services Global Sourcing Conference and Exhibition (or E-Services Philippines) to showcase the outsourcing capabilities of the Philippines.

Some prominent examples of call centres outsourced to Philippines included E-Telecare Global Solutions, a company founded by a pair of alumni from McKinsey’s call centre practice, who decided to locate its call centres in the Philippines in 2000.²⁹ Another early mover was PeopleSupport, a U.S.-based call centre that was severely affected by the dotcom implosion, which bankrupted many of its existing clients. Forced to restructure operations, the management eventually settled on relocating all call centre operations to a low-cost location.³⁰ While the obvious choice at the time was India, which had costs that were 15% lower than the Philippines, the company eventually chose the Philippines for its more Americanised workforce, culture, and crucially, a more familiar English accent.³¹

Medical transcription, another nascent BPO industry in the Philippines, had its roots in the dissolution of Outsource Transcription Philippines Inc. (OTPI). OTPI; a subsidiary of Houston-based Applied Voice Recognition Inc., was the largest player in the industry in the late 1990s, with employment close to 1,000 during the peak.³² The Lernout & Hauspie Investment Company acquired OTPI in 1999, and all its operations subsequently relocated to India. OTPI’s experienced medical transcriptionists, who lost their jobs, would later become the backbone of the Philippine medical transcription industry.

The outsourcing and offshoring industry experienced rapid growth after 2000 led by call centres. There were four call centres in 2000, with 2,400 employees and USD 24 million in revenues. By 2005, 108 call centres operated in the country, with 112,000 employees and USD 1.8 billion in revenues, which represented 75% of total BPO revenues. The cumulative amount of investment projects registered under the Board of Investment (BOI) and PEZA between 2000 and the first half of 2006 was about P43.2 billion (USD 0.86 billion) - call centres accounted for 52% of this amount. In the initial phase of industry development, all revenues came from exports, but while clients of call centres were primarily based in the UK and the US, BPO firms in the other subsectors served other developed countries and some Asian countries. The existing market of the animation subsector included not only the US, but also countries such as Australia, Canada, and France; and Asian countries such as China, Republic of Korea, Malaysia, and Thailand. Clients of software development companies included firms from India and Singapore.³³ The success of the BPO sector in the Philippines has been attributed to qualities of its workforce, government support and strong industry associations. These are discussed next.

An educated and effective labour force

The Philippines has a good demographic profile with 62% of the population between the ages of 15 and 64. The national literacy rate is 95.4% and 28% of the labour force has tertiary education.³⁴ In the academic year 2012/13, more than 550,000 students graduated from higher education institutions – 52.5% with degrees in business administration, engineering and IT (exhibit 6).³⁵ According to IBPAP, the Philippines has the third-largest (after India and China) talent availability, measured in terms of the number of graduates.³⁶ The country also fares well in terms of the quality of its talent pool – according to a recent study by the Associated Chambers of Commerce and Industry of India (ASSOCHAM), 30% of graduates in the Philippines are employable compared to 10% in India.³⁷ Nevertheless, the Philippines' leading position in voice BPO services is commonly attributed to three factors: English spoken with an American accent, cultural affinity with the United States and the hospitable nature of Filipino workers.

The Philippines' history of American colonisation has left strong cultural influences starting with Americanised English, which most of the population can speak with some fluency. The International Labour Organisation stated that “the Filipino accent is neutral as compared to the Indian workforce which possesses a stronger accent” and this advantage is seen as the main underlying cause for the Philippines' take-over in voice-based BPO.³⁸ In addition, there is also a general perception amongst employers that Filipino workers are “hardworking, responsible and customer-oriented employees and therefore especially suitable for the BPO industry, which is characterised by a lot of customer interaction.”³⁹

The cost of human resources is the largest cost component for BPO firms followed by rental and telecommunications costs. In 2012, the average annual salary of a BPO worker in Cebu City was USD 8,849 – around 50% more than a similar worker in Bangalore, India.⁴⁰ While competitive wages and the availability of English-speaking graduates propelled the Philippines' growth as an attractive outsourcing destination in its early years, the industry's rapid growth has resulted in a shortfall of available recruits both in terms of English language and business skills.

Despite Filipinos' historical connection to American English, their proficiency in the language has been in decline for a decade, a trend often attributed to the lack of good English skills among teachers and the poor quality of textbooks.⁴¹ The growing importance of local languages and Tagalog in the education system has been accompanied by the widespread use of “Taglish” (a mixture of Tagalog and English) in daily communication.⁴² Average rejection rates in the BPO industry have been very high, with only five out of every 100 applicants considered as suitable.⁴³ In 2006, the number of “near-hires”, those who failed to qualify because of English communication deficiencies but were otherwise trainable, was five times larger than qualified applicants.⁴⁴ Both government programs like the National English Proficiency Program (NEPP) targeted at teachers, and private training initiatives by call centres

have been trying to improve language skills deemed essential in preserving the Philippines' competitive edge.

Availability of sector-specific talent is another human resource constraint; hence most government and IBPAP programs focus on business skills development. In 2006, President Gloria Macapagal Arroyo's initiative launched the Industry-based Training for Work Scholarship (I-TWSP) managed by the Technical Education and Skills Development Authority (TESDA). The program invested P1.3 billion (USD 30.6 million) by 2014, and trained 65,000 BPO “near hires”, 70.7% of whom are now employed in the industry.⁴⁵ In 2012, the Commission on Higher Education and IBPAP launched a government-funded, P125 million (USD 2.9 million) program in 17 state universities and colleges which covers a 15-unit set of electives tailored for IT-BPM industry competencies plus six units or 600 hours of internship in an IT-BPM company.⁴⁶ The program targets to administer the Global Competitiveness Assessment Tool (GCAT), a BPO aptitude test, to 20,000 students.⁴⁷ Training of successful candidates is essential as the industry needs 170,000 new workers per year to meet demand and to address attrition.⁴⁸ Call centres have a particularly high attrition rate at 55%, though this is similar to attrition rates in India.⁴⁹

Infrastructure and government support

In addition to providing training opportunities for future BPO workers, the government has been promoting the BPO sector through financial incentives. According to the IT-BPO Investment Primer 2012, these include VAT, import and customs duty waivers; exemptions on local taxes; 6-8 years long tax holidays, and post-tax holiday tax payment at 5% rate on gross income. Investment incentives are granted through registration under one of two main regimes: the Omnibus Investments Code (OIC) offered by the BOI and the Special Economic Zone Act of 1995 (PEZA Law) managed by PEZA.

While progress has been slow, the government has also been promoting Internet connectivity. The country is connected to the world through seven undersea cable systems, and two fibre-optic backbone networks cover most of its regions. In order to encourage investment in the ICT sector and provide a variety of cyberservices at par with global standards, in 2006, President Arroyo announced that the Commission on Information and Communications Technology (CICT) would develop the Philippines Cyberservices Corridor (PCC) stretching 600 miles between Baguio City in Northern Luzon and Zamboanga in Mindanao.⁵⁰ Nevertheless, the underlying issue of unreliable and expensive electricity supply by the three existing power grids remains unresolved, though plans for future capacity expansion have been announced. According to 2011 figures from USAID, despite the unreliability, the Philippines charges some of the highest prices for electric power in Southeast Asia.⁵¹

The country fares better on the availability of Grade A office spaces – approximately 80% of which is taken up by BPO companies. The industry is a major driver of construction investment and its demand is expected to keep vacancy rates around

5% even as new developments are added. Rental costs are also competitive – in 2014, lease rates are at USD 29 per square foot per annum in Makati City. Charges for Indian office space are USD 31 to USD 118 per square foot per year depending on the city.⁵² Still, transportation in metro areas remains a major gridlock which the Aquino administration has been trying to improve by increased spending on infrastructure projects, most of which are yet to be completed.⁵³ Local government units, including those outside of Metro Manila, have become increasingly active in promoting their localities as viable BPO sites by improving their critical public services such as the public transportation systems and protective services needed by the 24/7 nature of BPO operations.

While the lack of adequate infrastructure hampers development, the BPO industry has received both political and policy support and is portrayed as a key growth sector for the Philippines. In a 2013 speech, Budget Secretary Florencio Abad declared: “through our now prosperous BPM market, our country has finally gained its momentum. We had taken great strides in making the Philippines a globally competitive country and we will continue to do so by supporting our stakeholders”⁵⁴ As proof of such government support, the Data Privacy Act 2012 was enacted to regulate the processing of personal information of individuals collected by both public and private entities. The law has adopted the European Union’s rights-based approach to privacy, and has strict compliance requirements for the collection, use and handling of personal information. Promoting data privacy is expected to attract investors in health care and human resources related BPO segments, where sensitive personal data is handled. The implementation of the Data Privacy Act is pending until the establishment of an independent regulator (National Privacy Commission).⁵⁵

Strong industry associations

Following rapid industry growth after 2000, companies began to band together to form industry associations. Two competing groups representing call centres, Contact Federation Philippines (CFP) and Contact Center Association of the Philippines (CCAP), were founded in 2001 along with a marketing promotion council, ‘Outsource Philippines’. CCAP became the dominant association with close to a hundred members representing 70% of the revenues and workforce in the industry in 2014.⁵⁶ In 2003, companies representing the medical transcription sector formed the Medical Transcription Industry Association of the Philippines (MTIAP), renamed Healthcare Information Management Outsourcing Association of the Philippines (HIMOAP) in 2010.

In 2004, the Business Processing Association of the Philippines (BPA/P) was initially established to represent the interests of the IT services industry, but later emerged as the de-facto representative of its partner associations: the Philippine Software Industry Association (PSIA, established in 1988), the Animation Council of the Philippines (ACPI), the Game Developers Association of the Philippines (GDAP, established in 2007), CCAP and HIMOAP. In 2013, BPA/P was renamed as Information Technology

& Business Process Association of the Philippines (IBPAP) to reflect the complete range of outsourcing services represented.⁵⁷ In 2006, IBPAP embarked on two broad initiatives: a master plan to chart the industry course (Roadmap 2010), and an implementation plan designed to make the association more professional – similar to India’s NASSCOM (Team 2010). In 2009, IBPAP launched its Next Wave Cities ranking promoting and assessing second- and third-tier cities as potential industry locations. In 2011, the organization’s IT-BPO Road Map 2011-2016 set new targets for the industry and outlined its development. Being the umbrella association of the BPO industry, IBPAP partnered with the government on large-scale training initiatives like I-TWSP, and important policy development like the Data Privacy Act of 2012. As Raul Cortez, Director for Corporate and Legal Affairs of Microsoft Philippines, explains, “BPAP has always been an active leader as far as policies are concerned. Anything affecting BPO, the BPAP representatives will always be playing a part in shaping outcomes amongst key players.”⁵⁸

There are several other collective associations representing more specific interests like the BPO Services Association Unlimited (BSA/U) which connects overseas customers with BPO providers, or the Global In-house Center Council (GICC). PhilCall was formed in 2007 to represent small and medium-sized call centres. Founded in 2013, BPO Workers Association of the Philippines (BWAP) and Inter-Call Center Association of Workers (ICCAW) are leading a nascent labour movement by representing BPO workers’ interest in lieu of trade unions.

IV. The Industry Today and its Economic Impact

Between 2007 and 2012, the IT-BPO industry was the fastest growing sector in the Philippines with revenues growing at compound annual rate of 25.3%. According to the 2012 IT-BPO survey of the Bangko Sentral ng Pilipinas (BSP), outsourcing industry revenues grew from USD 4.3 billion (2.9% of GDP) in 2007 to USD 13.4 billion (5.4% of GDP) in 2012. During the same period, direct employment grew from 272,000 (0.8% of total employment) to 770,000 (2% of total employment).⁵⁹ According to IBPAP, indirect employment generated by the IT-BPO sector grew from 600,000 in 2007 to 2 million in 2012. Further, IBPAP estimates suggest that industry revenues are expected to increase to USD 25 billion by 2016, accounting for 7.8% of nominal GDP. Direct employment and indirect employment are expected to increase to 1.3 million and 3.2 million respectively, by 2016.⁶⁰

The IT-BPO industry in the Philippines can be categorised into five subsectors: voice BPO (or call centres); transcription (mainly medical and legal transcription services); animation; software development and publishing (including game development); and other non-voice BPO activities (including finance and accounting services, market research, online content development, engineering services and data processing).⁶¹ Between 2007 and 2012, revenues of voice BPO grew at 29.9% (CAGR), faster

than the overall industry. Throughout this period, call centres continued to dominate, contributing 47% of industry revenues in 2007 and 56.4% in 2012, and employing 62.5% and 63.3% of the total IT-BPO workforce respectively.⁶² Among non-voice BPO services, transcription services grew the fastest, at 43.3% (CAGR) between 2007 and 2012, earning the title of ‘the hidden jewel’ of the industry from consulting firm Everest (exhibit 4). According to a survey by IBPAP, other fast growing non-voice BPO services in 2012 included back-office services (42%), non-voice customer care (18%) and IT services and infrastructure management (22%).⁶³ Going forward, IBPAP expects the contribution of these non-voice services to continue to grow, especially in industries such as banking, health care, media, engineering, and creative services.⁶⁴

In 2012, 93% of outsourcing industry revenue came from exports. The United States remained the industry’s biggest export market with 75.3% share of export revenues followed by Europe (9.9%) and Japan (8.5%). In 2012, 95% of total equity in the industry came from foreign investors – primarily Europe with 41% and the United States with 37% ownership of foreign equity (exhibit 5). Call centres attracted 48% of foreign investment followed by software development (28%) and other non-voice BPO services (21.7%).⁶⁵ The advantageous cost structure, investment incentives, and dedicated industry associations of the Filipino BPO industry have successfully counterbalanced the negative impact of the country’s weak infrastructure and difficult business environment. While the exemplary growth of outsourcing can be attributed to multiple causes, the country’s educated, English-speaking workforce has been the most important investment factor.

Impact on the Filipino economy

While BPO in the Philippines has grown steadily due to the factors outlined above, some questions remain about the impact of this growth. In a 2007 study by the Asian Development Bank, the BPO sector was found to have low inter-sectoral linkages.⁶⁶ Out of 240 sectors studied in the Philippines in 2000, the BPO sector ranked 138th in terms of forward linkages and provided services to three main sectors: tour and travel agencies, wholesale and retail trade, and banking. In terms of backward linkages, the BPO sector ranked 178th and required output of 40 other sectors in its operations. The three most important ones amongst these were banking, electricity and telecommunication services.

The same study estimated the output multiplier for the BPO sector in the Philippines to be 1.63, indicating that every dollar of new final demand in the BPO sector induced a total of USD 1.63 of additional output from all sectors of the economy. However, as more than 90% of the BPO sector’s output is exported, only a small share is left to be met by total intermediate demand.⁶⁷ The industry’s share of the Philippines’ total exports of goods and services has grown from 7.6% in 2007 to 19.3% in 2012, while its share of service exports as grown from 29.6% in 2007 to 67.2% in 2012.⁶⁸

Along with its growing contribution to the nominal GDP pegged at 5.4% in 2012, the BPO sector had a significant impact on compensation and employment in the

Philippines. As of September 2014, the industry is estimated to have employed a million people directly and around 2.5 million indirectly.⁶⁹ The World Bank’s 2013 Philippine Development Report credited BPO for the rapid creation of good jobs, unlike other segments of the economy.⁷⁰ High compensation in outsourcing has offered new income opportunities, especially for the middle class and lower-income groups, but it has also increased prices and contributed to income disparity.⁷¹ Metro Manila has been the BPO industry’s main centre but the industry is shifting to other cities across the country.

V. The Rise of Next Wave Cities

In the first wave of growth of the Philippines BPO industry from the late 1990s to 2010, three major hubs emerged: Metro Manila, Metro Cebu, and Metro Clark. However, rising costs in terms of rent, manpower and power generation have led to the increasing attractiveness of second- and third-tier cities. Further, the propensity to natural disasters has made the diversification of some operations away from Manila to other cities a logical move for big multinationals. The Information and Communications Technology Office (ICTO) of the Department of Science and Technology (DOST) and IBPAP have promoted the “Next Wave Cities” (NWCs) since 2009 based on talent, infrastructure, cost, risk management and business environment. In 2013, Baguio City, Davao City, Dumaguete City, Iloilo City, Lipa City, Metro Bulacan, Metro Cavite, Metro Laguna, Metro Naga, and Metro Rizal were named top NWCs; and Bacolod City joined the three ‘first wave’ metro areas as a Centre of Excellence. In 2007, 246,000 or 83% of full-time BPO industry employees worked in Metro Manila, 16,000 in Metro Cebu, 7,000 in Metro Clark, 3,000 in Bacolod City, and 26,000 in other cities. In 2011, 489,000 or 77% worked in Manila, 41,000 in Metro Cebu and 16,000 in each, Metro Clark and Bacolod City. NWC’s employed 68,000 full-time persons in 2011.⁷² DOST targets to have 141,000 new employees in NWCs by the end of 2015.⁷³

Demand for cheaper talent and office space has fostered the shift to NWCs. As Concentrix vice president Junar Amador put it, “Right now, we have more clients requesting for ramp up and so we’re making sure we have enough space for this and our organic growth of our clients ... so we’re looking at new wave cities (sic) on how we can leverage their capabilities and what they can offer so that we can also meet the requirements for our clients.”⁷⁴ The NWCs also benefit from the competitive dynamic between the cities themselves to be the best outsourcing destination. Strong regional support has been key, with the mayors and government departments of each city paying close attention to the attraction of major BPO companies to their cities. Naga City mayor John Bongat indicated that he was closely involved in negotiations to bring in major BPO companies: “We practice active intervention, meaning that we personally interact with leaders of corporations, conducting face to face talks with them to draft out contracts and other arrangement so as to ensure that we create

the right conditions for a successful partnership.”⁷⁵ Today Naga City is home to three major BPO companies, namely Sutherland, IBM and Concentrix, complementing its traditional agricultural and tourism sectors. Besides personal investment promotion, local development focused on the needs of the BPO industry – or as the mayor of Bacolod City, Monico Puentevella put it “dynamic urban governance” – has also contributed to the rise of NWCs.⁷⁶

The Case of Davao

Nestled in the heart of Mindanao, an area better known internationally for a long-running armed conflict between the Philippine government and the Moro National Liberation Front (MNLF), Davao City is an unlikely candidate for one of the top BPO investment destinations in the Philippines. Yet Davao has done very well in recent years in attracting and retaining big names in BPO, including Convergys, Ibex Global and Sutherland.

Davao has been rated as one of the top NWCs at each assessment, and has been steadily attracting industry players, especially into the voice BPO sector. Bert Barriga, the Executive Vice President of ICT Davao, an industry umbrella organisation, estimated that in 2013, there were more than 20,000 employed in the BPO sector, with an annual growth rate in excess of 20%. Davao’s case has been helped by an English-educated, disciplined workforce, good infrastructure, in particular power supply, generous incentives to BPO companies and a secure environment created by one of the most effective police forces in the country.

The government has played a major role in attracting BPO firms, to add to its existing agriculture and tourism sectors. The Duterte family’s political dynasty in the city ensures a level of continuity in policy, with Mayor Rodrigo Duterte and his daughter Sara Duterte alternating in office since the early 2000s. Mayor Duterte has kept a strong and firm hand on the city of Davao, not being afraid to use strong-arm tactics to keep drug smugglers and other social problems at bay. The foundation of peace and stability over more than a decade has led to a unique combination of low political risk in an otherwise highly volatile province, complemented by relatively low wages in Davao compared to Manila and a young, educated population eager to learn.

Industry associations have also played an important role in attracting investment. ICT Davao has promoted the city to major players in the call centre industry in particular. As Barriga puts it: “I tried for many years to get the major BPO companies to come to Davao. At first they were afraid because they had heard stories about how it is dangerous here, but once I managed to convince them to pay us a visit, they knew that this was an attractive destination to set up their operations.”⁷⁷

BPO investment has brought its share of problems for this city of 1.5 million. Workers in the industry note, that the advent of call centres serving a largely Western market has led to more liberal attitudes and to the erosion of traditional cultural mores. Talking on the phone to irate customers on the other side of the world can also be emotionally draining, according to one young call centre operator. Yet on the whole, BPO has significantly aided the human capital development of the city’s young graduates. As H. Paraiso, an experienced BPO worker noted, the industry has enabled her to improve her English skills and supplement her family income, allowing her younger siblings to go to school.⁷⁸ Her American accented English, honed from years of speaking to American customers, has allowed her to take on another job on the side – teaching English online to Korean students. Marvin Bandibas, a former manager in a major call centre said: “BPO has enabled me to grow in discipline and learn new skills such as Six Sigma. It has definitely been a good experience for me.”⁷⁹ Barriga mentioned the involvement of poorer children without college education in his “impact sourcing” experiment aimed at empowering them through employment, income and exposure to new technologies through working on simple outsourcing tasks such as image tagging.

Going forward, questions remain for Davao over the role of BPO vis-a-vis other industries such as manufacturing, tourism and agriculture. Challenges like automation and rising labour costs may also threaten the outsourcing industry in this Next Wave City. Yet against all the odds, Davao has managed to emerge as one of the major BPO centres in the Philippines with a combination of strong political will, favourable demographics and an effective business association.

VI. Future challenges

The rapid expansion of the Filipino BPO industry will likely continue to boost the country’s GDP, employment and service exports as well as create new opportunities for young college graduates. With companies shifting to locations outside the traditional BPO hubs, more regions will benefit from employment growth, improved infrastructure and transportation and revitalised retail and real estate markets, which the industry brings along. Yet there are some challenges ahead.

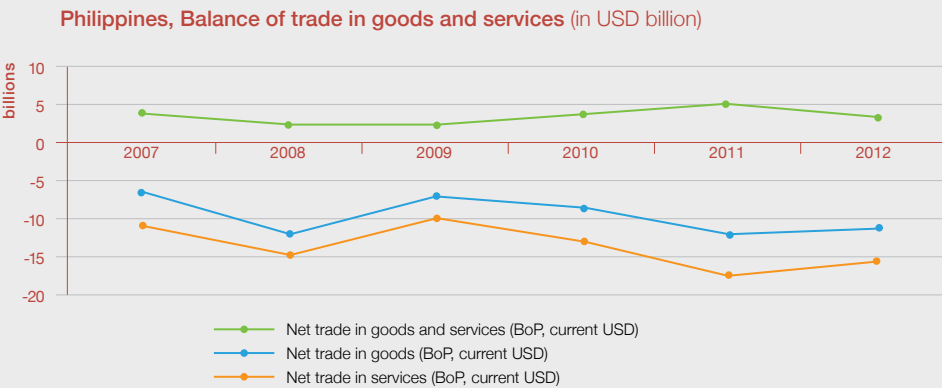
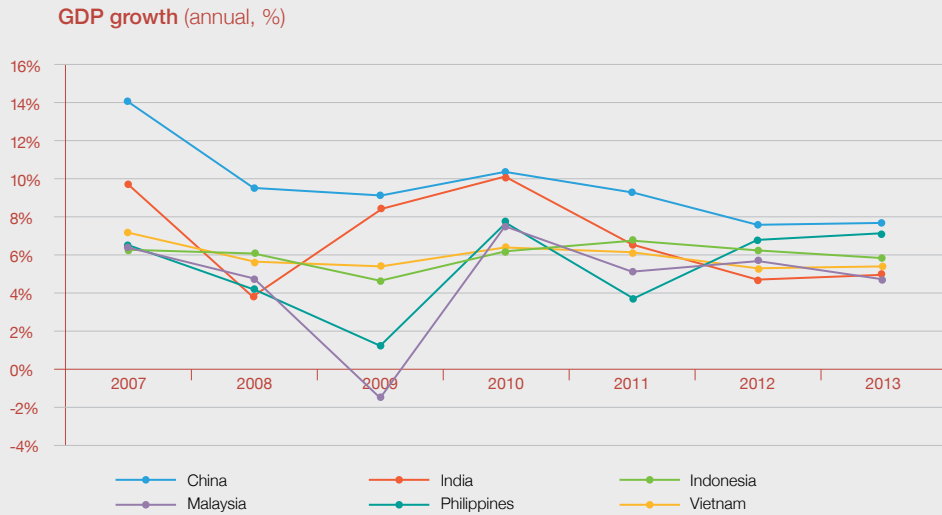
Firstly, a coherent tax policy would help to reassure investors and clarify the risks and costs of setting up their facilities in the Philippines. Several BPOs are established in PEZA areas – special zones where the government promotes investment and grants tax incentives for companies. While these zones are technically exempted from any type of assessment and taxation by local governments, anecdotal evidence suggests that local governments are creative in drawing taxes, leading to

more onerous tax burdens for foreign firms. While tax incentives are not the primary draw for BPO companies, the tax system should be as transparent as possible to provide assurance to foreign investors. Secondly, there is room for improvement in marketing the Philippines as a BPO destination. IBPAP has been actively organising industry events such as the International IT and Business Process Management Summit (formerly the International Outsourcing Summit), but more could be done to publicise the growth potential of the Next Wave Cities. Thirdly, the Philippines should continue to develop human resources for the BPO industry, not just in the voice BPO sector, but also in emerging industries such as web design and data analytics which provide higher value added services. Continued partnerships between educational institutions and industry stakeholders to create customised curricula to fit the needs of the sector would ensure an adequate supply of talent with the right skills. Fourthly, the BPO industry should capitalise on the capabilities of smaller local companies and trade associations should foster closer links between these companies. Lastly, the BPO industry should remain flexible in adapting to technological change. The threat of automation to simple labour intensive jobs such as data entry and medical transcription should encourage reflection on how to move up the value chain in the future.

Exhibits



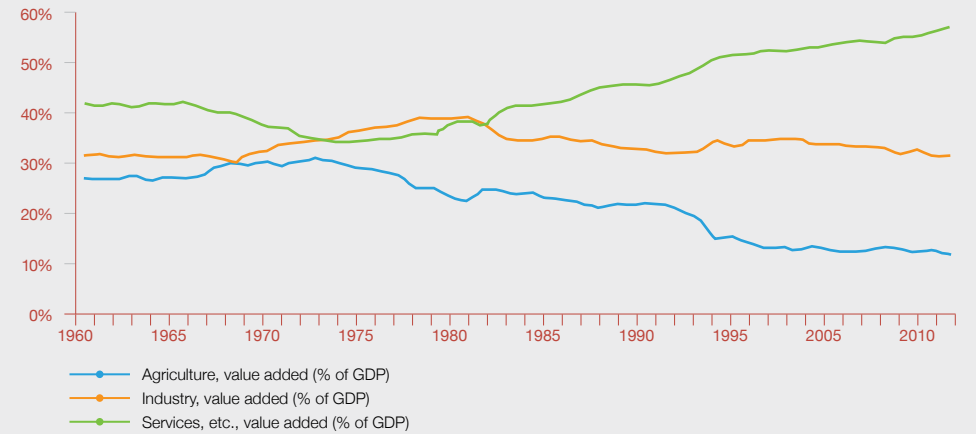
Exhibit 1 Philippines' GDP growth rate (vs. neighbouring economies) and balance of trade in goods and services



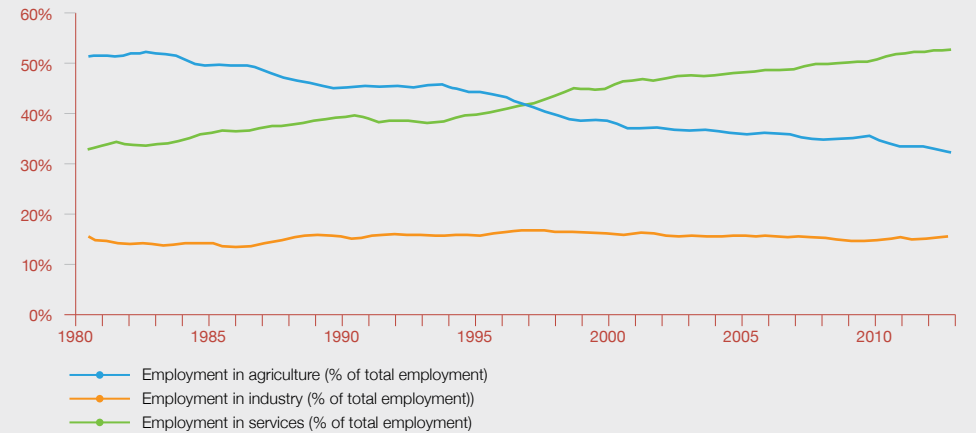
Source: World Bank, "World Development Indicators, GDP growth (annual, %), 2007-2013;" World Bank, World Development Indicators, Philippines, Net trade in goods and services (BoP, current USD), 2007-2013; Net trade in goods (BoP, current USD), 2007-2013," accessed October 20, 2014, <http://data.worldbank.org/data-catalog/world-development-indicators>.

Exhibit 2 Philippines GDP contribution and employment per sector

Philippines GDP per sector, 1960-2012 (% of GDP)



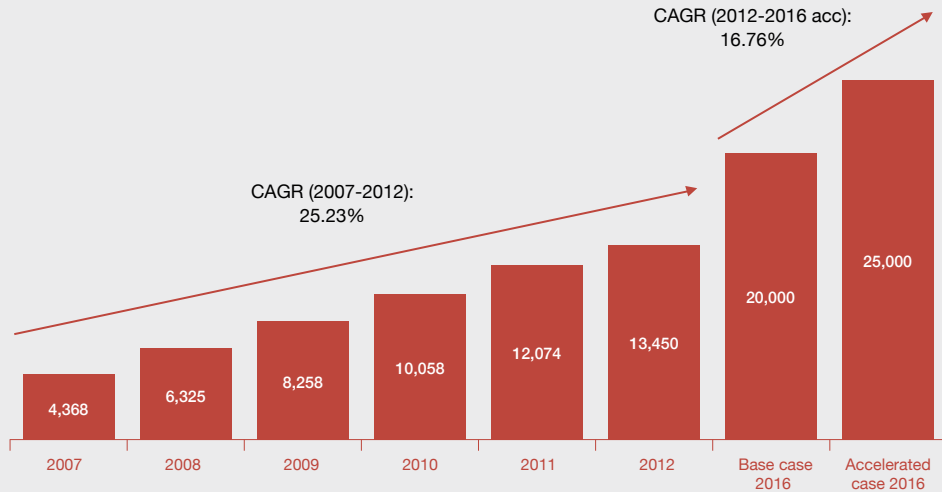
Philippines employment by sector 1980-2012 (% of total employment)



Source: World Bank, "World Development Indicators, Philippines, Agriculture, Industry, Services, value added (% of GDP) (nominal GDP, current USD), 1960-2012;" World Bank, World Development Indicators, Philippines, Employment in agriculture, industry, services (% of total employment), 1980-2012," accessed October 20, 2014, <http://data.worldbank.org/data-catalog/world-development-indicators>.

Exhibit 3 Philippines BPO industry growth

Philippines: BPO industry sales revenue (in USD millions)

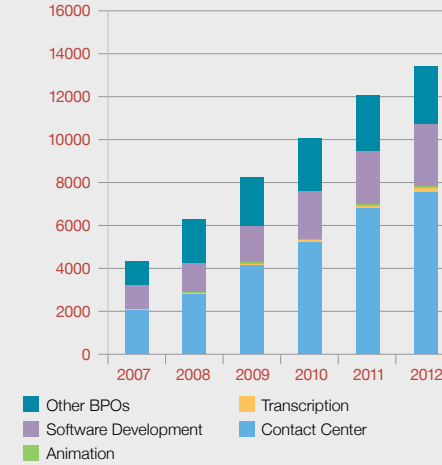


	2007	2008	2009	2010	2011	2012	Base case 2016	Accelerated case 2016
% of GDP (nominal, current USD)	3%	4%	5%	5%	5%	5%	6%	8%
Direct Employment	271,556	355,135	444,811	536,128	679,464	769,932	900,000	1,300,000
% of global BPO industry revenue	6.0%	6.0%	7.0%	8.0%	9.5%	10.0%	10.0%	10.0%

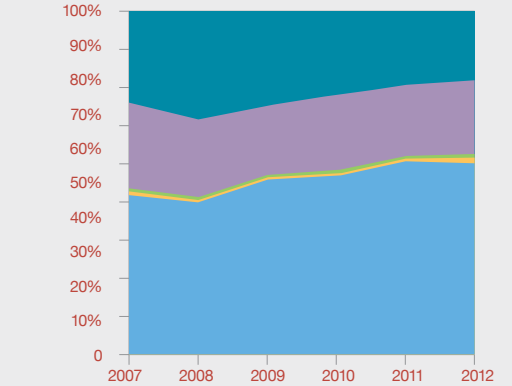
Source: Bangko Sentral ng Pilipinas, "2012 Survey of IT-BPO Services - Table 1. Revenue, by IT-BPO category," accessed October 20, 2014, http://www.bsp.gov.ph/statistics/keystat/ict/itbpo_1.htm; World Bank, "World Development Indicators, Philippines, GDP (current USD), 2007-2012," last accessed October 20, 2014, <http://data.worldbank.org/data-catalog/world-development-indicators>; Based on Everest Group and Outsource2Philippines (2012), Information Technology and Business Process Association of the Philippines (IBPAP), 2012-2016 Philippine Information Technology and Business Process Management (IT-BPM) Roadmap (Makati City, 2012), 6, accessed October 20, 2014, <http://www.ibpap.org/it-bpm-industry-road-map-2016-investors-version-download>.

Exhibit 4 Sales revenue and employment growth by IT-BPO category

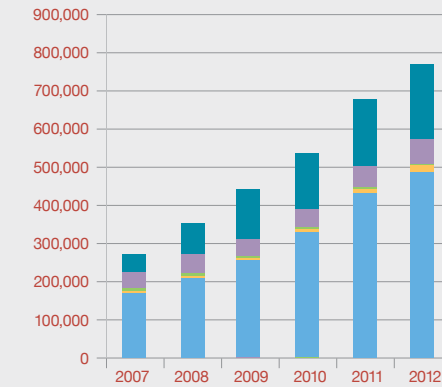
Sales revenue by IT-BPO category (in USD million)



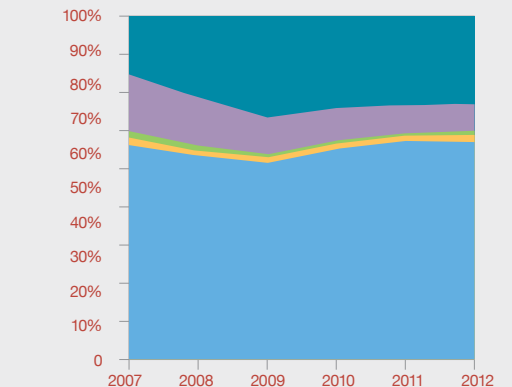
Sales revenue by IT-BPO category as share of the total revenue (% of total revenue)



Employment by IT-BPO category (number of persons)



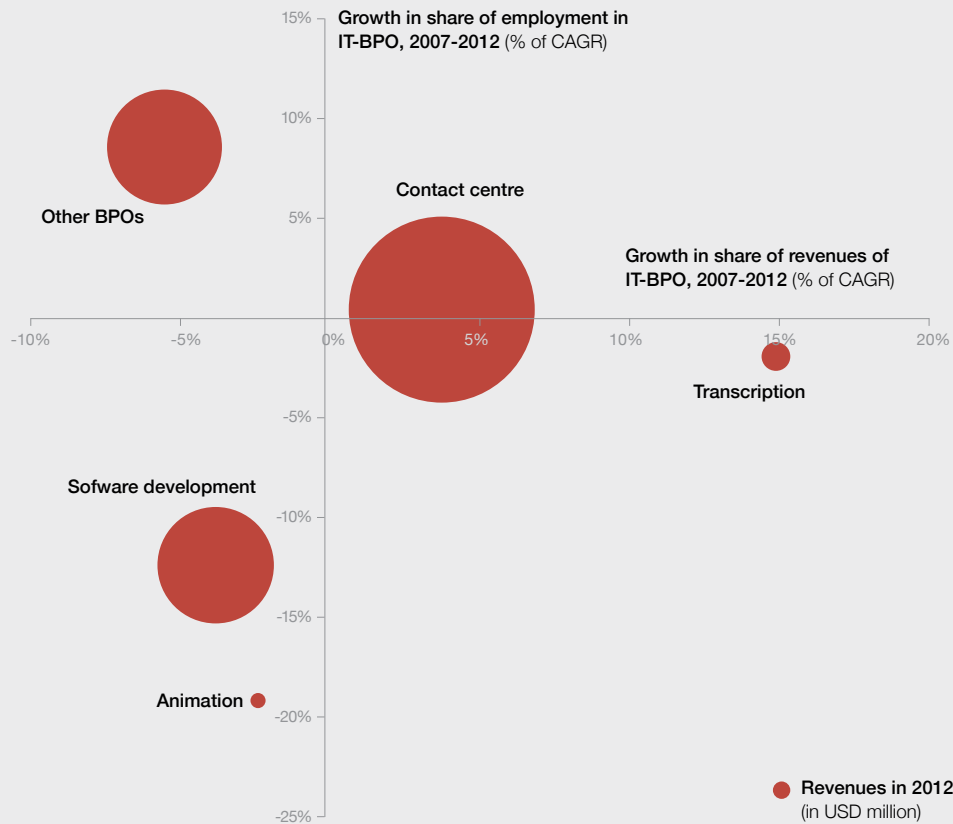
Employment by IT-BPO category as share of employment (% of total employment)



Other BPOs
 Transcription
 Software Development
 Contact Center
 Animation

Exhibit 4 Sales revenue and employment growth by IT-BPO category (cont.)

Growth in share of employment and revenues by IT-BPO category, 2007-2012



Source: Bangko Sentral ng Pilipinas, "2012 Survey of IT-BPO Services - Table 1. Revenue, by IT-BPO category, 2007-2012," accessed October 20, 2014, http://www.bsp.gov.ph/statistics/keystat/ict/itbpo_1.htm; Bangko Sentral ng Pilipinas, "2012 Survey of IT-BPO Services - Table 4. Employment, by IT-BPO category, 2007-2012," accessed October 20, 2014, http://www.bsp.gov.ph/statistics/keystat/ict/itbpo_4.htm.

Exhibit 5 Equity in Philippines IT-BPO

Total equity in BPO in 2012 by country of origin (in USD million)

	USA	Europe	Asia	Australia	Japan	India	Philippines	Total
Contact center	1,595	1,304	77	67	5	291	34	3,372
Transcription	67	0	0	28	-5	0	0	90
Animation	0	0	-7	0	83	0	1	77
Software development	177	1,509	94	3	163	2	90	2,038
Other BPOs	755	56	257	12	459	-31	244	1,751
Total equity (in USD million)	2,593	2,869	421	109	705	262	368	7,327

Source: Bangko Sentral ng Pilipinas, "2012 Survey of IT-BPO Services - Table 3.2.a. Foreign Equity by Country of Investor, 2012", accessed October 20, 2014, http://www.bsp.gov.ph/statistics/keystat/ict/itbpo_3.2.htm; Bangko Sentral ng Pilipinas, "2012 Survey of IT-BPO Services - Table 3. Total Equity, by IT-BPO Category, 2012," accessed October 20, 2014, http://www.bsp.gov.ph/statistics/keystat/ict/itbpo_3.htm.

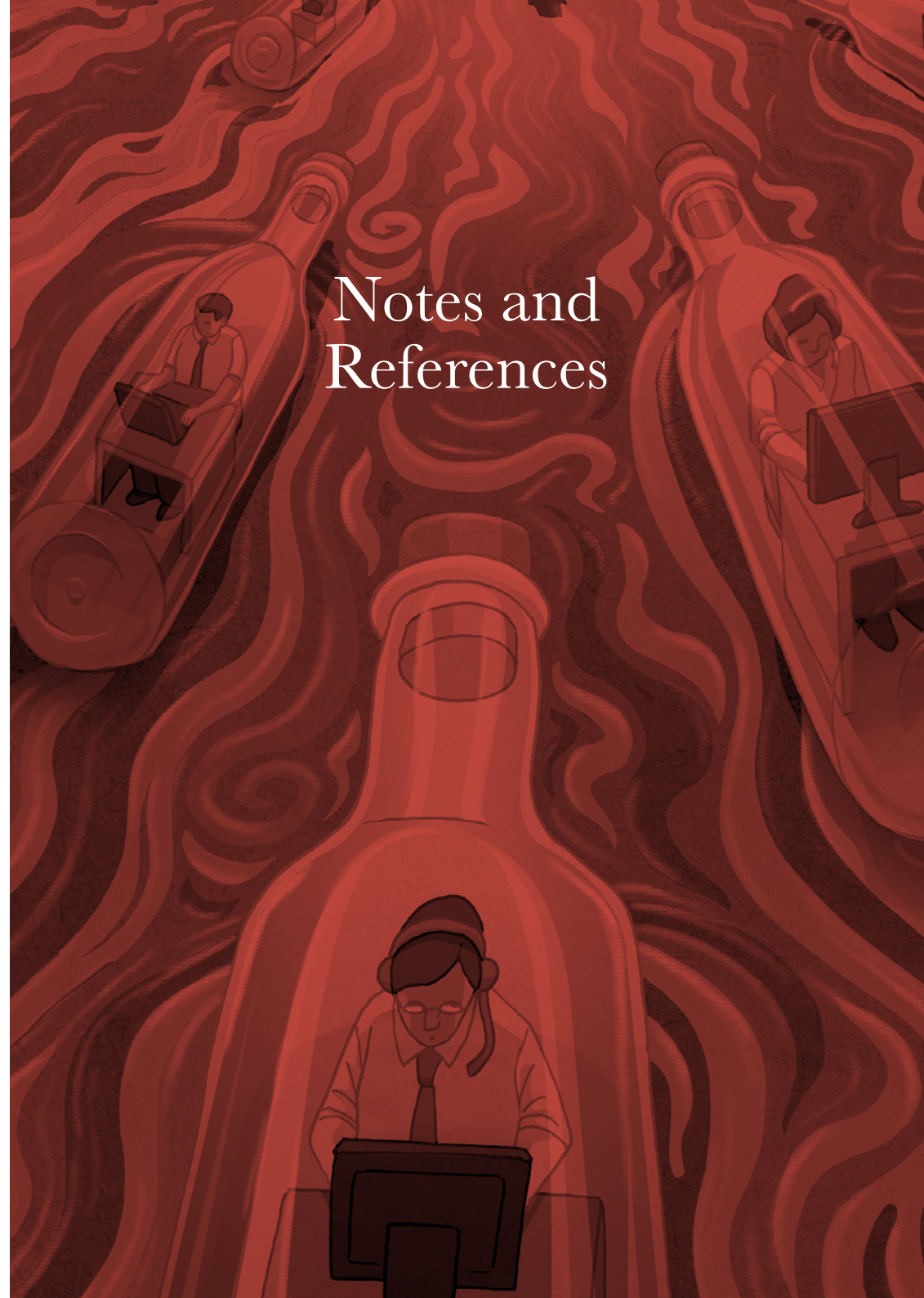
Exhibit 6 Higher education graduates by discipline

Higher education graduates by discipline 2006/7-2012/3

Discipline Group	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Agriculture, Forestry, Fisheries, Vet Med.	12,627	10,650	9,862	10,043	9,618	11,605	13,796
Architectural and Town Planning	2,234	2,292	2,322	2,274	2,245	2,278	2,624
Business Administration and related	98,578	94,034	107,403	117,399	125,840	141,327	164,541
Education and Teacher Training	68,942	63,188	55,849	56,419	62,715	69,738	86,903
Engineering and Technology	50,086	47,725	47,468	49,373	57,439	56,690	59,399
Fine and Applied Arts	2,028	2,194	2,079	2,346	2,516	3,207	2,813
General	1,970	1,662	1,426	1,587	1,402	2,032	1,211
Home Economics	914	957	955	1,107	809	997	966
Humanities	4,409	4,503	4,647	5,196	4,981	5,562	6,577
Information Technology	35,500	38,237	44,448	49,786	54,225	66,672	72,879
Law and Jurisprudence	2,956	3,244	2,916	2,829	2,927	2,743	2,705
Maritime	11,360	11,352	11,716	14,439	14,430	19,515	23,506
Mass Communication and Documentation	4,275	3,968	5,156	5,243	5,334	5,463	6,475
Mathematics	1,771	1,730	2,100	2,021	1,903	2,038	2,984
Medical and Allied	111,188	121,702	128,381	116,380	103,582	80,800	57,427
Natural Science	3,803	3,723	4,155	3,949	3,910	4,330	6,626
Other Disciplines	17,328	18,593	21,151	20,779	21,247	24,716	26,939
Religion and Theology	1,338	1,341	1,138	1,073	1,357	1,542	1,442
Service Trades	2,343	2,324	3,312	5,067	6,184	6,244	8,629
Social and Behavioural Science	12,255	11,400	12,598	12,723	13,168	13,816	15,953
Trade, Craft and Industrial	1,006	1,121	1,057	1,298	1,117	1,255	374
Grand Total	446,911	445,940	470,139	481,331	496,949	522,570	564,769

Source: Commission on Higher Education, "Higher Education Data: 2014 (Public and Private HEIs)," accessed October 20, 2014, <http://www.ched.gov.ph/wpcontent/uploads/2014/temp/10-03/home/Higher%20Education%20Data%202014%20-%20Public%20and%20Private%20HEIs.pdf>.

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