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*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

# Expanding RP-US Linkages in Business Process Outsourcing

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**EXPANDING RP-US LINKAGES IN**
**BUSINESS PROCESS OUTSOURCING**

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## Abstract

The Business Process Outsourcing (BPO) sector has experienced unprecedented global growth. This has greatly benefited the Philippines, where BPO has five main segments: call centers, medical transcription, animation, software development, and shared services. High population level, cultural affinity with the major markets, and advanced telecoms infrastructure are the key advantages of the Philippines. Political stability, on the other hand, is its main weakness.

To ensure the sustainability of BPO sector growth in the Philippines, supply- and demand-side issues were examined. From the supply-side, BPO companies are increasingly finding it difficult and costly to attract, recruit, and retain qualified BPO professionals. The Government—both at the national and local levels—has partnered with the BPO industry and with academic institutions in addressing this issue. Tripartite initiatives have focused on both the more immediate and the longer-term human resource development problems.

From the demand-side, on the other hand, critical developments in the United States—the main market for BPO services—highlighted potential threats to sustained BPO growth. First, the uncertain performance of the U.S. economy has led to increasingly vocal U.S. constituencies that demand protection for American workers. While the federal government is presently not disposed to enact legislation that will negatively affect Philippine BPOs, the political nature of the debate makes it unpredictable and subject to changing popular opinion. Second, heightened security precautions of the US have made it difficult, in general, to obtain visa. This has affected BPO professionals who need to travel to the US for technical, marketing, and human relations requirements of offshore projects. And third, there is an increasing need for data privacy and security especially in emerging BPO segments—health care and financial services.

Should negotiations for the proposed RP-US Free Trade Agreement commence, it is recommended that the Philippine Government incorporate discussions on these potential threats to the sustainability of BPO sector growth.



*Keywords: Business Process Outsourcing, Cross Border Trade in Services, E-commerce, Temporary Entry of Business Persons, National Treatment, Most Favored Nation, Market access, Local Presence, Standards and Certification, IPR, investments, competitiveness*

**Table of Contents**

## EXECUTIVE SUMMARY

The Business Process Outsourcing (BPO) sector has experienced unprecedented global growth, fueled primarily by advances in information communication and technology (ICT) and by the intense competition brought about by globalization. Like most new phenomenon, there has been confusion on how the term BPO is defined and, more importantly, captured in official government statistics. This is a problem that confronts not only the Philippine government but includes even the United States (US).

However, regardless of how BPO is defined or measured, there is convergence of opinion that its growth will be sustained at least over the next 10 years. This has greatly benefited the Philippines, where BPO has five main segments: call centers, medical transcription, animation, software development, and shared services. High population level, cultural affinity with the major markets, and advanced telecoms infrastructure are the key advantages of the Philippines. The country has emerged as a strong alternative BPO location vis-à-vis India—the current global BPO leader. Political stability, on the other hand, is the Philippines' main weakness.

BPO companies have however been experiencing difficulty in attracting, hiring and retaining qualified BPO professionals. In the short-term, fluency in the English language has been cited as the biggest problem. In the long-term, on the other hand, there is noticeable deterioration in the quality of education in the country. Especially troubling is the continued dismal performance of the Philippine students in benchmark international studies on Math and Science. Worse, Eastern European countries—perceived as strong future competitors for BPO projects—are performing excellently in these studies. Europe is expected to be the next biggest source of off-shored BPO projects.

In response, a tripartite partnership between the Philippine Government, BPO industry, and the Academe has initiated several projects to address the issue of human resource development. These included university-level courses focused on BPO operations, local government projects to improve English proficiency and computer skills, and government certification of vocational courses on IT-enabled service skills. In addition, Government is addressing the social environment requirements of 24/7 business operations, e.g. public safety and transport; and is providing a continuous review of policies for enhancing ITC infrastructure.

Lastly, the Government is also improving its national system of economic accounts. A first step is the development of the Centralized Product Classification system. This is an

important short-term measure that would allow enhanced analyses of the BPO sector and of its contribution to the economy.

The US is currently driving the global growth of BPO. While this is expected to continue, the past five years have highlighted the risks that BPO companies in developing countries face. First, the sluggish growth of the U.S. economy resulted in emotional and politically-charged clamors for the protection for American workers. While this threat seems to have ebbed after the November 2004 American Presidential Elections, the political mileage from the issue makes it highly susceptible for manipulation by politicians especially during elections.

Second, the tighter security measures applied by the U.S. after the 9/11 terrorist attacks included stricter requirements for Visa applications. This critically limits the ability of Filipino BPO professionals to visit US-based clients to coordinate project implementation. This is especially problematic considering that BPO professionals fit the profile of high-risk immigrants: young, single, and have not yet accumulated assets.

Third, data privacy and security has emerged as a key concern of Americans especially for high-potential BPO segments—health care and financial services. While the Philippines presently has a legislated national framework that governs e-commerce, this is not sufficient to meet the dynamic demand for heightened data privacy and security.

Should negotiations for the proposed RP-US Free Trade Agreement commence, it is recommended that the Philippine Government incorporate discussions on these potential threats to the sustainability of BPO sector growth.

Specifically, it is suggested that the Philippine panel consider negotiating for:

- Inclusion of a Chapter on Cross-border Trade in Services
- Inclusion of a Chapter on Temporary Entry of Business Persons
- Inclusion of a Chapter on Electronic Commerce, and
- Argue for Technical Assistance for Capability Building Programs.

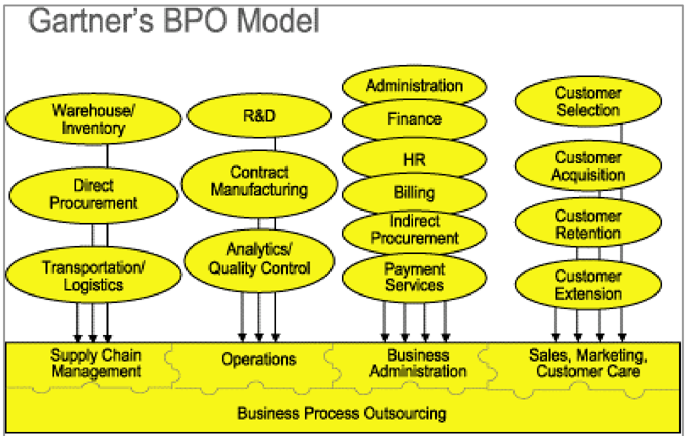
## I. INTRODUCTION: DEFINITION OF TERMS

### A. BPO Definition

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)*". [E-commerce and Development Report (EDR) 2003, United Nations Conference on Trade and Development (UNCTAD), p135]

This study will look at Business Process Outsourcing (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. It 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)

**Figure 1**




Source: www.outsourcingproject.com as cited by DTI, 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."* (as cited by DTI, downloaded from http://www.dti.gov.ph/contentment/9/16/119/422.jsp, December 2004)

Accordingly, BPO service offerings are categorized into four:

**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).

(UNCTAD EDR, 2003)

**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

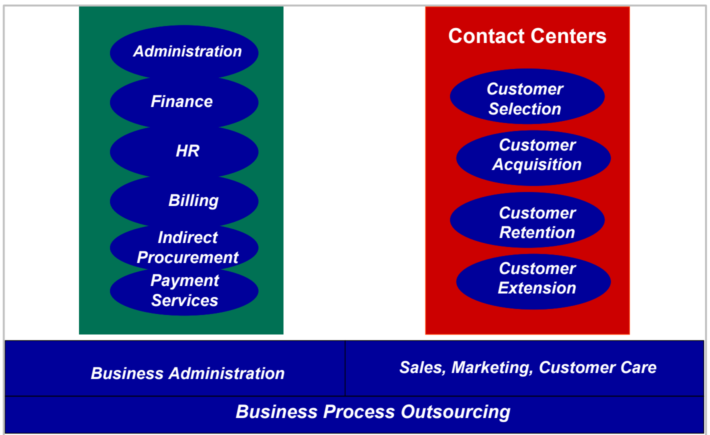
**Sales, marketing and customer care** - includes activities such as customer selection, acquisition, retention and extension

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. Based on this definition, there are three key elements 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 IT-intensive activities, i.e. 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 2. Limiting BPO Definition: IT-enabled Services**




Source: www.outsourcingproject.com, as cited by DTI, July 2003

**Table 1. 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

**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: UNCTAD EDR 2003, p. 141

## B. Outsourcing and Off-shoring

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. Developments in ICT made services more transportable and fragmented and simplified the tasks involved, thereby allowing them to be relocated more easily.[1]

**Box 2. Defining Off-shoring**

Many people are confused by the terms off-shoring and outsourcing. In a nutshell, outsourcing is hiring another company to do some of your work. Off-shoring 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 off-shore – but they aren't the same. In the early days of off-shoring, 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 off-shore subsidiaries. In addition more of the benefits fall to the bottom-line. Things are even more confusing in the United States where some off-shoring proponents have attempted to divert public criticism by substituting terms like *global sourcing, inter-sourcing, blended sourcing a*nd *rightsourcing*. But beneath the smart word-smithing, it's still off-shoring. (Report of Deloitte-Tousche-Tomatsu, 2004)

**Figure 3. Off-shoring and Outsourcing**

| | | 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

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).

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.

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

[1] UNCTAD World Investment Report, 2004

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.

The UNCTAD illustrates these options clearly in Figure 3. 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 off-shoring 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.

## II. SUSTAINABILITY OF GLOBAL DEMAND FOR BPO SERVICES

### A. General Trends in Tradability of Services

Off-shoring of BPOs is part of the emerging global trend of rapidly increasing cross-border trade in services. Unlike in the goods sector,[2] the services sector is only recently being globalized. This is mainly due to the very nature of services and of service transactions: these are *"economic output of intangible commodities that may be produced, transferred and consumed at the same time."*[3] (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 diagnosis of his/her medical condition (i.e., health service).

However, advances in Information and Communication Technology (ICT) have 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 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 (e.g. information provided via call centres) or at a different time (e.g. data entry, software development)."* (UNCTAD World Investment Report, 2004)

The ICT revolution has made it possible for services to be globalized, thus intensifying the competition for markets. In the same way that intense global competition pushed manufacturing processes to seek least-cost, alternative production locations for parts and components, service activities are similarly being fragmented and farmed-out in search of the most cost-effective supply network, i.e. within the organization or to a third-party; and within the country or to abroad.

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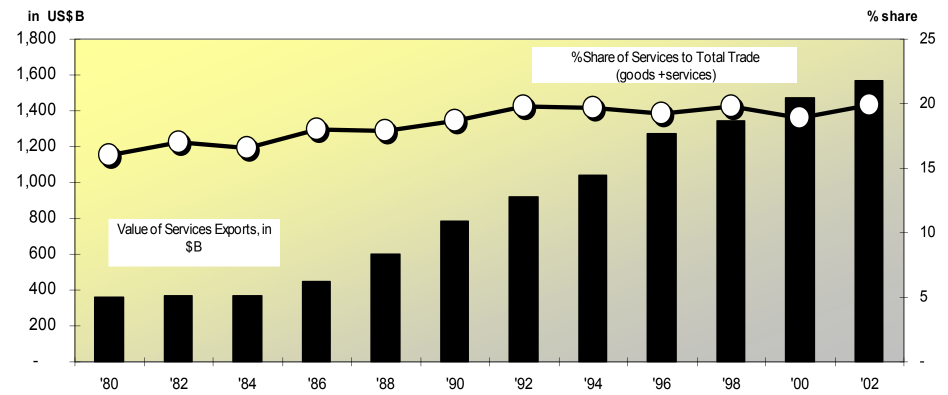
[2] Outsourcing—as a business strategy—is not actually new. Especially in the manufacturing sector, companies have long practiced "sub-contracting." In fact, starting from domestic sub-contracting, complex international supply-chains are now driving highly-globalized industries such as garments, electronics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

[3] Definition based on the Balance of Payments Manual of the International Monetary Fund (IMF)

## 1. Increasing Tradability of Services

As a result of revolutions in ICT, the services sector has been increasingly globalized. In 1980, the value of globally-traded service activities stood at US$364B, accounting for 16% of total trade (goods plus services). By 2002, this amount increased by more than 4.3 times and reached US$1,570B and now accounts for about 20% of total trade.

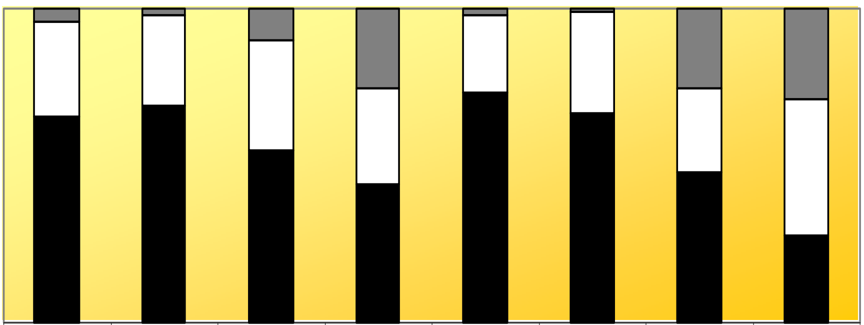
**Figure 4. Share of Services in Global Trade**




Source of Basic Data: WTO Website

This trend is expected to continue, especially considering that the services sector actually accounts for a much larger share of global economic activity than manufacturing. While industry and agriculture combined account for only 34% of total Global GDP, the services sector accounts for 66%.

**Figure 5. Share of Services in Global Economy** (in % share)



| | World | High income | Middle income | Low income | US | Japan | India | Nigeria |
|---|---|---|---|---|---|---|---|---|
| Agriculture | 4 | 2 | 10 | 25 | 2 | 1 | 25 | 29 |
| Industry | 30 | 29 | 35 | 31 | 25 | 32 | 27 | 44 |
| Services | 66 | 69 | 55 | 44 | 73 | 67 | 48 | 28 |

Source of Basic Data: WTO Website

2. Shifts in Cross-border Service Transactions

Moreover, the emerging trend in off-shore 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
Mode 3: Commercial Presence
Mode 4: Movement of Natural Persons

Table 2 and Figure 6 provide illustrations on these different modes of supplying services.

**Table 2. 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

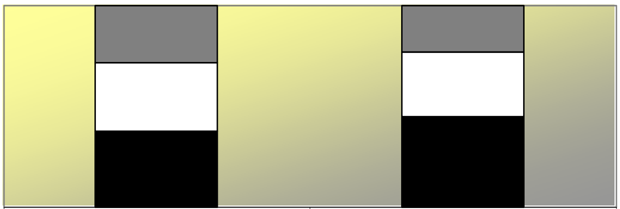
In the past, because of physical constraints on the manner by which services can be supplied, trade in services typically involved the cross-border movement of either the buyer or the provider of the service. For example, a tourist travels to the country of destination (Mode 2) or a professional service 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 transaction—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% in 1990 to about 45% a decade later.

**Figure 6. Shift in Services Trade Structure** (in % share)

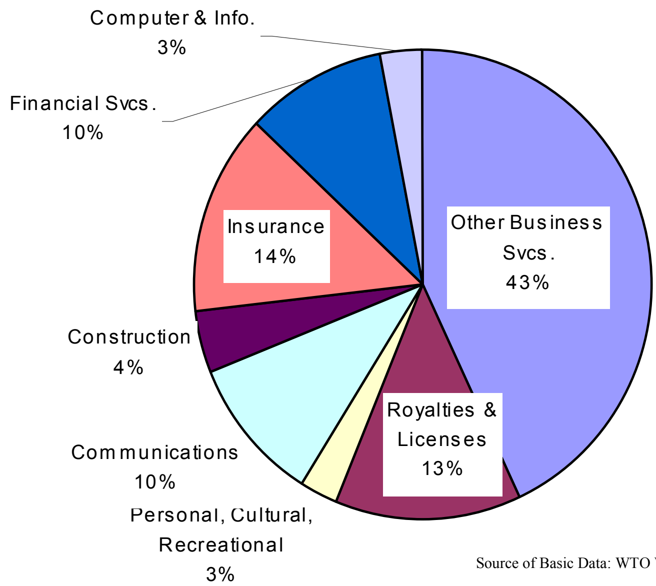


| | 1990 | 2000 |
|---|---|---|
| Transport | 28 | 23 |
| Travel | 34 | 32 |
| Other Comm'l. Svcs. | 38 | 45 |

Source of Basic Data: WTO Website

The extent of off-shore 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.

**Figure 7. Structure of Other Commercial Services Exports** (in % share, based on 1998 data)




Source of Basic Data: WTO Website

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.

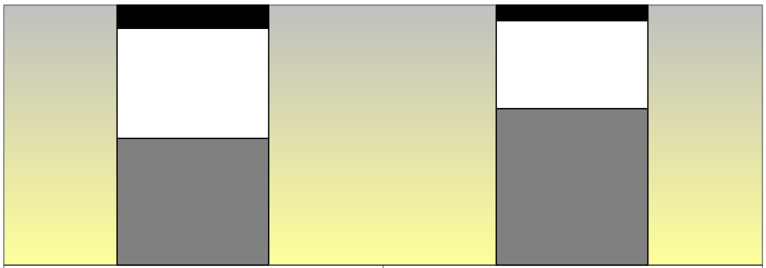
For instance, in health services, outsourcing began with Medical Transcription but now covers routine medical diagnosis—e.g., analysis of digital X-ray plates.

## 3. 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 in 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%).

**Figure 8. Shift in Structure of Inward FDI Stock** (in % share)



| | 1990 | 2002 |
|---|---|---|
| ■ Primary | 9 | 6 |
| □ Manufacturing | 42 | 34 |
| ■ Services | 49 | 60 |

Source of Basic Data: WTO Website

**Table 3. Shift in Distribution of Inward FDI Stock in Services** (in % share)

| | 1990 | | | 2002 | | | |
|---|---|---|---|---|---|---|---|
| | Developed Countries | Developing Economies | World | Developed Countries | Developing Economies | Centrl & East. Europe | World |
| 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 |
| Business Activities | 15 | 5 | 13 | 23 | 40 | 10 | 26 |
| Others | 13 | 8 | 13 | 9 | 5 | 3 | 9 |
| **Total** | **100** | **100** | **100** | **100** | **100** | **100** | **100** |

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 TNCs numbered 31.

**B. Growth of BPOs Worldwide**

1. Problems with Data on BPOs

Data on BPOs, and for the service industries in general, are quite problematic. Unlike goods, there is no tangible reference point for its measure and there is no centrally-available source of information. This is clearly illustrated in the following example:

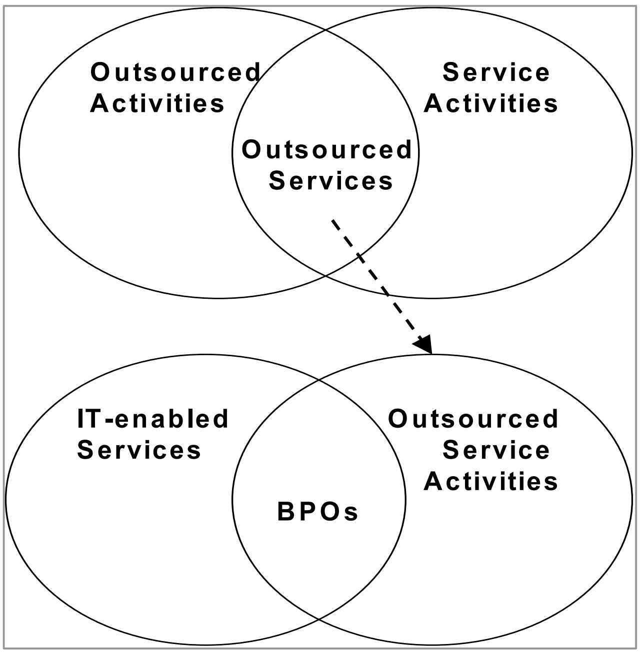
**Table 4. WTO Illustration on capturing e-commerce data**

| Activity | Services Sub-sector |
|---|---|
| A Customer sits down at computer . . . | Computer services |
| logs onto Internet . . . | Communication services |
| orders products . . . | Trade & Distribution services |
| pays for it . . . | Financial services |
| downloads the product or has it mailed to home address. | Delivery services |

Source: WTO Website

As a result, there had been conflicting estimates of the size of the global BPO industry. Figure 9 illustrates these definitional problems and consequently, data estimation problems. 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 in the existing premises of a particular company or in the facilities of an overseas affiliate (e.g., under the captured concept or shared services concept). To summarize, the difficulty in estimating BPO market size can be accounted by:

**Figure 9. Locating BPOs: A Graphical Illustration**




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

As result of these definitional problems, [4] it is difficult to pinpoint exactly the size of the global (or even domestic) BPO market.

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. Since there is no source for centrally-collected data, monitoring BPOs are done mainly through surveys. These are rather expensive exercises and sponsoring institutions recover their investments by market-based mechanisms.

## 2. Market Size and Projected Growth

### *a. Market for Outsourcing*

Gartner Dataquest—as cited by the Information Technology and Electronic Commerce Council (ITECC)—estimated the global market for Outsourcing at around US$495B. This figure includes both manufacturing and service activities—both those that can be IT-enabled and those which cannot. Those that are generally considered as not part of 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**

| Service Line | US$ Bn |
|---|---|
| Admin/Finance/Acctg/HR | 130 |
| Payment Services | 40 |
| Mnufacturing Services | 235 |
| Distribution/Logistics | 60 |
| Sales/Mktg/Customer Care | 30 |
| **Total** | **495** |

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

[4] 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).

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 in 2004 were the US (54%), followed strongly by Europe (31%); the other markets have substantially smaller shares: the Asia-Pacific region (5%), Canada (4%), Japan (3%), and Latin America (2%).

### *b. 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 of 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 "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).[5] The biggest segment is Data Search, Integration and Management; followed by Customer Interaction; Remote Education; Network consulting; and Finance and accounting.

**Table 6. Global Market for IT-enabled Services**
(2002, estimates)

| **Service Line** | **US$ bn** |
|---|---|
| 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 |
| **Total** | **141.2** |

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

[5] 2002 market size, as projected by the 1999 McKinsey Study

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.

**Table 7.**

| IT-Enabled Services | | |
|---|---|---|
| Projected 2005 Market (US$ bn) | | |
| | | |
| **Service Line** | **low** | **high** |
| 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 |
| **TOTAL** | **325** | **375** |
| Source: NASSCOM-McKinsey Report 2002 | | |

### *c. 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[6].

**Figure 10.**


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

[6] DTI Website. Downloaded November 2004.

*d. Summary of Global Market Sizes*

Regardless of how BPOs are defined and on how the market size has been estimated, all the reports consistently point to a growing market for BPOs. Thus, from a policy perspective, assuming there is are no regulatory changes in other countries,[7] 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 $1.6B[8] 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.

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

| | Gartner Dataquest* | McKinsey** |
|---|---|---|
| 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

*e. Market for Off-shored 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 currently off-shored. As reported by in the 2003 UN EDR (E-commerce Development Report), the following are some estimates of BPO off-shoring:

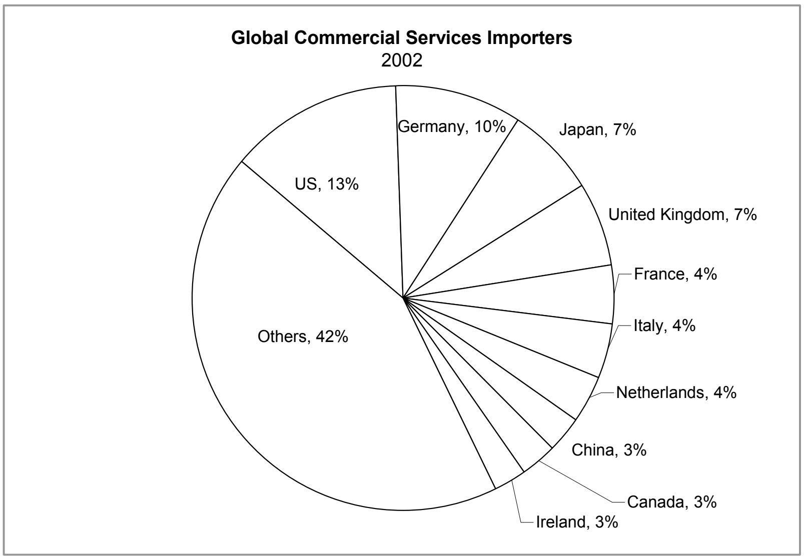
- Only 1-2% of all BPOs were off-shored in 2001;
- Global service exports totaled $32B in 2001; with Ireland accounting for over ¼

In terms of FDI projects (2002-2003) in export-oriented services, on the other hand, 90% originated from developed countries.[9] However, most of these investments—more than half—went also to developed countries, with Ireland and Canada as foremost destinations.

[7] For example, in the United States, bills have already been filed against outsourcing of federally-funded projects.
[8] Excludes accounting, finance and administration (including HR) and shared services
[9] 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.

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. Moreover, although those that took advantage of cost-advantages of off-shoring are mainly US-based companies, European companies—especially those from the United Kingdom—are starting to open up to the idea. In a recent study jointly undertaken by the UNCTAD and by Roland Berger Strategy Consultants, about 83% of large European companies with off-shoring 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. (UN EDR 2003)

**Figure 11.**




Source: WTO data, as cited by the United States General Accountability Office (September 2004)

Off-shoring of service activities from Europe is a very distinct possibility. At present, while the US is the single biggest country- of services (13% of world total), European countries are not far behind. In fact, the consolidated imports of Germany (10%), the United Kingdom (7%), France (4%), Italy (4%), Netherlands (4%), and Ireland (3%), would already account for more than 30% of total global imports of services.

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

Over-all the general verdict is that off-shoring is still far from maturing; 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.[10] There are more recent estimates done by business research groups, concluding that: (UN EDR 2003)

- About 3.4 million service jobs may shift from the United States to low-income countries by 2015;

[10] 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.

- 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.[11]

**C. 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;
- 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 drivers for off-shore outsourcing remain 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[12]. The results were:

(1) Reduce/control costs (44%)
(2) Free up internal resources (20%)
(3) Gain access to world-class capabilities (13%)
(4) Increase revenue potential (13%)
(5) Reduce time to market (11%)
(6) Increase process efficiencies (11%)
(7) Follow company philosophy of outsourcing noncore activities (11%)
(8) 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.

[11] While this figure may seem large, it should be compared with an average turnover of 4 million jobs every month in the United States.
[12] From a survey of 252 corporate IT managers in the US; 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.

## III. 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.

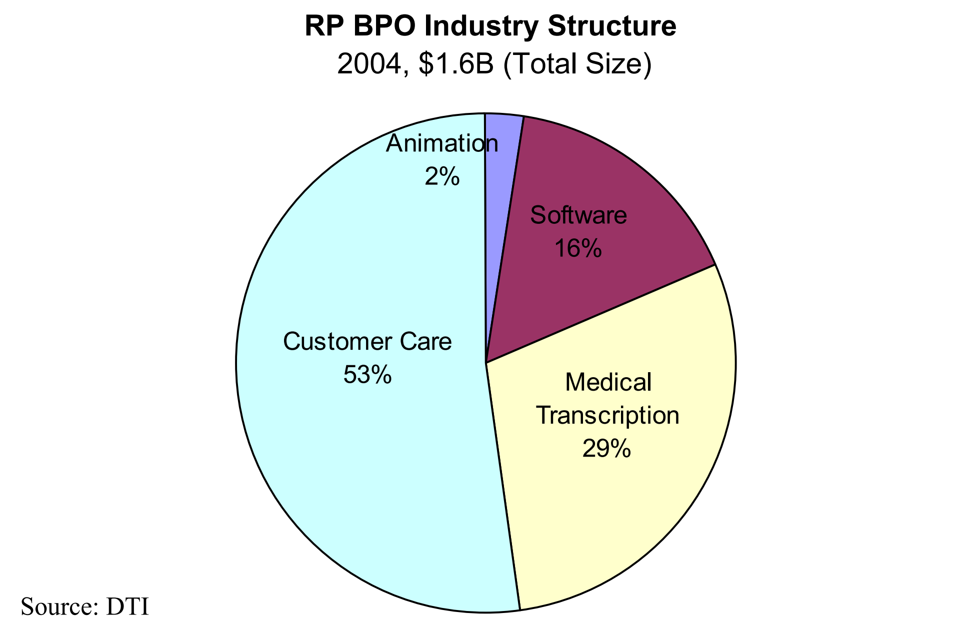
- **Software Development Services** - Analysis and Design, Prototyping, Programming and Testing, Customization, Reengineering and Conversion, Installation & Maintenance, Education & Training of Systems software, Middleware and Application Software

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 these are captive (in-sourced or shared services) or the third-party (outsourced) type. The main difference is that in the use of policy instruments. Captive off-shore service activities can be attracted to the Philippines through investment policies (Mode 3: Commercial Supply); while 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 is about $1.655B in size 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.

**Figure 12.**




Source: DTI

All of the BPO sectors registered cumulative growth rates of above 25% from 2001 to 2004, with Medical Transcription 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% |
| Definition | | A physical location where calls are placed or received in high volume for the purposes of sales, customer service, technical support, research, and others. | Process of interpreting/ encoding electronically the oral dictation of health professionals regarding patient assessment, therapeutic procedures, diagnosis, and so forth. | The process of giving the illusion of movement to cinematographic drawings, models or inanimate objects (thru either 2D or 3D rendition) | System of centralization / distribution where an independent business unit is dedicated to providing process- or knowledge-based financial services to other business units. | Analysis and Design, Prototyping, Programming and Testing, Customization, Reengineering and Conversion, Installation & Maintenance, Education & Training of Systems software, Middleware and Application Software |
| 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 cumulative annual average of 20%. In the US, only 47% of the market is outsourced, the rest is in-house. Anticipated surge in as hospitals have yet to convert records as required by Federal authority. | 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. |
| Current Players | | 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 |
| RP Value Proposition | | 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% | Can't be defined yet. |

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| | Contact Centers | Medical Transcription | Animation | Shared Financial & Acctg Services | Software Development Services |
|---|---|---|---|---|---|
| **Existing Market** | United States, United Kingdom | United States | (i) entertainment base - United States, Japan and Australia / Canada / France; (ii) education / business base - Malaysia, China, Korea, Thailand | Regional HQs - 300 in-country; HK/Singapore RHQs; 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% |
| **TOTAL** | **332,000** | **445,300** | **34%** |

Source: 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 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-related workers. 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 about $60,000. 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**

| Company | Activity | Market |
|---|---|---|
| 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**

| Company | Activity | Market |
|---|---|---|
| Alitalia | Business process outsourcing | Asia, Middle East, North & South America |
| International Red Cross | Business process outsourcing | Worldwide |

**Japanese Firms**

| Company | Activity |
|---|---|
| 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

# III. ATTRACTIVENESS OF THE PHILIPPINES AS A BPO LOCATION

Based on interviews and a review of past research done on BPOs in the Philippines, the main framework 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.

**Table 12. DTI's Factors for Philippine BPO Competitiveness**

| Factor | Determinants |
|---|---|
| Quality of Human Resource | Availability of qualified and educated staff<br>Access to multilingual skills: English and other regional languages<br>Flexibility of labor (labor laws, workforce attitude) |
| Cost of Doing Business | Labor cost<br>Property and telecommunication costs |
| Infrastructure and Utilities | Availability and reliability (telecommunication)<br>Office space or building with back-up power supply<br>Easy access (local and international) |
| Business Environment | Support services (recruitment, setting up, telecommunication)<br>Stability, reliability, etc.<br>Data Protection<br>Bureaucracy |

Source: DTI 2003

**Table 13. SGV's (Knowledge Institute) Factors for Philippine BPO (Call Center) Competitiveness**

| Factor | Determinants |
|---|---|
| People | Education level<br>Size / depth of labor pool<br>English literacy / accents<br>Retention levels |
| Cost | Cost of labor<br>Cost of infrastructure<br>Real Estate<br>Telco Facilities<br>Government incentives |
| Environment | Country risk (peace & order)<br>Cultural compatibility<br>Friendliness to expats |
| International Awareness | Trade Missions / Institutional Marketing<br>Presence of Industry Groups<br>Track record |

Source: F. Huang, SGV (2003)

## A. Factors Affecting Competitiveness

For purposes of this study, however, these most important factors will be aggregated into three: (1) cost and quality of human resource, (2) cost and quality of infrastructure and utilities, and (3) the business environment.

Based on interviews, on selected financial statements and as estimated by the DTI, Salaries and Wages can easily take more than half of the operating costs of any BPO operation . This will be followed by telecoms costs and then by office rentals.

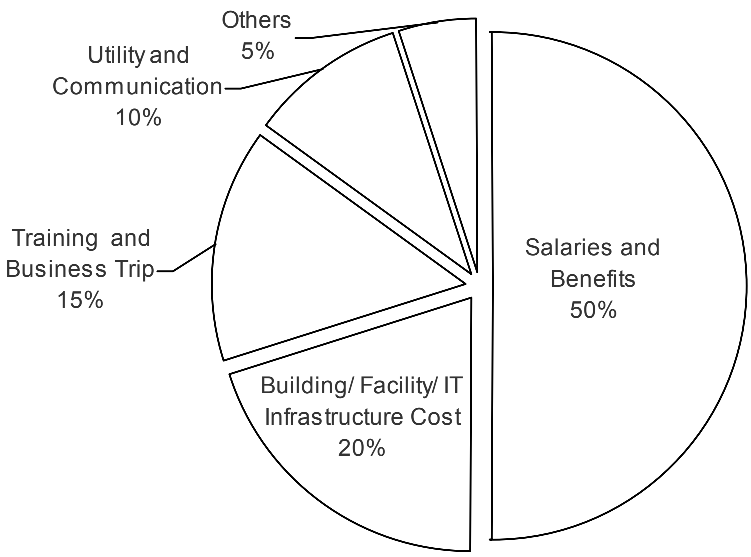
**Table 14. Structure of BPO Costs, per Interviews & Financial Statements**

| 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 13. Structure of BPO Costs, per DTI Report**




Source: DTI

1. Human Resource

***a. Cost***

The cost and availability of qualified human resource is a key variable for any prospective BPO locator. As mentioned, salaries and wages can easily take up 50% of total direct cost. At present, the Philippines is mildly competitive in terms of cost and quality of human resources, especially in the following areas: (1) cost, (2) service ethic, and (3) language proficiency.

For BPOs, in general, the wages of business workers in the Philippines is quite competitive at US$234 per month, ranking next to Indonesia (US$58) and India (US$150) as among the lowest in Asia. The Philippines has an advantage in salary and wages.

**Table 15. Average Gross Base Wage of Business Workers**
(2003)

| Country | US$ per month |
|---|---|
| Australia | 1,540 |
| Hong Kong | 1,448 |
| New Zealand | 1,263 |
| South Korea | 1,056 |
| Taiwan | 915 |
| Singapore | 839 |
| Malaysia | 337 |
| Thailand | 298 |
| Philippines | 234 |
| India | 150 |
| Indonesia | 50 |

Source: as cited by DTI

Specifically, the wages for the Philippines are as follows:

**Table 16 . Philippine Wage Rate Statistics**
(2003)

| Type of BPO Worker | in US$ per month (approximate) |
|---|---|
| Wage Rate for Contact Center Agent<br>-- Entry-level<br>-- With some type of vertical (industry) expertise | <br>$200-$300<br>$300-$380 |
| Wage Rate Accountant | $300-$500 |
| Wage Rate for Accounting clerk | $150-$200 |

Source: as cited by BOI and CFP

The competitiveness of Philippine wages for BPOs is seen clearly in the call center industry. A Filipino call center agent's salary (entry-level) is one of the lowest in the region, bested only by India and matched by China. But a call center agent's salary can easily go to as high as US$500 per month, depending on the ability to speak another major language (e.g., Spanish, German, French, etc.) aside from English.

**Table 17. Comparative Average Salary of Call Center Agents**
(annual estimates, in US$)

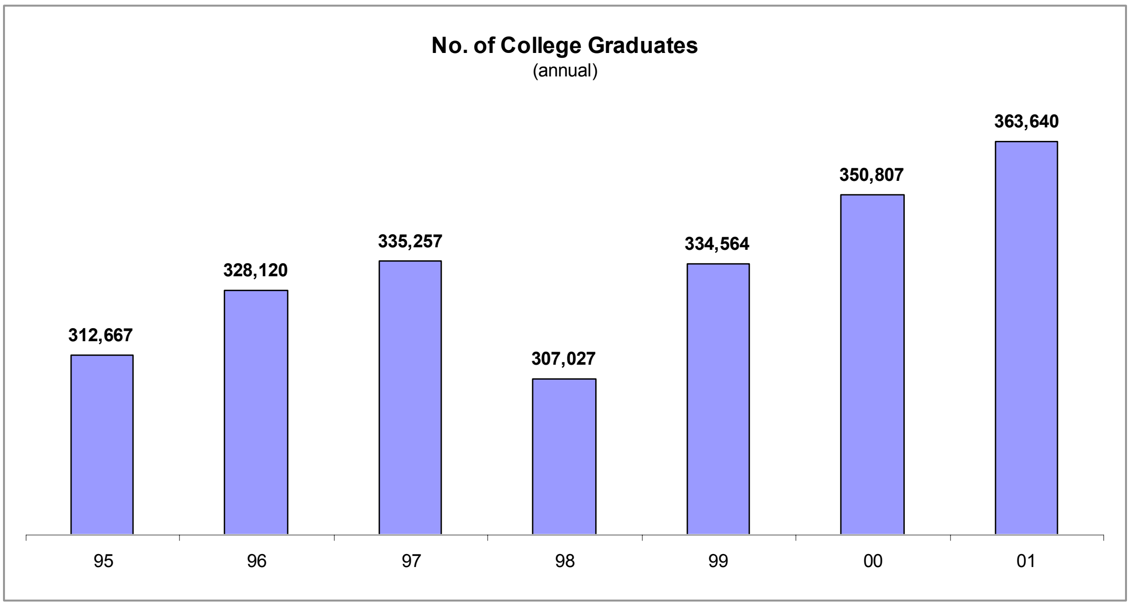
| Country | Salary |
|---|---|
| US | 25,000 |
| RP | 2,828 |
| India | 1,689 |
| China | 2,804 |
| HK | 16,438 |
| Malaysia | 3,960 |
| Singapore | 11,748 |
| Thailand | 3,949 |

Source: 2003 Callcentre Benchmarking Study, as cited by F. Huang

***b. Availability***

Currently, the size of the total labor force of the Philippines is approximately 29 million with 363,640 college graduates each year. The growth of the number of college graduates from 1995-2001 is shown in the chart below.

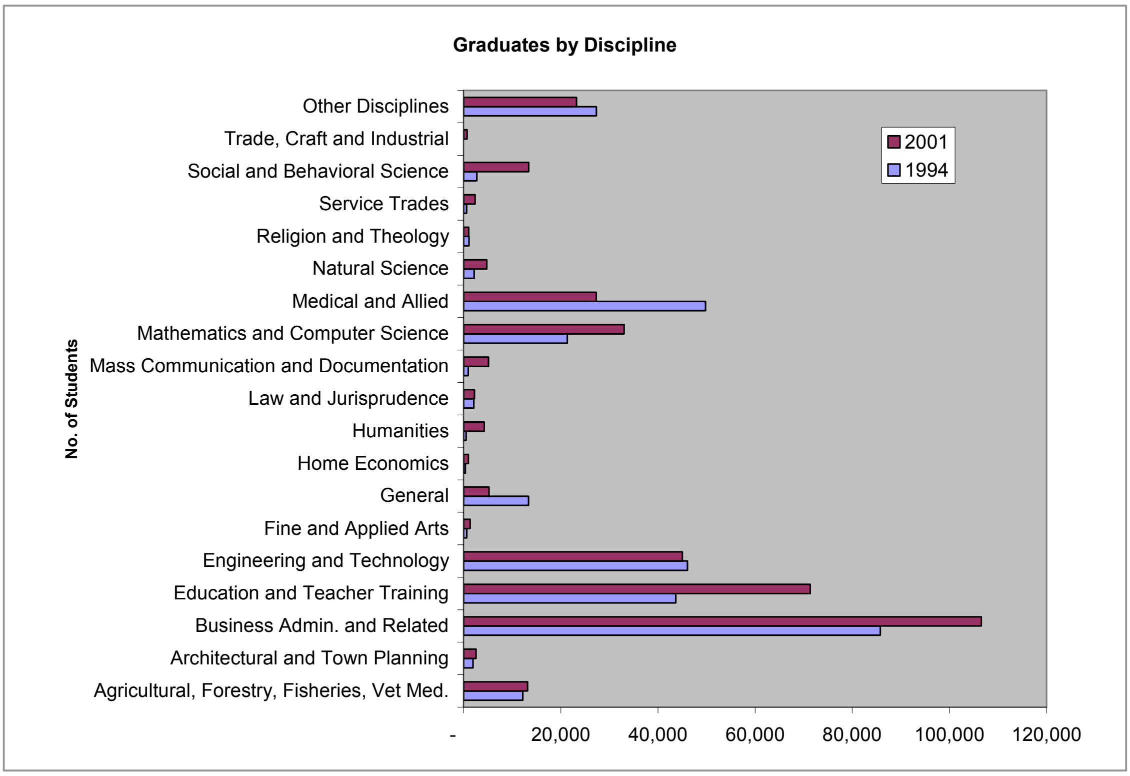
**Figure 14.**




Source: CHED

The Philippines has a relatively large pool of technically-proficient workers, with background in computer science and programming producing an estimate of 30,000 to 50,000 graduates per year. Moreover, nearly 50% percent of the total graduates are knowledgeable with business administration, mass communication and other related courses. For that reason, there is a high concentration of workers that can achieve the desired level of expertise in U.S. business processes, specifically in finance and accounting and human resources. The statistics of graduates and their respective courses are in the following illustration.

**Figure 15. No. of Graduates of Philippine Colleges and Universities**




Source: DTI

**Table 18. Philippine Labor Pool Statistics** (approximate)

| **Total Number of Graduates (2002-2003)** | **363,640** |
|---|---|
| Business Administration and Related Courses | 106,559 |
| Engineering and Technology | 45,041 |
| Math & Computer Science | 33,059 |
| Mass Communication & Documentation | 5,140 |

Source: Philippine Commission on Higher Education (CHED)

### *c. Key Issues in the Human Resource Value Chain*

Problems in Philippine Human Resource situation may clearly be seen by tracing the whole Human Resource value chain:

- Recruitment and Selection
- Pre-employment Training, e.g. on Communication Skills, Customer Orientation, Computer Skills, and Core Skills (industry or profession specific).
- Actual Work and Continuous Training and Development
- Retention and Attrition

*i. Success Rate in Recruitment*

The main challenge to the Philippines' emergence as a regional leader in call center operations is the looming shortage of qualified agents. This is becoming a serious problem. Until 2003, it was being reported that the industry's recruitment success rate (i.e., percentage of qualified applicants from among the total number of applicants) was about 5%.; in early 2004, based on interviews, it was down to about 2%. However, even some of the biggest call centers were reporting a success rate of about 1.6% towards the end of 2004. As mentioned before, the country's short-term problem, with respect to BPOs, is concentrated on the availability of qualified call center agents. While hit rates for call centers have gone down to as low as 1.6%. For BPOs, in general, the success rate is most likely higher. An interviewee placed the success rate at 10%.[13]

Success rates must however be used with more caution when referring to an industry context. In the call center industry, organization-wide success rates are commonly used to compute for the total number of applications needed to recruit a certain number of qualified agents. For example, to recruit 20,000 of call center agents needed by the industry per year, the success rate of 2% is simply divided to this projected need. Thus, one gets 1,000,000 (i.e., 20,000 needed agents ÷ 2% success rate) as the needed total number of applicants. This approach however assumes that candidates apply in only one call center company. If this is the case, then the organization-wide success rate is indeed equivalent to the industry success rate.

However, it is more likely that candidates apply to multiple companies. This is especially true with the ease by which applications can now be made (e.g., e-mail, mobile recruitments stations at major malls). For example, assuming that candidates who are not qualified apply to an average of four companies (and they are rejected by all), the success rate for the whole industry would actually be about 8.2%. This means that to recruit the 20,000 qualified agents, the whole industry must attract 245,000 applicants (and not 1,000,000).[14]

*ii. Attrition Rate*

Attrition is also becoming a problem for BPOs, especially call centers. Based on interviews, attrition rates currently range at between 20% to 40% annually. While still below India's and the US (reported to be above 100%), this is increasing becoming a concern for the industry.

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[13] For backroom finance and administration-related BPO.
[14] This insight was first shared to the author by Mr. Raffy David, President of E-teleserve.

There are basically two general categories of attrition: voluntary and involuntary. For voluntary attrition, the most common reasons are, based on interviews, (1) the night work schedule and (2) the increasing popularity of pirating call center agents.

One of the major advantages of the Philippines is that its night-time work schedule complements the day-time commercial activities in the US. However, this very same advantage is most commonly-cited factor for the resignation of call center agents. The physical demands of night-time work leads to a deterioration in the individual's health and the inverted work schedule leads to an increasing sense of social alienation.

Moreover, with the increasing difficulty in recruiting qualified agents—aggravated by higher attrition among the existing pool of agents—call centers are resorting to the practice of pirating. Premiums for experienced call center agents range from 100% for first-level agents; to 200% for team leaders; and 300% for managers and directors. The problem with pirating is exacerbated by the proximate locations of call center facilities. This provides many opportunities for interaction among agents and recruiters.

It must be noted that even within a specific call center, 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.

All these factors are eroding the cost-competitiveness of Philippine BPOs as call centers now resort to practices that ultimately increasing costs of salaries and benefits. These include:

- Wage premiums for "international call center experience"
- Signing bonuses
- Multiple locations[15]
- In-house pre-employment training
- More benefits, e.g. educational opportunities

***c. Quality of Graduates of the Philippine Educational System***

Ultimately, the problem with the recruitment of agents can be traced to the quality of the Philippine Educational System. Based on interviews, entry-level BPO applicants are tested generally on four (4) "Cs": Communication Skills, Customer Orientation, Computer Skills, and Core Skills (e.g., specific professional requirement or product knowledge). However, the most pressing concern of BPOs, especially of call centers, is the declining English proficiency of Filipinos.

To address this, the call centers are engaging in a variety of firm-specific and in cooperative measures, including:

[15] Having multiple locations increases the chance of recruiting qualified candidate-applicants from the catchment area.

- Liaison with Academic Institutions – a number of call center companies initiated joint courses with colleges and universities to offer electives on call center-related skills.
- Pre-employment training for the "high-failure" applicants (i.e., those that can be trained). Some of these are already using software-aided language training programs.

Deficiencies in language skills can actually be remedied. Based on interviews, an average-level English speaker could acquire the needed fluency if immersed eight (8) hours daily in a purely English environment for one month. For a below-average speaker, one needs to be immersed for about three (3) months.

There are also English training programs run by third-party providers. However, these are quite costly and have uncertain effectiveness. For example, based on an interview, a three-day training seminar for 15 people costs about Php60,000.

If English proficiency is the most immediate concern of the industry, the country faces a more serious threat in the medium-to long-term. There is an observed decline in the quality of education in the Philippines, especially in key disciplines such as Math and Science. The country has been consistently placing near the bottom of competitive examinations that test the general level of Math and Science knowledge of 8th grade students. As a benchmark indicator, the Trends in International Mathematics and Science Study (TIMSS) of the Boston College provides depressing results.

**Table 19. Philippine Performance in Math and Science Benchmarking Studies**

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

| | 1999 | | 2003 | |
|---|---|---|---|---|
| | Math | Science | Math | Science |
| | *Rank out of 38 countries* | | *Rank out of 45 countries* | |
| **RP** | **36** | **36** | **41** | **42** |
| 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 |
| **RP Score** | **345** | **345** | **378** | **377** |
| **Int'l. Ave.** | **487** | **488** | **467** | **474** |

Source: Boston College TIMSS Report, December 2004

While neighbors like Taiwan, Korea, Singapore and Japan have consistently topped the TIMSS, The Philippines has always been at (near) the bottom: in 1999, among Grade 8 pupils, the country ranked 36th out of 38 for both Math and Science. In the latest study, conducted in 2003 but released just in December 2004, out of 45 countries, the Philippines placed 41st for Math and 42nd for Science.

It is interesting to note is that Eastern European countries, in addition to Russia (ranked 12th for Math and 17th for Science) are also getting high scores. For example, in 2003, for Mathematics achievement, Belgium placed 6th; Estonia, 8th; Hungary, 9th; Latvia, 11th; Slovak Republic 13th; and Lithuania, 16th; to name a few. The same can be said of the Science exams: Estonia placed 5th; Hungary, 7th; Slovenia, 12th; Lithuania, 14th; Slovak Republic, 15th; Belgium, 16th; and Latvia, 18th.

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 also from Western European countries who will outsource some of their service activities.

### *d. Over-all Human Resource Attractiveness*

In general, the Philippine's pool of labor compares 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, Political and Economic Risk Consultancy, Ltd. (PERC) and Contact Center World (CCW). The only advantage of the Philippines over India is its cultural affinity with the United States, currently the biggest BPO market. Thus, overall, in terms of the Human Resource factor, the Philippines seems more suited for BPO activities that require customer interaction; while India will be more suitable for backroom operations.

**Table 20. Philippine Performance in Math and Science Benchmarking Studies**

| Overall Labor Force Quality | | India | RP | China |
|---|---|---|---|---|
| | | Highly Suitable | Highly Suitable | Unsuitable but Quality is improving |
| 1. Skill | NeoIT* | Good | Fair | Poor |
| | PERC** | Good | Fair | Fair |
| | CCW*** | Good | Good | Fair |
| 2. English-proficiency | NeoIT | Good | Good | Poor |
| | PERC | Good | Good | Poor |
| | CCW | Good | Good | Poor |
| 3. Cultural affinity | NeoIT | Fair | Good | Poor |
| | CCW | N/A | Good | Poor |

Source: As compiled by San Agustion (UA&P 2004) from various sources:

* NeoIT, an off-shore IT and BPO services advisory and management firm (www.neoIT.com)

** Political and Economic Risk Consultancy, Ltd.

*** ContactCenterWorld.com

2. Telecoms Infrastructure

Most third-party analysts place telecoms infrastructure as a key strength of the Philippines. This advantage can be traced to the liberalization and deregulation of the sector in the 1990s. According to the DTI, these advantages include:

- a good infrastructure for both voice and data, compared with other Asian countries
- redundant international connectivity, including fiber optic cable and satellite communication
- availability of significant amount of trans-Pacific data communication bandwidth
- a high-quality, low-cost bandwidth that is expanding the domestic telecommunication network; of which six platforms are available:
  - Fixed line
  - Cellular
  - Cable TV
  - Over the Air TV
  - Radio
  - The Very Small Aperture Terminal (VSAT) System

As cited by DTI, bandwidth costs have declined by 70 percent during the past four years.

**Table 21. Comparative Quality of Telecoms Infrastructure**

| (2001, latest) | RP | India | US |
|---|---|---|---|
| **ICT Infrastructure & Access** | | | |
| 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 | -- |
| **Computers & the Internet** | | | |
| 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 |
| **ICT Expenditures** | | | |
| 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

2. Real Estate

The Philippines has readily available locations with the necessary IT infrastructure capability to support BPO companies. According to the DTI, BPOs are presently primarily located in the following areas:

- Metro Manila, specifically the central business district of Makati and the business districts of Ortigas, Fil-invest 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.

3. Business Environment

The business environment covers the macro situation faced by businesses in the country. This includes the socio-cultural, political and economic dimensions of doing business in the country. Of these, the Philippines has advantage regarding its cultural affinity to the major market—the US. In addition, the business experience in the Philippine is at par with international standards. The country has consistently received a high ranking for "International Business Experience" from the IMD World Competitiveness Report.[16] In addition, it is already using international standards in its business operations. For example, in accounting, aside from using GAAP (Generally Accepted Accounting Standards) for financial reporting, which is being applied in the US, Japan and soon in the most of Europe, the Philippines also follows the application of Accounting Standards as set by the Accounting Standards Board and International Accounting Standards Board.

Its main drawback is in the area of political and regulatory environment. Business groups (e.g., the Makati Business Club and the Philippine Chamber of Commerce and Industry), together with international agencies (e.g., the Asian Development Bank), have documented the business sector's continued dissatisfaction over corruption in the country. This is where the Philippines is weakest.

4. Over-all Rating: Philippines' Attractiveness as BPO Location

The Philippines has been rated by AT Kearney, an often-consulted off-shore location management company—as among the most attractive BPO locations in the world. It in fact is a strong second to India, in terms of financial (cost) attractiveness. However, its key weakness is

[16] For example, it was ranked 16 out of 49 countries for "International Business Experience" in 2001 by the IMD World Competitiveness Report.

its "business environment." For 2004, the only countries lower than the Philippines' 0.92 rating in this category are: Russia - 0.51; Vietnam - 0.70; Turkey - 0.73.

**Table 22.**
**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 |
| **Philippines** | **3.59** | **0.92** | **0.94** | **5.45** |
| 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 Kearnery website

Based on a review of past studies, it seems clear that over-all, the Philippines is attractive because of:

- Competitive wages
- Generally skilled (business-related and people skills) labor force, with strong cultural affinity with the US
- Advanced development of its IT infrastructure

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
- High power rates

**Figure 16. Philippine Cost Proposition**

| | KI | NeoIT |
|---|---|---|
| **Cost in US** | **100%** | **100%** |
| **Less: Labor Savings** | **~55%** | **50% – 90%** |
| **Plus: Add'l. Expenses of remote operation** | **~15%** | **20%** |
| **Net Savings** | **~60%** | **30% to 70%** |

Source: F. Huang (Knowledge Institute, Dec. 2003); A. Vashistha (NeoIT presentation, May 2003)

All these advantages and disadvantages currently translate to a cost-saving proposition (for off-shore outsourcing) of around 50% of US-based expenses. The biggest savings-component comes from labor; however, additional expenses will have to be incurred in support of operations located in another area.

## IV. THE US MARKET FOR BUSINESS PROCESS OUTSOURCING

### A. Macroeconomic Data on the US Services Sector

The US' private sector is largely driven by the Services sector. However, while the Services sector accounts for about 78% of the total non-government GDP, its share of trade remains low: just 16% for imports and 30% for exports.

**Figure 17.**

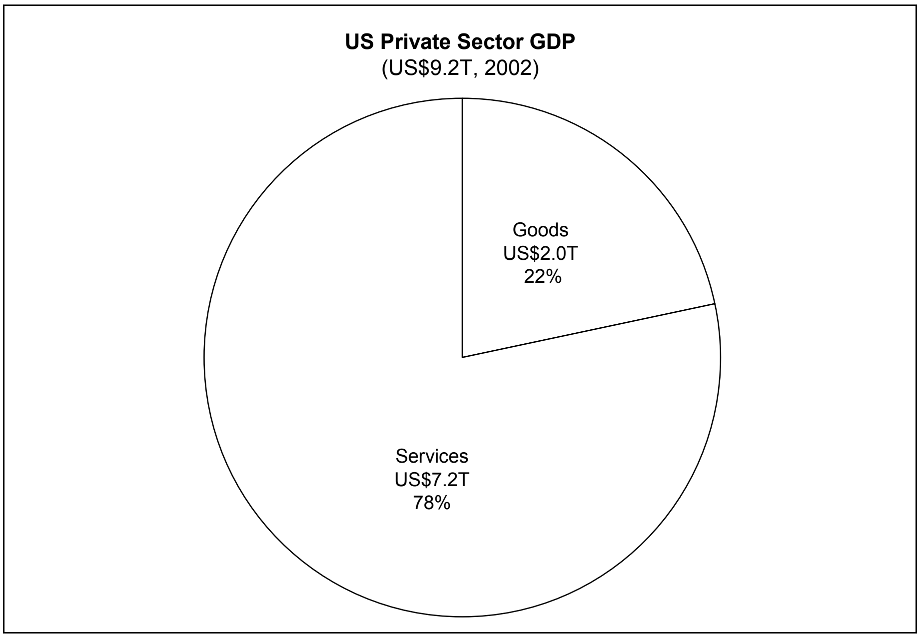
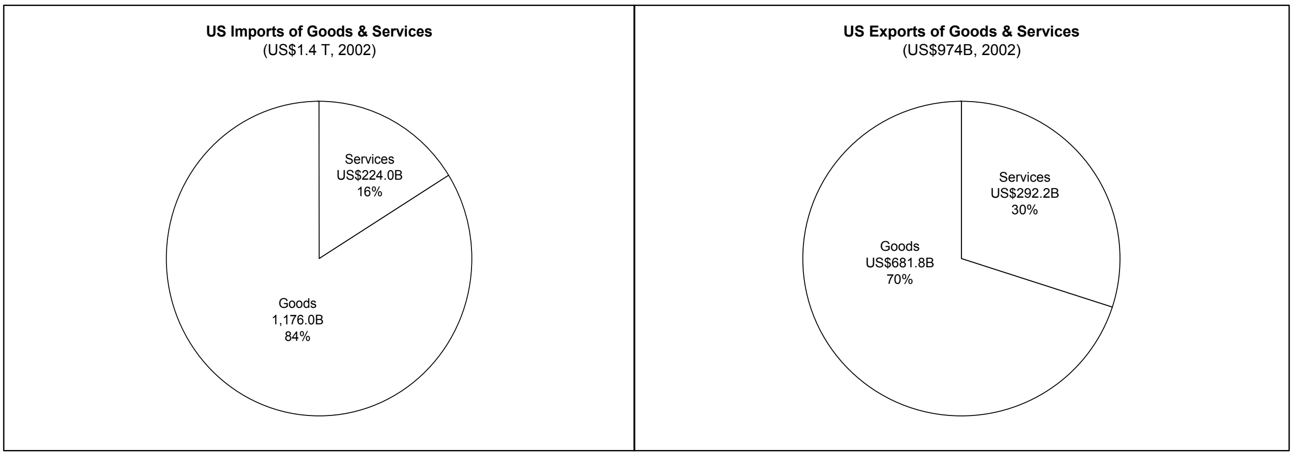



**Figure 18. US Imports and Exports of Goods and Services**



The ICT Revolution, as mentioned earlier, is facilitating the globalization of services. Given services' disproportionately low share of total trade, compared with its total contribution to the economy, there is a strong potential for expansion in services trade for the US.

Among imports of private services, the category "Other Private Services" account for the biggest share (34%). Moreover, within this category, "Business, Professional and Technical Services" is the largest component (54%). This category of service activities includes most BPOs, including: administrative and financial services (e.g., accounting, auditing and bookkeeping), computer and data processing, engineering, architectural services, database and information, management consulting, research and development, etc.

**Table 23.**

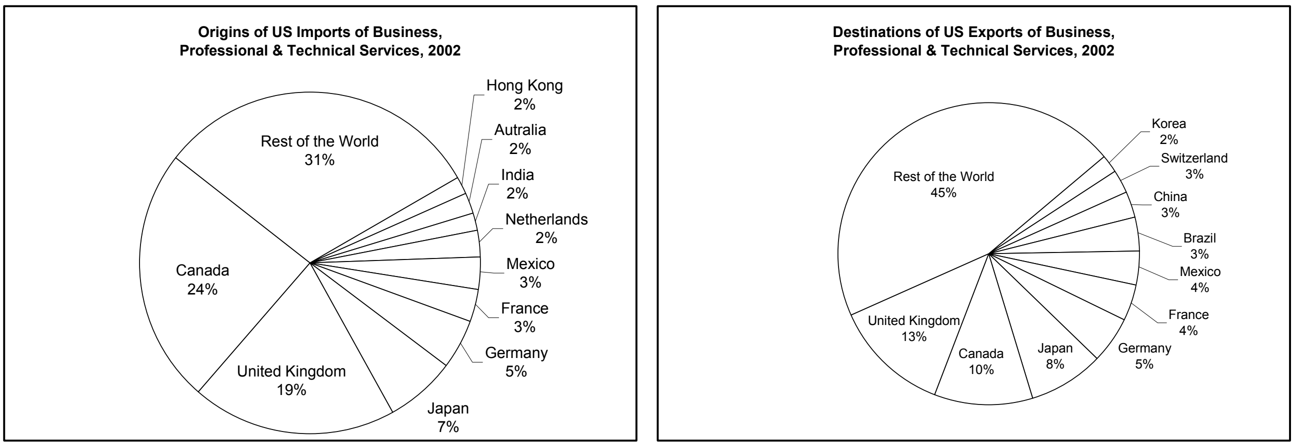
| US Imports of Private Services (2002) | |
|---|---|
| | **% Share** |
| **Other Private Services** | **34** |
| *Other Services (1%)* | |
| *Education (4%)* | |
| *Telecommunications (6%)* | |
| *Financial Services (13%)* | |
| *Insurance Services (22%)* | |
| *Business, Professional & Tech. Svcs. (54%)** | |
| **Royalties and License Fees** | **9** |
| **Passenger Fees** | **10** |
| **Other Transportation** | **19** |
| **Travel** | **28** |
| **TOTAL** | **100** |

* lumps together several services, including:
- Accounting, Auditing & Bookkeeping
- Architectural Engineering & other Technical
- Computer & Data Processing
- Database & Other Information
- Legal
- Management, Consulting & Public Relations
- Research, Development & Testing

Source: 2004 US GAO Report

While the US is major market for the Philippine BPOs, the reverse is not true: the Philippines is not a major source of services imports of the US. As mentioned earlier, the main source service imports for the US are geographically-proximate developed—Canada (24%) and the United Kingdom (19%). This indicates that, with the developments in ICT, wage differentials can still be fully maximized by US companies who source service imports from lower-wage cost countries. Among developing economies from Asia, India has been able to penetrate the US market . However, its 2% share is still miniscule compared with the shares of developed countries.

**Figure 19. US Trade in Business, Professional & Technical Services**



The biggest destination of US exports of Business, Professional and Technical Services are, on the other hand, also developed countries.

**Table 24. US Trade in Unaffiliated Business, Professional, and Technical (BPT) Services**
(RP vs. Total US, 2002)

| | | Total US | RP | RP Share |
|---|---|---|---|---|
| | | (in Million US$) | | (in %) |
| **Computer & Data Processing** | | | | |
| | Imports | 3,004 | 11 | 0.4 |
| | Exports | 1,057 | 20 | 1.9 |
| **Database & Other Information Services** | | | | |
| | Imports | 2,426 | 6 | 0.2 |
| | Exports | 236 | 3 | 1.3 |
| **Research, Dev't. & Testing** | | | | |
| | Imports | 1,056 | 2 | 0.2 |
| | Exports | 1,040 | 1 | 0.1 |
| **Management, Consulting & PR** | | | | |
| | Imports | 1,696 | 17 | 1.0 |
| | Exports | 1,188 | 9 | 0.8 |

Source: as cited by the 2004 US GAO Report

The Philippines, for across all the categories of BPO services, has been insignificant as both a source of US imports and destination of their exports.

**B. Backlash against BPOs in the US Market**

The UN EDR mentioned several impediments to services trade, both those which are market-based and policy induced. These were already enumerated in page 20.[17]

Of these, those which are policy induced are the following:

- Regulations and legal requirements (e.g. regarding privacy) may also raise transactions costs and limit international trade in services
- Required by law to be provided by companies established locally
- Lack of international recognition of professional qualifications, together with the lack of globally agreed privacy rules

As more American white-collar jobs are affected by off-shore outsourcing, negative opinion on the phenomenon is increasingly being developed. This process reached a climax during the political debates accompanying the November 2004 US Presidential Elections.[18] With the Democratic Party's Presidential candidate vocally adopting a protectionist line on off-shore outsourcing, the following were some of the measures proposed:

- "Collecting better data and analyses on the trend and its implications. (Rep. Adam Smith commissioned a US GAO report on the topic)
- Using the bully pulpit to urge domestic procurements and/or "shame" those who outsource offshore. (House Small Business Committee)

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[17] To repeat, the 2003 UN E-commerce Development Report mentioned several impediments to services trade, both those which are market-based and policy induced. These are:

- Proximity to markets, interaction with customers, trust and confidence outweigh the possible benefits
- Not possible to be digitized and/or separated from related activities
- 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
- Required by law to be provided by companies established locally
- Lack of international recognition of professional qualifications, together with the lack of globally agreed privacy rules
- Some locations lack the capacity to host off-shored service activities: supply of reliable telecom infrastructure, appropriately educated workers, rising wage costs and high levels of attrition in the fastest growing destinations
- TNCs have different perceptions of the risks and benefits of off-shoring services and some are reluctant to do so

[18] For example, an indirect manifestation of this is the initiative against telemarketing called the "Do Not Call" list. While targeted against both in-shore and off-shore telemarketing activities, it gained momentum as off-shoring of telemarketing functions was intensified. The US' "Do not call" list prevents telemarketing operators, under certain conditions, from calling those who have registered in the list. This measure currently does not make a distinction between off-shored and in-shore telemarketing activities. However, should further revisions in the US **Telemarketing Sales Rule** include the mandatory disclosure of the telemarketer's country-location, then this can be construed as a rule targeting off-shoring.

- Tightening rules and enforcement for the use of L1 visas. (Rep. Nancy Johnson & Sen. Chris Dodd)
- Reducing the quantity of H1B visas and/or greater enforcement of the "prevailing wage" rule. (IEEE)
- Offering tax incentives to keep work and jobs onshore. (various)
- Offering tax incentives to subsidize the retraining of American workers. (various)
- Expanding the Trade Adjustment Assistance program to include those who lose service sector jobs to foreign competition.
- Reducing capacity building assistance to developing nations.
- Requiring companies to notify customers if overseas contractors have access to financial or personal data. (NJ Programmers Guild)
- Increasing "Buy American" requirements for federal procurements. (House Armed Services Chairman Duncan Hunter)
- Prohibiting taxpayer financed projects from going offshore.
- Requiring future trade agreements to include labor, environmental or other baselines to reduce foreign markets' cost advantages. (various)
- Banning companies that move operations offshore from access to government contracts. (Wash Tech)
- Supporting or encouraging unionization of the technology workforce. (CWA)"[19]

**C. Possible Issues during the Negotiations**

To guide Philippine government negotiators during discussions for the proposed the RP-US FTA, the policy-induced measures impeding Philippine access to the US' services market should be framed in the context of the GATT's different modes of supplying services for international trade.

It must be noted, though, that these issues are mainly **prospective** in nature, except for the issues on the granting of Visas. However, as economic performance of the US remains uncertain, negative sentiments towards off-shoring may be expected to continue. This will in turn place pressure on the US government, despite the avid pro-market stance of Pres. George W. Bush, to become stricter (i.e., more protectionist) in dealing with the issue of off-shoring.

Anti-BPO policy measures which the US government may adopt include:

(1) **Mode 1**. <u>Impediments to Philippine cross-border provision of BPO services to the US</u> – these result from policies that would increase the transaction costs of off-shoring services, including:

   a. imposing stricter standards on off-shored services than on local service providers (e.g., stricter data privacy requirements such as requiring companies to obtain

[19] "Offshore Outsourcing and the Future of American Competitiveness," as presented by Bruce P. Mehlman, Assistant Secretary for Technology Policy, US Department of Commerce, before the ITA ISAC-13 Advisory Committee, Washington, DC, October 14, 2003.

explicit customer approval before private information can be transferred and processed in off-shore locations);

b. legislations banning the off-shoring of publicly-funded projects or of portions of these projects;
c. legislations that require service activities to be provided by local (US) companies; and
d. certification standards that open certain service activities to be performed only by those certified according to US laws, including those that restrict the practice professions only to American citizens.

From the purview of Philippine BPOs, the specific regulations critical in data privacy are those related to the US financial sector (The Financial Modernization Act of 1999, also known as the "Gramm-Leach-Bliley Act or GLBA") and to medical transcription (The Health Insurance Portability and Accountability Act "HIPAA" of 1996). These two legislations actually do not single-out off-shoring in terms of stricter data protection requirements. However, their stricter implementation, or even possibility of their amendment, may prospectively make it more difficult for off-shored operations—including those based in the Philippines—to comply.[20]

The HIPAA was primarily enacted to improve the administration of the US' health insurance system. It requires companies to comply with a variety of regulations related to standardization, security, and privacy.

On the other hand, financial services are covered mainly by the GLBA. However, there are virtually no few legal restrictions on off-shore transfer of financial information if: (1) the transfer is related to the financial service or process that the customer requested or authorized; or (2) it is necessary to maintain or service the customer's account. However,

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[20] For instance, the US Federal Deposit Insurance Commission (FDIC) recommended (2004) the following stricter measures on the transfer of information to off-shored locations:

(1) **Encourage Identification of Undisclosed Third-Party Contracting Arrangements**. "Undisclosed third-party contracting arrangements may increase risk in outsourcing relationships. This potential increase in risk occurs regardless of whether the undisclosed third party resides domestically or offshore; however, inherent outsourcing risks may be amplified due to unique country risk when the third party is an offshore vendor. Our recommendation is that financial institutions that outsource data to domestic vendors should be aware when domestic vendors have in turn subcontracted out that same work to overseas or domestic third parties. This practice has not always been the case; the May 2004 edition of the American Bankers Association's Banking Journal discusses an instance where subcontracting to an offshore vendor occurred without the knowledge of the financial institution . . . . "

(2) **Consider Enhancing Bank Service Company Act (BSCA) Retention Procedures through Creation of a Central Database**. "To assist in measuring and monitoring the systemic risk posed by foreign technology service providers, the Federal financial institution regulators should consider enhancing their BSCA retention procedures. Section 7(c)(2) of the BSCA states that any regulated financial institution that has services performed by a third party "shall notify such (appropriate Federal banking agency) of the existence of the service relationship within 30 days after the making of such service contract or the performance of the service, whichever occurs first." Currently those notices are not aggregated in a central location. The agencies should conduct a cost/benefit analysis of establishing one shared, central repository of institution notices of outsourcing arrangements for use in analysis, monitoring, and tracking by the Federal Financial Institutions Examination Council."

the GLBA obligates financial institutions to respect customer privacy and protect customer personal information against reasonably foreseeable internal or external threats to its security, confidentiality, and integrity.[21]

(2) **Mode 3**. Impediments to Provision of BPO Services to the US Market by Philippine-based companies – these result from policies that would provide disincentives to American companies that want to establish or intensify commercial presence in the Philippines, for purposes of servicing US' needs. These would include providing tax incentives for keeping American investments and jobs in US shores.

For example, provisions in the 2003 proposed "Invest in the USA Act" in the Senate (i.e., the "Homeland Investment Act" in the House) sought to encourage foreign earnings accumulated overseas by US companies to be invested in the United States by allowing a one-year opportunity for foreign-earned income brought into the United States subject to an effective 5.25 percent tax rate, thus substantially reducing the current tax disincentive to investing foreign earnings in the United States.

(3) **Mode 4**. Impediments to Movement of Natural Persons – these pertain to measures that would further limit or make more difficult the temporary movement of Filipinos to the US. Currently, this is the most pressing obstacle faced by Philippine BPOs. At the initial stage of a BPO contract, project team members are ideally sent to client companies (i.e., American companies) to gain familiarity with the specific technical requirements of the project (e.g., product and process technical familiarity) and to foster close relationships with their counterparts.

BPOs are specifically vulnerable to strict procedural Visa requirements of the US government. A typical BPO worker is young, single and normally without accumulated assets—a profile matching most illegal immigrants in the US. In the context of a very low recruitment success rate and tight schedules for implementing new programs (i.e., new BPO contracts), difficulty in obtaining visas could lead to serious problems for BPO companies.

While strict visa requirements directly impede the movement of natural persons (Mode 4), their impact also negatively impact on Mode 1 (cross-border provision of services). As mentioned earlier, local team members executing BPO projects normally need to be temporarily assigned to US client companies.[22]

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[21] "Offshore Outsourcing of Data Services by Insured Institutions and Associated Consumer Privacy Risks," study undertaken by the Federal Deposit Insurance Corporation. June 2004.

[22] For example, interviewed resource persons from Philippine-based international call centers share their difficulty in obtaining US visas for customer support agents and technical support agents/engineers. Recent experience involved a requirement to send 80 agents to the US. After a difficult recruitment process, with a success rate of less than 2%, half of the 80 successful applicants were denied visas. Given only one-and-a-half months from contract closing to full implementation, the company had to rush through the recruitment of additional 40 agents (preferably with live US visas).

**Table 25. Summary of BPO-related Issues in the Proposed RP-US FTA**

| Modes of Supply | Description | Possible Impediments |
|---|---|---|
| Mode 1 | Cross-border Supply | Possible legislation limiting outsourced off-shoring of publicly funded projects<br>Possible legislation similar to EU Data Privacy Directive<br>State and national standards & certifications for professionals |
| Mode 2 | Consumption Abroad | none identified |
| Mode 3 | Commercial Presence | Lower tax rate for repatriated income from abroad |
| Mode 4 | Movement of natural persons | Temporary Business Entry Processing time for granting of temporary business VISA |

## V. RECOMMENDATIONS TO THE PHILIPPINE PANEL

In May 2003, the governments of the US and of Singapore signed the US-Singapore FTA. A review of the specific chapters of this document reveals that it may be used by the Philippine government as a template for the negotiations, in the context of impediments—**existing** and **potential**—to Philippine provision of BPO services to the American market.

Specifically, it is suggested that the Philippine panel consider negotiating for:

### A. Inclusion of a Chapter on Cross-border Trade in Services.

This chapter is critical to ensure that prospective regulations against off-shoring will have minimal impact on Philippine BPOs. As such, the said chapter should include articles on:

1. National Treatment – that the US shall treat Philippine service suppliers in no less favorable manner as it treats US service suppliers; and that this provision extends to the regional (State) governments of the US. However, the Philippine negotiators must also request that, for purposes of compliance with Domestic Regulations—for example, should US regulations require prior authorization for the delivery of a particular service—Philippine service companies be accorded also National Treatment.[23]

2. Most Favored Nation Treatment – that the US shall treat US service suppliers in no less favorable manner as it treats any other country.

3. Market Access – that the US—either the federal government or any of the states—shall not adopt or maintain any measure that will:
   - limit the number of Philippine service suppliers, whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirement of an economic needs test;
   - limit the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
   - limit the total number of service operations or the total quantity of services output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
   - limit the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

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[23] The Philippine government may also consider negotiating for Safe Harbor Classification—or its US equivalent—of the Philippines, in view of possible US legislations adopting the European Union's Data Protection Directive. Should the US adopt stricter data privacy requirements for off-shored services, the Philippines may be accredited, per force of the FTA, as among those countries who comply with strict data privacy laws. However, should Philippine BPOs already be accorded National Treatment status, safe harbor provisions may no longer be needed.

- restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.

4. Local Presence – that the US shall not require a Philippine service supplier to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border supply of a service.

5. Recognition – that for purposes of the fulfillment, in whole or in part, of its standards or criteria for the authorization, licensing or certification of services suppliers, the US should recognize the education or experience obtained, requirements met, or licenses or certifications granted in the Philippines; and that such recognition, should be achieved through harmonization of standards or even accorded autonomously.

**B. Inclusion of a Chapter on Temporary Entry of Business Persons.**

This Chapter is critical to address the most pressing concern of Philippine BPOs, in relation to US government regulations—the issuance of visas. It should tackle the facilitation of procedural requirements for the granting of visas to BPO professionals. Perhaps a certification from the local BPO association can be considered to give additional merit for the visa application of a BPO professional.

Current WTO negotiations and commitments on Mode 4 cover mainly "intra-corporate transfers of high-level personnel and business visitors."[24] The **US-Singapore FTA** contains a chapter on "Chapter 11. Temporary Entry of Business Persons," where four types of business persons are recognized:

- Business Visitors
- Traders and Investors
- Intra-company Transferees
- Professionals

Based on how they are currently defined in the US-Singapore FTA, all categories would be useful for BPOs.[25] Specifically, the Philippine government should negotiate for:

1. Negotiate for the inclusion of a Chapter on Temporary Entry of Business Persons, and the inclusion in the said Chapter of articles on:
   - Regulatory Transparency
   - Provision of Information
   - Temporary Entry Coordinators
   - Dispute Settlement

2. For classification as "Business Visitor," remove requirement that visa applicant should demonstrate that:

[24] 2004 World Trade Report, World Trade Organization, p.46

[25] The category "traders and investors" may however be useful only for BPOs that want to establish commercial presence in the US.

- <u>the primary source of remuneration for the proposed business activity is outside the territory of the Party granting temporary entry</u>;

  but retain the requirement that:
- <u>the business person's principal place of business and the actual place of accrual of profits, at least predominantly, remain outside such territory</u>.

- For classification as "Intra-company Transferees," remove the requirement that: <u>a Party may require the business person to have been employed continuously by the enterprise for one year within the three-year period immediately preceding the date of the application for admission</u>.

- Include in the definition of "Business Visitors" BPO professionals, including customer call agents and technical support agents / engineers undergoing product familiarization in the US.

- Within the purview of the categories of "Business Persons," insist on the inclusion of **prohibitions** on:
  - as a condition for temporary entry, require prior approval procedures, petitions, labor certification tests, or other procedures of similar effect; or
  - impose or maintain any numerical restriction relating to temporary entry.

**C. Inclusion of a Chapter on Electronic Commerce.**

This refers to the inclusion of provisions that will ensure the continued free flow of electronic commerce between the two countries. This chapter is critical especially in connection with the provision of cross-border trade in BPO services (Mode 1).

Specifically, the Philippines should negotiate for the inclusion of the following articles:
1. the US shall not apply customs duties or other duties, fees, or charges on or in connection with the importation or exportation of digital products by electronic transmission;
2. that the customs value of an imported carrier medium bearing a digital product according to the cost or value of the carrier medium alone, without regard to the cost or value of the digital product stored on the carrier medium; and
3. that the US shall not treat Philippine digital products any less favorable than digital products (a) created, produced, published, stored, transmitted, contracted for, commissioned, or first made available on commercial terms, outside its territory; or (b) the author, performer, producer, developer, or distributor of such digital products is a Filipino.

**D. Argue for Technical Assistance for Capability Building Programs.**

The US government, on the other hand, will most likely negotiate for:
1. Enhanced Philippine compliance to Intellectual Property conventions
2. Stricter data privacy protection legislation

3. Removal of restrictions on foreign investments in the telecoms sector (e.g., the 40% limit on foreign ownership of telecoms companies), together with the removal of anti-competitive policies (e.g., clearer policy on the Voice over the Internet Protocol (VoIP).

In as much as these likely US negotiating points will also benefit the Philippine BPO sector, the Philippine government may want to use this (i.e., US government interest) as leverage and negotiate instead for Technical Assistance in the nature of Capability Building Programs for the said items, specifically:

- For reviewing and, if needed, revising Data Privacy Protection bill(s) filed in the Philippine House of Representatives; and developing government and industry capability for its implementation and enforcement. These would include US government assistance for research, advocacy and training. Passing and enforcing a data privacy protection law for the Philippines is critical given (a) apprehensions in the US on the risk of inappropriate use of personal information transferred and processed through off-shore outsourced services; and (b) passage by India, the country-leader in BPO services, of its own Data Privacy Law. As mentioned earlier, the European Union has already adopted strict measures to restrict the transfer of personal information to non EU-member countries (except those which were given "Safe Harbor" status, due to the adequacy of their data protection mechanisms).

- For the enhancement of Philippine compliance in Intellectual Property laws – client companies, especially for higher value-added services, are susceptible to intellectual property infringements.

- For the conduct of a policy study on removing the remaining barriers to foreign investment and anti-competitive policies in the telecommunication sector and in other related sectors, e.g. clearer policy on the use of Voice over the Internet Protocol (VoIP).

Moreover, the Philippine government may also request for Technical Assistance in the following areas:

- For the enhancement of Philippine education, especially in (a) the replication of successful college-level and professional intervention for improving IT-related skills and (b) the use of technology in language training.

- For the conduct of a comprehensive promotional campaign for building the Philippines as Asian Outsourcing Hub for US companies.

- For a market study on emerging opportunities for Philippine BPOs, in light of stricter corporate governance standards and laws on data privacy (e.g, Sarbanes-Oxley Law, Gramm-Leach-Bliley Act, FTC Rules on Telemarketing, the HIPAA, etc.).

- For enhancement of the Philippine Statistical System to allow for the accurate monitoring of the contribution of the services sector, specifically of BPOs, to the national economy and of the flow of service activities within the regions of the country and to export markets.

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