

BUSINESS PROCESS OUTSOURCING: BREAKING NEW GROUNDS

While many industries struggle to cope with the effects of the global economic crisis, the Philippines' business process outsourcing (BPO) industry posted staggering revenue growth in 2008. Last year, the sector reported a 26% surge in earnings to \$6 billion from \$4.9 billion in 2007. Sixty five percent of the revenues were contributed by its voice segment or call centers while non-voice segment such as back office operations added 17%. The rest of the industry's earnings came from IT and engineering design sectors. As expected, the United States remains the country's biggest market, accounting for 86% of its total revenues.

The BPO industry is increasingly becoming an important sector of the economy. From a mere speck in the country's GDP of about 2-3% in 2004, the industry now accounts for 6% of the national income. Moreover, its number of workers has grown exponentially from merely 4,000 in 2001 to more than 372,000 workers in 2008. Last year alone, the industry added 74,000 talents to its workforce, or about a fifth of the net employment generated in the services sector.

The Philippines is the third largest exporter of BPO services, next to India and Canada, and the market leader in Southeast Asia. It corners 7% of the estimated \$89 billion industry compared to India's 38% market share..

The Roadmap to 2010

To harness the country's potential for offshoring and outsourcing (O&O) services, the Business Processing Association of the Philippines (BPAP), in collaboration with McKinsey and Company Global Consultants, published the Roadmap 2010 in 2007. Roadmap 2010 is a comprehensive three-year plan for the industry to double its worldwide market share from 5% to 10% by 2010 and to increase its GDP contribution to as much as 8.5%, a level that could rival remittances in economic importance. These translate to \$13 billion in industry revenues and total employment of 900,000 workers.

The industry's goals are based on the premise that the sector has the potential to grow annually by 40% in the next three years. Amidst the current business environment, these goals seem to be highly ambitious.

Nevertheless, BPAP is still confident that it will deliver dramatic growth this year to meet its targets.

On the demand side, the growth potential of the industry is expected to remain very strong as organizations around the world started to find more and more value through the O&O services. In fact, a McKinsey report showed that 88-90% of the \$450 billion addressable market for O&O services has yet to be penetrated.

On the supply side, our current advantages such as the abundance and quality of workers, the large pool of English-speaking workers, our low cost base, and strong government support will continue to be the growth drivers for the industry. But this will further be supported by industry initiatives to enhance talents, infrastructure, and facilities.

Developing talents is the main area of concern for the industry to support its growth momentum. Thus Roadmap 2010 identified five strategies to meet this goal: (1) to develop a comprehensive assessment and training program to increase suitability of workers for the industry; (2) to create awareness of career opportunities in the industry; (3) to tap alternative labor pools (i.e. housewives, retirees, non-graduates, etc); (4) to help working students to fund their education to create ways for students to begin their careers in O&O; and (5) to work with the educational sector to develop curricula in high school and college suitable for students planning to work in the industry.

Another industry initiative is the development of the Next Wave Cities as alternative locations for BPO operations. There are two strategies to this end. First is to provide investors, LGUs, property developers and utilities with critical information that would help them accelerate decision making and coordinate their efforts. Second is to provide advisory services to the LGUs particularly on the issue of their readiness and needs vis-à-vis the BPO requirements.

The industry will also actively participate in efforts to improve the industry's business environment. They will support initiatives to improve the financial incentives to investors, to support investors over end-to-end process of an investor decision-making, to improve the country's perceived risk environment, and to gain overall support

to develop the industry from the government, industry organizations and other stakeholders.

Industry leaders

The advantages of the Philippines as a BPO destination have attracted a number of major global players in the industry. As a matter of fact, 21 of the 24 BPO companies in the top 1,000 corporations, which account for 23%¹ of the total industry revenues, are owned by multinational corporations.

eTelecare is the biggest BPO company in the Philippines both in terms of assets and revenues. It has a total asset size of P7.4 billion and annual gross revenues of P7.1 billion. Sykes Asia and People Support followed with P6.4 billion and P6.1 billion in revenues, respectively. Rounding up the top ten income-earning BPO companies are Convergys, ICT Marketing Services, HSBC Electronic Data Processing, Telus International, IBM Business Services, Advanced Contact Solutions and Sitel.

Riding out the Crisis

It would seem that BPOs should thrive during economic crisis as firms look for opportunities abroad to lower their costs and improve their bottom lines. However, it also poses a number of challenges to the industry.

Growing at 20-30% in the current business environment would normally be an achievement for any industry. But this is not the case for the BPO sector which was expected to grow at a faster pace of 30-35% in 2008. BPAP attributed this marked slowdown to some delayed projects in the fourth quarter of last year as economic uncertainty hold back decision-making processes among major firms, while substantial job losses in recessionary economies such as the US have led to the resurgence of protectionism.

Nevertheless, market players remain confident for the long term prospect of the BPO industry. Cincinnati-headquartered Convergys recently opened three contact centers in Quezon City, Laguna and Cebu that can provide 3,100 additional jobs. Two more contact centers are expected to open in June. Moreover, Aegis Ltd, which has recently acquired US-based People Support in the Philippines for \$250 million, recently announced

their plan to increase their workforce by 12,000 worldwide including its Philippine operations.

Filipinos Innate Advantages

The Philippines emerged as one of the leading destinations for BPO services because of Filipinos innate advantages.

- *World class English proficiency* – The Philippines proficiency in the English language is one of the biggest pull factors for outsourcers to choose the country over other BPO destinations. With 72% of the population fluent in English, the Philippines is the third largest English speaking country in the world. The country's English speaking workforce is also perceived to be world class (Gartner, 2002) due to our ability to adopt accents and understand American idiomatic expressions. Furthermore, our workers verbal skills are far superior than other English speaking BPO destinations due to its clarity and understandability.
- *Availability of highly skilled and educated workforce* – With an estimated 400,000 college graduates every year, the Philippines provides a large pool of highly skilled and educated workers that can cater to the demand of the industry. In fact, half of these are graduates of courses that are commonly required in the BPO industry such as business administration and mass communications. An additional 30,000-50,000 are technically proficient, with degrees in computer science and programming. Furthermore, a vast numbers of graduates can also be trained to become experts in US business processes such as accounting and human resources and industry specific knowledge such as medical transcription.
- *Close affinity to US culture* – The Philippines close cultural affinity to the US, as demonstrated in the adaptation of various US business and government procedures, is an added advantage for BPO locators in the country. Expatriates managing BPO companies in the country are expected to have an easier time to adapt and assimilate in local business setting. Furthermore, it is also a cost saving for BPO companies as they do not have to provide cross-cultural and language trainings to familiarize its employees to the US culture.

¹ Exchange rate: \$1 = P44.4745

- *Strong work ethics* – The Filipinos are also known to have excellent work ethics. That is we are perceived to be hardworking and that we produce excellent results. It is also a plus factor that Filipinos have a customer service-oriented culture which is a necessary trait for this line of work.
- *Cost advantages* – In addition to the quality of workers, BPO locators also take advantage of the low labor costs in the country. The Philippines has one of the lowest average base salaries in Asia at \$234 per month vis-à-vis Singapore (\$839), Malaysia (\$337) and Thailand (\$298); nevertheless India is still more competitive at \$150 per month. Compared to standard US rates, this translates to around 50-60% cost savings for a BPO company.

Furthermore, Philippines also have readily available locations and infrastructure facilities to support its IT-enabled industry. The Philippines has an abundant supply of low cost real estate in major urban areas. Consequently, real estate cost in the country is one of the lowest in the region. Occupancy costs in Manila, for instance, averaged at around \$414 per square meters per annum. This is a bargain compared to cities such as Bangalore (\$521), Mumbai (\$2,271) and New Delhi (\$1,263) in India, Singapore (\$1,500), and Seoul in South Korea (\$769).

The Philippines telecommunication infrastructure is also considered to be relatively good and cost competitive - the result of the industry's deregulation in the 1990s. The country has a redundant international connectivity including fiber optic cable and satellite communication which gives readily available bandwidth for significant amount of trans-Pacific data communication at lower costs. Comparatively, the Philippines telecommunication costs are cheaper by 30-50% than in India. It also has shorter procurement times (3 weeks as opposed to 3 months) and less transmission delay.

- *Strong government support* - The BPO sector also enjoys strong government support in the development of the industry. Aside from various tax incentives, the national government has been actively coordinating with the private sector and the academe to address developmental issues specifically those that pertain to the enhancement of critical BPO skills among college students and the international promotion of the Philippines as an attractive offshore BPO location.

These advantages have helped the Philippines BPO industry to catch up with India in the O&O market. Nevertheless, India continues to dominate the industry which can be attributed to several factors.

India has a huge labor pool of highly skilled English-speaking talent with superior service maturity. Every year, 2.5 million college students graduate in India and of which, 240,000 are qualified for BPO employment (compared to 90,000 in the Philippines). Furthermore, India also boasts of 340,000 IT professionals, the second largest pool of IT talents in the world after the US. Another advantage of India is in terms of labor and non-labor costs (i.e. electricity cost) which are considered to be the cheapest among BPO destinations.

Challenges to sustaining growth

- *Difficulty in finding qualified employees* - The Philippines' deteriorating educational system has been noted as one of the major impediments to the long-term growth prospect of the BPO industry. Sourcing of competent BPO professionals and keeping these talents within the organizations have increasingly become a major constraint for the industry. This phenomenon may be partly explained by skills mismatch or at worse, by the lack of qualified workers forcing firms to poach on the talents of their rivals. Moreover, the industry faces scarcity of skilled workers that can take on managerial positions in their companies.
- *Lack of global awareness of the Philippines advantage* - Another major hurdle for the BPO industry to attract a significant share of the market is the lack of global awareness for the Philippines' advantages as a BPO destination. Unlike India, the Philippines competitive advantages vis-à-vis other BPO locations are not adequately promoted to the global business community.
- *High non-labor costs* - Although the Philippines labor costs are relatively low, further efforts are still needed to bring down to competitive level non-labor related costs. In particular, the Philippines electricity cost is comparatively high (\$0.109 per kilowatt hour) compared to India (\$0.076) and China (\$0.066).
- *Financing alternative* – Last year, in one of BPAP's regular business meetings, the issue of financing choices by a number of industry participants was raised by industry players. Given the growth

potential of the industry, players need access to financing alternatives whether through debt or equity.

Future BPO growth areas

- *Capturing the non-voice segment* - On the back of its successful offshore delivery of voice-based BPO services, the Philippines is also poised to become a leading destination for non-voice BPO works (i.e. back office processing, digital animation, game development, medical and legal transcription, software development) for companies looking for alternative providers to India, a recent report of *Everest Research Institute* revealed. The non-voice BPO services are expected to rake in 90% of the future BPO market of \$220-\$280 billion by 2012. As of now, non-voice services in the Philippines are concentrated to transactional services, while the scale and maturity of judgment-intensive services remains low. Nevertheless, the potential for the local BPO market in this segment is huge once talent related constraints have been successfully addressed.
- *Geographic diversity* - Geographic diversity can also be a source of future growth for the local industry. The Philippine BPO services are primarily concentrated in the traditional markets like the US, UK and Australia, but substantial demand for these services are high in other regions such as Europe and Africa.

External threats to growth

- *Emerging competition* - Given its immense potential, the Philippines BPO industry is facing stiff competition from other countries that wanted to get a share of the BPO market. With large labor pool and low labor cost, several Asian countries such as China, Thailand and Indonesia pose significant threat to the country's position as the most favored alternative to India. In its Annual Global Services Location Index for 2009, management consulting firm A.T. Kearney predicted that the "strong fundamentals" of Thailand and Indonesia could push the Philippines out of its present spot as these countries offer a large pool of untapped talent at low cost relative to the Philippines.

- *Perception of political instability* - Another impediment to the inflow of investments in the country is the perception on the country's political instability as news of graft and corruption, coup d'etat and kidnappings headlined the news on the country in the international media. This deters foreign investors to invest their money in the Philippines for the long-term horizon.
- *Threat of protectionism* - The massive layoffs particularly in major economies also poses the threat of economic protectionism as their governments try to keep jobs within their respective country. In the US, for instance, its government's latest proposal to reduce tax breaks of US firms who outsource jobs overseas poses a threat to BPO countries such as the Philippines.

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