Chapter 13
Evaluating the Internal Capabilities and External Linkages of the Philippine IT-Enabled Services (ITES) Industry

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ABSTRACT

Over the past five years the Philippine IT-enabled services industry has grown tremendously, fuelled primarily by strong global demand. The main competitiveness drivers of the Philippines as an attractive location for offshore IT-enabled services are well documented: highly skilled, English proficient workforce; low labour costs; cultural affinity towards the United States; reliable telecommunications infrastructure; and business-friendly policies. It is this rare combination of resources that has attracted many FDIs to locate their outsourcing operations in the Philippines which has made the country a prime location for customer contact service centres and business process outsourcing. This chapter examines the internal capabilities and external linkages of the Philippine ITES industry based on an empirical study. It focuses on how these various capabilities and linkages play a significant role in facilitating the ITES industry’s growth and long term sustainability.

INTRODUCTION

Globalization has enabled the seamless delivery of information technology and business process services across borders, through time zones, and over oceans. It has transformed our world into more of a global village than it has ever been. The demand for outsourced services, particularly in offshore destinations, is growing exponentially. In today’s highly competitive global market, outsourcing is increasingly seen as a strategic management option to reduce costs while allowing the enterprise to focus on its core competencies, thereby achieving efficiency within the organization. McKinsey and Co. forecasts demand for outsourcing services to...
reach US$180 billion by 2010, with the customer contact services, finance and accounting, and human resource sub-sectors taking up the largest shares (Reloc8 Asia Pacific Group, 2007). Therefore, a fierce race in becoming a leading offshore destination has inevitably been set into play and driven by global competition.

Many countries are now starting to develop their IT-enabled services (ITES) and business process outsourcing (BPO) industries to cater to the growing demand in outsourced services. The market leaders in supplying services at present are India and Canada. India’s early software services firms have been able to leverage their earlier head start in software services into capabilities for other ITES sectors such as BPO and call centres. Canada has historically been a significant outsourcer because a significant portion of the U.S., the largest client of BPO services at present, is a major trading partner. Ireland is also a big player in IT services exports. However, 2003 witnessed a significant growth in services exports in other countries such as China, Russia, and the Philippines. At the same time, countries such as the Czech Republic, Poland, Hungary, and Mexico emerged from relatively insignificant markets to legitimate contenders for market share in the growing ITES market (neolT, 2004). In addition, many countries have had some success in attracting such work, or have the potential to do such work. These include Malaysia, Jamaica, South Africa, Ghana, and Costa Rica (Tschang, n.d.).

Over the past five years the Philippine IT-enabled services industry has grown tremendously, fuelled primarily by strong global demands. The rapid growth of the ITES industry can be attributed as a result of two forces: 1) the information revolution, which has made the movement of information fast and cheap; and 2) the dramatically lower costs of carrying out some business operations in developing countries due to relative abundance of cheap educated manpower. This enticed businesses in industrialized countries to outsource certain backroom operations in the Philippines, leading to the expansion of such service activities in the country like call centres for customer relations, medical and legal transcription, financial and personnel management, engineering design, animation, development of web and software programs, and other services powered by information and communications technology. The Philippine government has already identified the ITES industry as one of the ten industries that will bring in huge revenues for the country under the Philippine Export Development Plan (PEDP). In 2007, the sector has reached a size of about US$4.9 billion from just about US$350 million in 2001. The Philippine outsourcing industry is projected to generate US$12 billion in annual revenues and employ over 1 million workers by 2010 (Locsin, 2006). The Philippines is now increasingly being recognized as one of the locations that companies are seriously looking into as a major outsourcing destination. In 2005, the Philippines was voted by IT Executives around the world as one of the Top Four Leaders in the Outsourcing Market, next to India, China and Malaysia (Our Corporate Bureau, 2005). In July 2007, the International Data Corporation (IDC) released a report about the new Global Delivery Index (GDI) which compares cities in the Asia/Pacific as potential offshore delivery centres, based on a comprehensive set of criteria such as cost of labour, cost of rent, language skills, and turnover rate. In the report, Bangalore and Manila ranked numbers one and two respectively out of 35 Asia/Pacific cities studied (“China to topple India”, 2007).

Indeed, the Philippine ITES industry has an opportunity to play a profound role in the Philippine’s economic development directly and indirectly through spillovers. Evidently, the industry has done a lot to ease the country’s unemployment problem because of the thousands of jobs it is generating. However, this industry is also a very dynamic sector that is growing by leaps and bounds. Inevitably, various challenges and issues emerge. At this point, the Philippine ITES indus-
try’s two greatest problems are: 1) the looming shortage in qualified, highly skilled workforce that may hold back the industry from sustaining its current growth rate and 2) strong competition from other low-cost countries. Add to these are the problems faced by the country in general, such as political and social instability, which have great potential to affect foreign investments in the long run. Although the Philippines has marked advantages in the field of offshore outsourcing, it must overcome significant obstacles in order to effectively compete with other outsourcing destinations. Therefore, the main questions which we would like to answer in this chapter are:

• What are the key success factors in enhancing the competitive advantage of the Philippine IT-enabled services industry?
• How can the Philippines sustain its strong performance as a leading offshore outsourcing destination in the midst of strong competition in the global market?

This research tries to elaborate answers to these questions by evaluating the internal capabilities and external linkages of Philippine ITES firms based on an empirical study. It focuses on how these various capabilities and linkages play a significant role in facilitating the ITES industry’s growth and long term sustainability.

BACKGROUND

The rapidly globalizing economy has opened a huge door of opportunity for the Philippines in the form of IT-enabled services. Such strong industry development has caught the attention of many scholars, researchers, and academics during the past few years and has prompted many to write reports and research studies discussing the ITES industry in detail. Most of these reports and studies are based on government data and primary source materials but they generally just tend to describe what is happening in the industry or present its inherent advantages over other countries, such as the study made by E. Antonio and W. C. Padojinog who examined the profile of the IT-enabled services industry, its prospects and potential contributions to the Philippine economy (Antonio & Padojinog, 2003). Very few reports and studies actually analyses firm-level conditions and factors why Philippine ITES firms perform so well even in the international market. Thus, we would like to better understand the factors influencing the success of this service export industry and to assess future prospects as to how it can sustain its strong performance in the next few years. We used two broad bodies of literature to support this study: 1) the resource-based view of the firm (RBV) and 2) the social capital theories. Applying both the RBV and social capital theories, we will try to examine the firms’ internal capabilities and external linkages.

Resource-Based View of the Firm (RBV)

Understanding sources of sustained competitive advantage for firms has become a major area of research in the field of strategic management. Since the 1960’s, a single organizing framework has been used to structure much of this research. This framework suggests that firms obtain sustained competitive advantages by implementing strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses. Although both internal analyses of organizational strengths and weaknesses and external analyses of opportunities and threats have received some attention in the literature, recent work has tended to focus primarily on analyzing a firm’s opportunities and threats in a competitive environment. As exemplified by research by Porter and his colleagues, this work has attempted to describe the environmental conditions that favour high levels of firm performance. Porter’s
(1980) “five forces model” for example, describes the attributes of an attractive industry and thus suggests that opportunities will be greater, and threats less, in these kinds of industries.

However, much of this type of strategic research focus more on the analysis of the impact of a firm’s environment on its competitive position and has placed little emphasis on the impact of firm attributes on a firm’s competitive position. Instead of understanding the impact of a firm’s environmental performance, the RBV examines the link between a firm’s internal characteristics and its performance. The fundamental principle of the RBV is that the basis for competitive advantage of a firm lies primarily in the application of the bundle of valuable resources at the firm’s disposal. Barney (1991) referring to Daft (1983) says: “...firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc; controlled by a firm that enable the firm to conceive and implement strategies that improve its efficiency and effectiveness”.

A firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when other firms are unable to duplicate the benefits of this strategy. Not all firm resources hold the potential of generating sustained competitive advantages. To have this potential, a firm resource must have four attributes. First, it must be valuable in the sense that it exploits opportunities and/or neutralizes threats in a firm’s environment. Resources are valuable when they enable a firm to conceive or implement strategies that improve its efficiency and effectiveness. Second, it must be rare among a firm’s current and potential competition. A firm enjoys a competitive advantage when it is implementing a value-creating strategy not simultaneously implemented by large numbers of other firms. Third, it must be imperfectly imitable. Valuable and rare organizational resources can only be sources of sustained competitive advantage if firms that do not possess these resources cannot obtain them. For firm resource to be imperfectly imitable, one condition could depend on the ability of the firm to obtain the resource based on unique historical conditions or circumstances. The RBV approach asserts that firms are not only intrinsically historical and social entities, but that their ability to acquire and exploit some resources depends upon their place in time and space. Once this particular unique time in history passes, firms that do not have space-dependent and time-dependent resources cannot obtain them, and thus these resources are imperfectly imitable. Another reason that a firm’s resources may be imperfectly imitable is that they may be very complex social phenomena, beyond the ability of firms to systematically manage and influence. When competitive advantages are based in such complex social phenomena, the ability of other firms to imitate these resources is significantly constrained. A wide variety of firm resources may be socially complex. Examples include the interpersonal relations among managers in a firm, a firm’s culture, a firm’s reputation among suppliers, and customers. Fourth, the final requirement for a firm resource to be a source of sustained competitive advantage is that there must be no strategically equivalent valuable resources that are themselves either not rare or imitable (substitutability) (Barney, 1991).

Social Capital

Social capital, generally defined as the actual and potential resources embedded in relationships among actors, is increasingly seen as an important predictor of group and organizational performance. Social capital is an “umbrella concept” that acknowledges the inherent value of social structures such as relationships, networks and groups. It refers to the value of membership in a social group and the benefits individual actors derive from their social relationships. The central thesis of social capital theory is that “relationships
matter” and that “social networks are valuable assets”. Interaction enables people to build communities, to commit themselves to each other, and to knit the social fabric. A sense of belonging and the concrete experience of social networks (and the relationships of trust and tolerance that can be involved) can, it is argued, bring great benefits to people (Smith, 2007).

The concept of social capital has received considerable attention recently among sociologists, economists and political scientists. Irrespective of disciplinary focus, three thinkers that most commentators highlight in terms of developing a theoretical appreciation of social capital are Pierre Bourdieu, James Coleman and Robert Putnam. Pierre Bourdieu developed his concept of social capital during the 1970’s and 1980’s as one of the three forms of capital (economic, cultural, and social) present in the structure and dynamics of societies. For him, social capital represented an “aggregate of the actual or potential resources which are linked to possession of durable network”. He stressed that access to social capital occurred via the development of durable relationships and networks of connections especially those among prestigious groups with considerable stocks of economic and cultural capital. James Coleman’s contribution to the development of the notion of social capital was to develop a rational choice theory of social capital. According to Coleman, social capital is defined by its function. It is not a single entity, but a variety of different entities, having two characteristics in common: they all consist of some aspect of a social structure, and they facilitate certain actions of individuals who are within the structure. The structure of relations could help establish obligations between social actors, create a trustworthy social environment, open channels for information, and set norms and impose sanctions on forms of social behavior. In his book Bowling Alone, Robert Putnam argued that “the core idea of social capital is that social networks have value....social contacts affect the productivity of individuals and groups.” He referred to social capital as “connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them” (Putnam 2000).

The concept of “organizational social capital” points to a resource that is controlled by the collective, as opposed to a particular individual (Coleman, 1990; Leana and Van Buren, 1999). From an organizational point of view, social relationships function as valuable resources that enable individuals to act as groups and to undertake complex actions like joint knowledge work. Whereas human capital refers to the knowledge and capabilities of individuals, social capital takes into account the social fabric to empower individuals to collaborate effectively. The resources associated with organizational social capital consist of the relationships among employees within a firm (“internal social capital”) as well as linkages between the firm and its external stakeholders, competitors and/or customers (“external social capital”). Organizations transact with suppliers and other partners in order to acquire external resources to produce products/services at competitive prices, so that they can attract and retain customers. Social capital can therefore explain the basis for the development of linkages and connections to enable firms to acquire resources from their external environment.

Linking the RBV and Social Capital Theories to the Philippine IT-Enabled Services Industry

The Resource-based view of the firm and Social capital theories have divergent concerns on the roots of firm performance, with the RBV stressing the internally accumulated resources or capabilities while social capital theory has underscored its relational characteristics with external entities. The two theories ought to be synthesized, since firms should develop specific assets while obtaining other critical resources through their social networks.
The main competitiveness drivers of the Philippines as an attractive location for offshore ITES services are well documented: its highly skilled workforce; low labour costs; cultural affinity towards the United States, its reliable telecommunications infrastructure; and business-friendly policies. It is this rare combination of resources that has attracted many FDIs to locate their outsourcing operations in the Philippines which has made the country a prime location for customer contact service centres and business process outsourcing. The country’s English language proficiency can be traced back to its historical ties with the US. A former American colony for almost 50 years, English was made the medium of instruction in schools at all levels. It adopted a similar form of government structure, legal, and accounting systems. On top of that, Filipinos watched American TV shows and programs, enabling them to easily adopt a neutral American accent. Going back to the RBV theory, the country was able to accumulate a vast pool of English speaking professionals very much accustomed to Western culture and business processes not by its own choice but through its particular path in history. Adding to the country’s overall competitive advantage is the Filipino people’s innate customer service orientation, owing to the country’s general culture of helpfulness and respectfulness, which gives the country an edge particularly in providing customer care services.

As to the quality and quantity of human resources, the Philippines is home to over 80 million Filipinos, more than half of whom are younger than 40 years old. Therefore, it has a young population that can contribute immensely to the global economy in terms of abundant labour supply. In the 2002 Global New Economy Index (GNEI) of the META Group, a US-based research firm, the Philippines was given the highest rating in Southeast Asia for “excellent availability” of skilled IT workers. The Philippines ranked fourth after India, Israel, and Ireland. In addition, a study on the competitiveness of the Philippines’ IT sector conducted by Gartner Research in March 2002 showed that the Philippine workforce is technically proficient in computer science and programming, and many can achieve the desired level of expertise in US business processes (such as accounting and human resources) and knowledge-specific to an industry (for example, medical terms for transcriptions). Investors will find that Filipinos are highly trainable, persevering, and resilient. Literacy rates are also among the highest in Southeast Asia.

The social capital theory stresses the importance of forging ties within and across communities. As the ITES industry continued to grow, representatives of the state, the corporate sector, and civil society created forums through which they can identify and pursue common goals. The government spearheaded the creation of an industry association which in turn created platforms for the dissemination of knowledge in the industry through its surveys and conferences. Drawing upon the success of India’s IT/software industry, the government identified ITES/BPO as a key contributor to economic growth. It prioritized the attraction of FDI in this segment by establishing “IT Parks” and “Export Economic Zones”. It offered benefits like tax-holidays and special tax rates for IT parks/Ecozone locators. It liberalized the telecommunications industry and opened up national, long distance, and international connectivity to competition (Tschang, n.d.).

**RESEARCH METHODOLOGY**

The Philippine ITES firms’ internal capabilities and external linkages were measured using the following determinants and indicators:

The primary research for this study was conducted in Metro Manila, specifically in the central business districts (CBD’s) of Makati, Pasig and Quezon City where a huge concentration of ITES firms, both domestic and multinational, have set base since the industry took off in 2001.
Evaluating the Internal Capabilities and External Linkages of Philippine IT-Enabled Services

### Table 1. Analytical framework

<table>
<thead>
<tr>
<th>Determinants</th>
<th>Indicators</th>
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<tbody>
<tr>
<td><strong>Internal capabilities</strong></td>
<td></td>
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<tr>
<td>Human resources and climate/institutional culture</td>
<td>Education</td>
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<td></td>
<td>Attrition rate</td>
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<td></td>
<td>Professional development and training</td>
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<tr>
<td>Entrepreneurial orientation</td>
<td>Services offered to clients</td>
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<tr>
<td>Technological capability</td>
<td>International certification</td>
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<td></td>
<td>R&amp;D</td>
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<td></td>
<td>Market research</td>
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<tr>
<td><strong>External linkages</strong></td>
<td></td>
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<tr>
<td>Networking with other ITES/BPO firms</td>
<td>Existence of cooperation with other local or foreign ITES/BPO firms</td>
</tr>
<tr>
<td></td>
<td>Areas of cooperation</td>
</tr>
<tr>
<td>Participation in industry associations or informal association networks</td>
<td>Membership/affiliations in industry associations</td>
</tr>
<tr>
<td></td>
<td>Benefits derived from membership in industry association</td>
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<tr>
<td>Collaboration with universities or research institutions</td>
<td>Existence of collaboration with universities or research institutions</td>
</tr>
<tr>
<td>Support from government institutions</td>
<td>Types of government support programs available for ITES/BPO firms</td>
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The main instrument used to gather primary data was an electronic survey in the form of an online questionnaire. The survey was conducted from November 2006 up to March 2007. A total of 226 executives representing a broad cross-section of the Philippine IT-enabled services and business process outsourcing industry (BPO) were invited to participate in the research study. Only one executive per company was asked to fill out the questionnaire. They were randomly selected from the 2005 ICT Directory provided by the Business Processing Association Philippines (BPA/P), a private sector-led organization representing the six distinct sectors of the Philippine BPO and ITES industry and their supporting industries (see Table 2). Out of the 226 executives invited to participate, 60 completed questionnaires (27%) were gathered and used for data analysis.

Ninety percent of the respondents belong to the top executives and managers of the companies surveyed which means they are very knowledgeable about the company’s operations and organizational characteristics. Forty-five respondents, or 75%, are male and the remaining fifteen, or 25%, are female. Although there are fewer female respondents, they nonetheless occupy very important positions in the industry such as Chairman of the Board, CEO or President of the company.

### Table 2. Philippine ITES industry – six distinct sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>No. of Firms</th>
<th>No. of Employees</th>
<th>Est. Revenue</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Contact Centre (or Call Centre)</td>
<td>124</td>
<td>145,000</td>
<td>US$1.7 Billion</td>
<td>90%</td>
</tr>
<tr>
<td>2) Business Process Outsourcing (BPO)</td>
<td>62</td>
<td>36,500</td>
<td>US$180 Million</td>
<td>80%</td>
</tr>
<tr>
<td>3) Software Development and Maintenance</td>
<td>300</td>
<td>15,000</td>
<td>US$204 Million</td>
<td>40%</td>
</tr>
<tr>
<td>4) Medical Transcription &amp; Legal Transcription</td>
<td>64/9</td>
<td>9,500/650</td>
<td>US$70 Million/ US$6 Million</td>
<td>80%/50%</td>
</tr>
<tr>
<td>5) Animation &amp; Graphics</td>
<td>42</td>
<td>6,000</td>
<td>US$40 Million</td>
<td>25%</td>
</tr>
<tr>
<td>6) Engineering Design</td>
<td>24</td>
<td>3,800</td>
<td>US$48 Million</td>
<td>30%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>625</td>
<td>214,450</td>
<td>US$2.2 Billion</td>
<td></td>
</tr>
</tbody>
</table>

Note: Number of firms and employees are based on 2006 figures, while estimated revenue and growth rates are based on 2005 figures.
All sub-sectors of the ITES industry were represented among the 60 respondents. Many of the companies indicated that their core business operations encompass several of the six ITES sub-sectors simultaneously. For example, a call centre firm is also into the business of medical/legal transcription while a software development firm is also engaged in BPO. The most number of respondents came from the software and development sector with twenty three respondents (38%), followed by medical/legal transcription (27%) and contact centre services (23%).

Forty five companies, or 75% of the total number of companies interviewed, were established from 2001 up to 2006. As such, many of the companies that participated in the survey were barely five years old and are therefore relatively young in the business.

Forty six companies, or 76%, have 1-100 employees while nine companies, or 15%, have 101-500 employees. The Philippine Small and Medium Enterprise Development (SMED) Council defined small enterprises as having 10 – 99 employees and medium enterprises as having 100 – 199 employees. Therefore, a large number of the companies that participated in the survey are categorized as small and medium-sized enterprises (SMEs).

Fifty three companies, or 88%, are either 100% Filipino owned or Filipino companies that have tied up with a foreign company to run the business (joint venture). Only six out of the 60 companies surveyed (10%) are foreign-owned.

Forty seven companies, or 78%, export their services to other countries. The exporting firms indicated USA as the top destination of their export services. Second top export destination, though far behind the USA, was the United Kingdom while Canada and Australia tied in the third place. Because of close cultural ties, it is no wonder that the Philippines exports primarily most of its services to the United States. For US clients, having such closer cultural links help reduce some of the problems that result from teams working together but have different cultural backgrounds.

THE INTERNAL CAPABILITIES OF PHILIPPINE ITES FIRMS

The resource-based view highlighted the importance of a firm’s resources and capabilities and helps explain why some firms perform better than others. Examining a firm’s internal capabilities helps to determine its resources and likely sources of competitive advantage and to establish strategies that will exploit any sources of competitive advantage.

Human Resources

The Philippines continues to attract global companies to set up business process outsourcing facilities. Besides costs, other top considerations for many outsourcing firms include the education and language skills of workers, the availability of labour, and attrition risk in outsourcing destinations.

Education

Fifty six companies, or 94%, indicated that majority of their employees have bachelor’s degree – implying that most of the employees in the industry went through a normal 4-year course at the university. Two companies have employees mostly holding Masters degree, while also two companies have employees mostly having non-degree or vocational training certificates. Foreign business have been attracted all along to the high number of college graduates in the work force and are impressed by the country’s contemporary culture that values college degrees. Each year, the Philippine educational system produces around 400,000 graduates, 60 percent (240,000) of whom come from business administration and related courses, engineering and technology, fine and applied arts, law and jurisprudence, mathematics and computer science, medical and allied professions, and natural science (Llorito, 2005). These are the types of skills needed to man the growing non-voice BPO that is emerging. Filipino graduates’
knowledge on liberal arts, or studies that provide general knowledge and intellectual skills, rather than more specialized occupational skills, gives the Philippines an advantage over other offshore destinations like India which are well-known for their technical skills. India is reported to have better technical universities but the Philippines is better in liberal arts, which is more appropriate for back-office processing.

**Attrition Rate**

One of the main drivers for the industry’s success is the low attrition rate. Compared to India, Canada, and the United States where attrition rates go as high as 90 percent or even more, the Philippines have a much lower attrition rate at about 50 percent. Majority of the companies surveyed (66%) indicated that they do not have problems with high employee turnover.

Many Filipino graduates are lured to work for the ITES industry because it offers more attractive salary packages compared with other industries. But in reality, working in this industry is a very high pressure job that requires high level of commitment and skills. What’s helping the country to maintain a low attrition rate is the fact that most contact centres now have implemented lifestyle programs, organizing and providing several activities like sports competitions, battle of the bands, and other recreational activities. Such programs aim to promote a healthy balance of life and work and help reduce or counter stress that goes with a call centre job.

**Professional Development and Training**

Fifty respondents, or 83%, indicated that their employees undergo professional development and training. This shows that the majority of the companies are investing in developing the skills and talents of their work force. Only nine companies do not have professional development programs for their employees.

For firms not showing professional development and training programs for employees, the most common cited reason for not having such kind of programs was hectic work schedule. As early as 2003, industry Executives say they already begun to notice shortages in English speakers which has somewhat caused an alarm for the Philippine outsourcing community. Many companies have since then established training programs at private universities and human resource consulting companies that train potential recruits. Sensing the potential loss in one of the few bright spots in the Philippine economy, the National government has also started to throw money at the problem. In 2006, President Gloria Macapagal-Arroyo earmarked US$9.8 million for outsourcing training, dubbed as “Training for Work” scholarship program. As part of that scheme, students interested in outsourcing jobs are given vouchers that may be used for tuition at government-accredited human resources institutions (Llorito, 2006). The President has also ordered the education department to make English the primary medium of instruction nationwide.

**Entrepreneurial Orientation**

The success of the Philippine ITES industry also depends in fostering an entrepreneurial environment that promotes the creation of new technologies, concepts, and processes. Results of the survey show that from 2004-2006, thirty seven companies, or 62%, have increased the number of their service offerings. Twenty companies, or 33%, said the number of services they offered for the past three years remained constant. No company indicated a decreasing trend for the same period. Thirty companies, or half of the total number of respondents, indicated that they offer new services to their clients “most of the time”, while fourteen companies “always” offer new services to their clients. As already mentioned many of the companies indicated that their core business operations encompass several of the six ITES
sub-sectors simultaneously. As such, it is normal for call centres which operate at night shift to also engage in BPO or software development during day-time to maximize office space and increase profitability. During the past few years, outsourcing has expanded beyond call centres into almost every conceivable business processes such as accounting, financial analysis, design engineering, software development, animation, medical and legal transcription services, etc. which exhibits a very entrepreneurial mindset among ITES/BPO companies.

Technological Capability

Aside from enhancing the language proficiency and technical skills of its human resources, another challenge that confronts the industry is the low level of technological capability of ITES/BPO firms. For instance, survey results revealed that few companies have certification in international quality standards or other internationally recognized qualification levels such as ISO, CMM, eSCM-SP, TQM, etc. Fewer companies also have R&D departments or conduct market research activities than companies that actually engage in such kind of activities.

International Certification

Forty three companies surveyed, or 71%, do not have certification in international quality standards or other internationally recognized qualification levels. Only sixteen companies indicated that they have international certification. Thus, majority of the ITES/BPO companies surveyed do not yet have international certification, which is a mark of excellence that assures consistent product and service quality. Such certifications are deemed very important especially to clients abroad.

Research and Development (R&D)

The key source of technological innovation is R&D. However, survey results revealed that more companies do not engage in R&D activities than companies that actually do. Twenty three companies, or 38%, have R&D department while thirty seven companies, or 62%, do not have such department. Majority of those that have R&D department are software companies. Out of the twenty three companies that have R&D department, only sixteen companies provided information that they spend in average 12.5% of their total revenue for R&D expenditure.

Market Research Activities

Market research is an essential part of any business that wants to offer products or services that are focused and well targeted. Business decisions that are based on good intelligence and good market research can minimize risk, identify opportunities, and create benchmark to help measure the company’s progress. However, survey results revealed that not all Philippine ITES/BPO firms are actually engaging in such kind of activities. Only twenty six companies, or 43%, indicated that they conduct market research activities. This figure is slightly higher compared to the number of companies which conduct R&D activities.

Philippines ITES/BPO firms, which are predominantly SMEs in their early stages of growth, mostly rely on experience in understanding their customer needs. As such, marketing strategies are normally developed based on experience and not through systematic gathering and analyzing of data about their target market, competition, or market environment. However, market knowledge based on experience alone may not always be current and may become less relevant over time. Ultimately, these firms will need to have a better understanding of the market in which they operate—a market that is driven by globalization, stiff competition and more discriminating customers.
Thus, conducting market research activities will help these firms to maintain their advantage, reduce risk, and provide more room for innovation and growth in the long run.

Summary of Findings: Internal Capabilities

Based on survey results, it appears that Philippine ITES/BPO firms are quite strong in the quality of its human resources. A large percentage of employees have bachelor's degree. Aside from English language proficiency, the Philippines' contemporary culture that values college degrees also impresses many foreign businesses and helps to attract them to invest in the country. Attrition rate is also significantly lower compared with other countries, which is brought about by initiatives of some firms to implement "lifestyle programs" to improve employee satisfaction. A large percentage of the firms surveyed also invest in the professional development and training of their workforce. While there is indeed a looming shortage of highly skilled, English proficient workers due to the huge demand for outsourced services, firms are nonetheless taking initiatives to address the problem by partnering with universities and human resource consulting firms in establishing training programs for potential recruits. Likewise, the government is pouring money to develop the country's human capital.

Majority of the companies surveyed exhibited entrepreneurial orientation. As proof, many of them indicated that they have increased their new service offerings during the past three years (2004-2006). Not a single company reported a decreasing trend in new service offerings for the same period.

A big drawback for the industry is the low level of technological capability of ITES/BPO firms, a problem that is recognized by the industry association itself. Survey results revealed that fewer companies have certification in international quality standards or other internationally recognized qualification levels. More companies do not engage in R&D activities than companies that actually do while less than half of those surveyed conduct market research activities.

One explanation for this could be that the industry is still in its early stages of growth. Many of the respondents were just start-ups or young companies. Aside from their age, many of these companies are still categorized as SMEs. For Philippine SMEs, acquiring international certifications or investing in R&D and market research activities are normally very costly and are often not prioritized especially during the firm's early stages of growth. In contrast, the technological capability of the Indian ITES/BPO industry is undoubtedly more sophisticated and mature. However, more and more Philippine ITES/BPO firms are expected to build up their technological capability in the next few years to keep up with the growing demand and pressures of globalization.

THE EXTERNAL LINKAGES OF PHILIPPINE ITES FIRMS

Organizations, whether established ones or start-ups, cover only part of their value chain and depend critically on their environment. Firms have limited resources, outsource certain parts of the value chain, and transact with other economic actors having complementary assets. Networks are vital to the discovery of opportunities, to the testing of ideas, and to secure resources for the organization.

Networking with Other ITES/BPO Firms

Fory four companies, or 73%, indicated that they are able to cooperate or exchange information with other local or foreign ITES/BPO firms. On the other hand, only sixteen companies have no form of cooperation with other firms in the industry. Sales and marketing in the form of trade missions
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was cited as the top area where firms cooperate, followed by joint production and R&D.

For a long time now, the Philippines and India have been talking about collaboration to help boost their chances in the global outsourcing industry. This vision has finally turned into reality when the Business Processing Association of the Philippines (BPA/P) and India’s National Association of Software and Service Companies (NASSCOM) signed an agreement in September 2006 to cooperate in seven "strategic" areas: strategic communications; geographic risk mitigation; shared best practices and adherence to international standards; data security and privacy; workforce development, collaboration and cooperation; and infrastructure improvement. Strategic communications involves joint lobbying to promote outsourcing in the global market, while geographic risk mitigation will mean both organizations selling the Philippines and India as one "geographic risk mitigation package". The two organizations will also work on data security and privacy standards for both countries, and share best practices in workforce management and infrastructure improvement.

By collaborating with India, the Philippines have the unique opportunity to learn from its Asian neighbour and at the same time create its own path to development. Thus, in the age of globalization, the Philippines and India need not be mere competitors in the ICT Outsourcing market. They could also be strategic partners who together can enlarge their respective shares in the global outsourcing market.

Participation in Industry Associations or Informal Networks

Forty seven companies surveyed, or 78%, are members of industry association. On the other hand, only twelve companies, or 20%, replied that they are not part of any association. Next to clients, the industry association was chosen by most respondents as source of information that influences the company’s success. It ranked higher than universities or academic/research institutes and government agencies. Companies cited access to databases, studies and surveys as the top benefit they get from being a member of the association. This was closely followed by access to market opportunities as the association normally organizes trade missions abroad and performs business matching opportunities between its members and potential clients. Many of the companies surveyed are small in size and thus do not have enough capability to conduct such activities on their own. Hence, they turn to industry associations for support in order to further strengthen their market access and performance potential.

Collaboration with Universities or Research Institutions

It is a fact that some companies are now hard-pressed in finding enough skilled workers to manage their growing operations in the country. The problem is not really a shortage in people but a shortage in qualified, skilled and well-trained people. But the good news is that the industry, academe and government recognize the "education gap" problem and are taking concrete steps to address that gap. Since this industry is human resource-driven, there should be a steady supply of suitable talent and this can be achieved by establishing partnerships between the private sector and the academe. This has already happened to India and is similarly emerging in BPO locations in the Philippines such as Cebu, Bacolod and Dumaguete. Some specific examples of collaboration between firms and universities or research institutions aimed in addressing the "education gap" are:

- Etelecare, one of the leading call centres in the country, partnered with the Technical Education and Skills Development Authority (TESDA) to develop a courseware suited to call centre work.
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- Exist Engineering, a Philippine-based software firm, is now working with local universities to design courses that will prepare fresh graduates for a software engineering job at the company.
- Sitel has partnered with the University of the Cordilleras (UC) for a five-year testing project to flesh out a curriculum designed for BPO firms. In 2007, the UC started a preparatory course in English proficiency, technical competency and customer relations designed by Sitel. The course gives college students a concrete idea what it is like to work in a call centre, where the final stretch of training will be an on-site, hands-on lesson at Sitel (Baguio City).

Support from Government Institutions

Thirty nine respondents, or 65%, indicated that there are no government programs helping their business to develop. On the other hand, eighteen companies or 30% have been beneficiary of several government support programs. Companies which indicated receiving government support for their businesses cited business matching activities as the most common form of government support program, followed by training and scholarship grants. Other forms of government support come in the form of tax breaks and subsidized trade missions.

Survey results revealed that despite the government’s best efforts to carry out programs that will sustain the industry’s long term competitiveness, very few companies actually benefit from such programs. It is not to say there are no government programs available, for clearly government support and commitment for this sector is as strong as ever. However, larger-scale programs meant to support the industry were only instituted beginning 2006 and may not have been fully implemented yet at the time of the survey. To prove the government’s strong support for this industry, the Philippine President already announced in her annual State of the Nation Address (SONA) in July 2007 a promise to pour an unprecedented increase of investments in developing the country’s human capital. Some US$642 Million more investments in education were allotted in 2007 compared to 2006, bringing the total spending on education to US$3.3 Billion - the highest in Philippine history.

Summary of Findings: External Linkages

73% of the companies are able to cooperate or exchange information with other local or foreign ITES/BPO firms. Sales and marketing in the form of trade missions was cited as the top area where firms cooperate, followed by production and R&D. The industry association plays a big role in raising the level of cooperation among ITES firms especially in marketing their service offerings to potential local and overseas clients. Next to clients, the industry association was chosen by most respondents as source of information that influences the company’s success. It ranked higher than universities or academic/research institutes and government agencies.

The Philippine ITES industry also aims to strengthen its position in the global outsourcing market by creating strategic alliances with other leading outsourcing destinations. This resulted into forging an agreement with outsourcing leader, India, to cooperate in seven “strategic” areas.

In view of the looming shortage in skilled and well-trained manpower, firms are establishing partnerships with the academe through curriculum development and basic and applied research to ensure a steady supply of suitable talent.

65% of the respondents indicated that there are no government programs helping their business to develop, but one explanation could be that large-scale government programs intended to support the industry were only instituted in 2006 and may not have been fully implemented yet at the time of
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the survey. The Philippine government is supporting the vigorous growth of the ITES industry by pledging unprecedented increase of investments in developing the country's human capital.

CONCLUSION AND RECOMMENDATIONS

The medium-term outlook for the Philippines in the ITES industry remains to be very positive, particularly if the country is able to improve the maturity of its service providers and further develop the quality of its workforce. Leveraging on labour arbitrage alone will not take the industry to the next level. In order to improve the Philippines' competitive advantage, the country should continuously enhance the suitability of the labour supply through investments in English language proficiency; move up the value chain by focusing more on non-voice sector or services other than call centres; enhance its technological capability; improve the business environment; and focus on capturing more markets aside from the US.

Developing the Country’s Human Capital Through Education

In the emerging knowledge-based economy, the sustainable competitive advantage of nations will reside in their ability to harness their countries’ intellectual assets. The key to exploiting the opportunities lies in creating the kind of human resources that are needed for the global information economy. The Philippines’ attractiveness as an outsourcing destination is no longer limited to low labour cost alone, but also to being able to provide global partners with a human resource possessing the “right skill sets and competencies supported by a sophisticated telecommunications infrastructure”. The number one priority should be developing the country’s human capital because investor’s top concern now is whether the Philippines can actually supply the great demand for outsourced services. While political stability is important to their investment, investors are looking closely at how good the country’s human resource base is. Particularly detrimental to the further development of the ITES industry is the declining English-language proficiency of the population, which could be addressed by a renewed emphasis on English-language teaching. Enhancing English proficiency is important as it is required in all six ITES sub-sectors.

The continued growth of the ITES labour force will require significant educational reform. One of the key issues in the education sector is to reform the curricula and learning objectives (e.g. types of skills to be acquired) in order to meet the challenges of ITES work. At a minimum the work appears to require improvements in the general quality of logical-analytical thinking skills as well as communication skills. A stronger focus on proper training could help, but rather than just training in IT, training involving a broader general education would be more beneficial. In Singapore for instance, universities and polytechnics have incorporated in their curricula programs for specific sectors such as animation and videogames, as well as IT-type programs that emphasize multidisciplinary work, new kinds of integrative thinking and problem-solving ability, and strong industry practicum. Thus, developing the country’s human capital requires changes throughout the system including the curricula, content, and learning objectives.

Moving up the Value Chain

As the world becomes flatter with the outsourcing trend, Philippine ITES companies are becoming aware that to be able to compete in the global market they have to move up the value chain. With increasing competition from other low-cost countries, the imperative is for firms to shift their main activities to a higher level rather than just passive transactions like the Q&A type of call centre service or low level offshore program-
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... This is indeed a natural progression because companies initially just outsource low value functions offshore but soon start moving higher value processes when they are comfortable. Most of the clients of the call centres are now looking at what else the country can do apart from call centres. Back office business processes are considered more high value because they involve more than just answering queries from customers. One is actually doing process work and depending on the type of the business process, it could be a highly specialized business process like investment consulting. In the case of software development, maintenance and coding work are considered to be in the lower end of the value chain and higher value work is analysis and design.

While the offshore outsourcing industry has flourished by providing well-specified, structured and repeatable tasks, the ability to perform more value-added, knowledge-based activities like analytics, research, and credit analysis is opening up opportunities in Knowledge Process Outsourcing (KPO). This service requires significant area proficiency and the ultimate goal is to generate value for the client by providing business expertise rather than process expertise. Higher value work is what is perceived to give the industry a sustainable competitive advantage because it calls on creativity, domain expertise, and a reputation for quality.

Enhancing Technological Capability

Building competitive advantage based on low-cost service alone can’t lead to sustainable growth. This is the oldest, harshest lesson of the global economy: If what you do can be done by anyone, there will always be someone willing to do it for less. Eventually, labour arbitrage will not be the major focus of outsourcing anymore. Within 7-10 years, when labour arbitrage has already ran its course and with prices always having a certain amount of difference, it will be those with deep process knowledge who will be successful. As such, prospects are good for those who can bring data security and have good knowledge of the complexity of the compliance environment that the U.S. and other potential markets have to live under. In a couple of years, companies should be able to move to the high-cost segment of the market and do more collaboration for bigger projects. Therefore, there is a need for companies to invest in the improvement of quality processes like getting certified and building domain expertise in light of the need to “demonstrate” competitiveness.

Likewise, the country should also invest more in R&D and promote local centres of innovation. R&D is the lifeblood especially of the software and BPO sub-sectors which are largely driven by cutting-edge technology. As such, it would be wise for Philippine firms to conduct “technology road map and R&D needs assessment” to ensure that they do not miss out on any trends. When society produces lots of scientists and talents, it would be easy to generate products, services and intellectual properties that entrepreneurs could sell to the rest of the world - and whose competitive advantage depends less on labour cost and more on knowledge content and other intangibles like branding.

Improving the Business Environment

As the ITES industry continues to shine, there are areas that need to be monitored in order for the country to preserve the country’s position as a leading offshore service provider. The country still has a problem with perception as a risky location, both politically and economically. The general business condition should be improved, particularly by creating a stable political condition. The country’s subpar business environment suffers from strict labour laws, high levels of corruption, and a surfeit of bureaucracy. Obtaining approval to open a call centre in the Philippines, for instance, takes twice as much time as it does in India or Malaysia. Another drawback is the lack of direct flights from the Philippines to important markets such as the United States.
A number of ITES/BPO locators have started to grumble about the relatively high costs of electricity in the Philippines. Among the countries in the Asia-Pacific region, the country has one of the highest per kilowatt-hour power rates. This oft-mentioned deterrent to Philippine economic development remains a disincentive for foreign investment, not only in the outsourcing sector, but also throughout the manufacturing, services and even agro-industrial sectors of the country. For certain outsourcing firms, energy charges have counted among their largest monthly expenditures, particularly for companies with 24-hour operations requiring 24-hour air-conditioning. The passage of legislation on the privatization and liberalization of the country’s electricity industry was expected to significantly lower electricity charges nationwide. Unfortunately, the reforms in this sector have been hit by bureaucratic snags.

Looking Beyond the US Market

The success of the business also depends a lot on the country’s ability to attract more markets for outsourced ITES services in the country. At the moment, the market is heavily skewed towards the U.S. so the country has to strengthen its ability to attract North American companies to outsource in the Philippines. But to further expand its market, the country must look beyond the United States and should reach out more to countries that are nearer to it like Japan, Taiwan, Korea, and other more developed countries in Asia. European countries also constitute a very attractive market for outsourced IT-enabled services. The Philippines is an important economic and trading partner of Europe. About 27 percent of the total foreign direct investments (FDI) in the Philippines came from the European Union (EU). United Kingdom is still the dominant market but outsourcing is gaining ground in Germany, the Netherlands, Spain and France. The relatively high cost of doing business in Europe is driving European companies to look at offshore outsourcing as a strategic alternative. The financial services sector is the largest consumer of BPO and IT-enabled services in Europe, followed by utilities and telecommunications, while human resources, finance and accounting are also showing notable growth.

The government must regularly organize trade missions to Europe such as business forums, business meetings with potential clients, and high-level networking receptions. It would be helpful for the Philippines to adopt a country-by-country strategy that will fit the service requirements of each market. As for marketing the Philippines to investors, the large population of Filipinos in US and Europe can be tapped as a “steady and continuous supply of ITES/BPO marketing advocates”.

REFERENCES


