An In-Depth Assessment of the Philippines for Offshore IT-Enabled Services

The Philippines has significant potential to capture specific segments of the IT services market. This Strategic Analysis Report provides an in-depth assessment of the Philippines as a destination country for offshore IT-enabled services.

Management Summary

Despite economic woes and geopolitical uncertainties, offshore sourcing and global delivery will become an integral part of any enterprise’s sourcing strategy. Today, there are only a few countries with active offshore IT professional services industries aimed at the offshore clientele; and there are even fewer with robust, mature offerings that address global delivery of IT services. However, governments around the globe are attempting to nurture similar industries, making the competition fierce for attracting multinational corporations (MNCs) and United States — as well as European — buyers of services. For an enterprise evaluating the options, the process can become quite complex.

Gartner’s recommendation is: “country before company.” This advice to end-user organizations means that before considering individual vendors, enterprises must consider a wide range of country-level characteristics to determine country suitability for offshore projects. Thus, this Strategic Analysis Report examines the Philippine market and provides an overview of its potential.
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1.0 Introduction

As many U.S. enterprises are increasingly making the global sourcing of IT resources a staple part of their overall IT strategy, the interest in offshore delivery has grown significantly. A “top of mind” agenda item for many CxO’s has been to figure out how to capitalize on the “offshore advantage.” Today, the Philippines is an important offshore player, with best estimates of approximately $1 billion in exported IT service and business process IT-enabled revenue generated from approximately 290,000 skilled professionals.

The Philippines has long been considered a destination country for sourcing programmers for more than 20 years. However, for myriad of reasons, the Philippines was not able to harness this IT work into the type of success story achieved by India. Gartner research indicates that India has captured 80 percent to 95 percent of the total of offshore application outsourcing (AO) market for U.S. commercial buyers. However, a number of other sectors — including business process outsourcing (BPO) and contact centers — are still “up for grabs” (i.e., markets in which any one of several competitors can command a leading market share). This is primarily because the majority of U.S. buyers still have not moved these services offshore because the industry is very nascent. As a result, there are no clear countries or vendors that have established themselves in the offshore market for these services. Given the forecasts for these services, numerous investment initiatives and facilities are sprouting up in India, the Philippines and China.

1.1 Starting Point

It is important to note that as Gartner compares the Philippines to some of its counterparts in Asia (e.g., India), the Philippines has a different launching point with regard to forays into the business and IT services arena. The Philippines has been working in high technology for the past 40 years as a center for electronics manufacturing and assembly. Some of the world’s leading robotics and chip manufacturing work has been executed in facilities throughout the Philippines. As a result, the Philippines’ starting point is very different than India’s. In many ways, India was able to “leap-frog” to its current coveted status of being a leader in the application development offshore market as the software industry started from a “clean slate.” The government in India was not involved in the infancy of the industry. By comparison, the Philippines is coming from a place of “transition” rather than starting from scratch. The focus of growing the Philippine IT and communication industry is juxtaposed to its involvement in electronics exports.

1.2 Doing Business in the Philippines

The Philippines has a long history of close relationships with the United States because the Philippines was under U.S. rule for almost 50 years at the beginning of the 20th century. As a result, there is a great deal of cultural understanding of the United States. This positions Filipino professionals well for trade and interactions with the United States.

The political system in the Philippines is patterned after the United States including a democracy with a free press. It is the oldest working democracy in Asia and focuses on a strong adherence to constitutional process. Once again, this positions the country well to work with and conduct business with U.S. end user buyers seeking to procure services from Filipino external service providers (ESPs) or MNCs focused on establishing offshore operations in the country.

The governmental policies regarding investment and economics are geared toward creating an “inviting” climate for U.S. and European enterprises, including allowing in some instances up to 100 percent foreign-equity participation and market-oriented foreign exchange policies.
1.2.1 English Proficiency

The Philippines is the third-largest English speaking nation in the world. In addition, according to government sources, the overall literacy rate for the country is 94 percent. The Philippine government also asserts that 72 percent of the population is fluent in English. Thus, because a majority of the population speaks English, almost everyone can understand English throughout the country. The two elements of English proficiency that are important to various IT sectors are verbal expression (i.e., articulation) of language and verbal comprehension.

**Verbal expression:** The English that is spoken is American English vs. British English; consequently, distinctions and nuances in pronunciation, spelling and even slang is much less of an issue as compared to India where British English is the norm. Thus, Philippine workers are well suited to doing business with the United States as their ability to adopt accent and the level of understandability by Americans of Filipino workers can be considered comparatively better than India and significantly better than China. For example, this skill is extremely important in contact center services that involve call center operators working with clients via the phone ensuring that customers can clearly understand the spoken English with limited detection of an accent.

**Verbal comprehension:** The other side of language proficiency to consider is verbal comprehension (e.g., if an American is seeking to explain a complex business problem that must be interpreted and subsequently documented and designed). In this area, the Filipino worker is generally ahead of offshore destinations such as China but either on a par or at times slightly below India.

1.3 Investment Incentives and Government Requirements

An overview of the investment incentives and government requirements for entities interested in working in the Philippines include:

- **Ownership of businesses:** Foreign investors can do business or invest in a domestic enterprise up to 100 percent of its capital, except when the business in question is a financial institution, a mass-media entity, an advertising agency, a real estate company, a public utilities firm, or a defense-related concern. The full list of exemptions is available from the Philippines’ Board of Investments’ Web site (www.boi.gov.ph).

- **Ownership of land:** Ownership of land by a foreign entity (i.e., more than 40 percent foreign-owned enterprise) is subject to the following limitations:
  - The Philippine Constitution of 1987 prohibits alien (i.e., a person) or foreign-owned corporations from owning land
  - Republic Act 7652 (Investor’s Lease Act) allows the lease of land for a period of 50 years, renewable once for a period of 25 years, unless a law amending the limitation is enacted.

- **Investment incentives:** A number of investment incentives have been designated for entities conducting business in the Philippines. The incentive incentives fall into two broad categories:
  - Locations outside economic zones and free ports
  - Locations within economic zones and free port areas

Enterprises located outside economic zones and free ports are entitled to a package of incentives, provided the firm’s activity or project is listed in the Investment Priorities Plan (IPP) or is export-oriented. The general incentive package for entities outside the economic zones is as follows:
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- Income Tax Holiday (ITH) for new project with pioneer status: six years with possible bonus of two years
- For new projects with nonpioneer status: four years with possible bonus of three years
- For expansion projects: three years
- Potential additional deductions for training expense
- Potential additional deduction for labor expense
- Potential additional deduction for necessary and major infrastructure work

Others incentives available for IT service providers include:

- Tax- and duty-free importation of spare parts and supplies
- Exemption from wharfage dues and any export tax, duty, impost and fee
- Unrestricted use of consigned capital equipment subject to posting of re-export bond
- Employment of foreign nationals
- Simplification of customs procedures

With regard to the employment of foreign nationals, the following rules apply:

- Under the Implementing Rules and Regulations of E. O. 226, Art. 39 (h) — Employment of Foreign Nationals, subject to the provisions of Section 29 of Commonwealth Act Number 613, as amended, a registered enterprise may employ foreign nationals in supervisory, technical or advisory positions for a period not exceeding five (5) years from its registration, extendable for limited periods at the discretion of the Board.

- Provided, however, that when the majority of the capital stock of a registered enterprise is owned by foreign investors, the positions of president, treasurer and general manager or their equivalents may be retained by foreign nationals beyond the period set forth herein.

- Foreign nationals under employment contract within the purview of this incentive, their spouses and unmarried children under twenty-one (21) years of age, who are not excluded by Section 29 of Commonwealth Act Numbered 613, as amended, shall be permitted to enter and reside in the Philippines during the period of employment of such foreign nationals.

- A registered enterprise shall train Filipinos as understudies of foreign nationals in administrative, supervisory and technical skills and shall submit annual reports on such training to the Board.

The second broad category involves enterprises located within economic zones, and free ports. The government designed these as a national development strategy and has a declared a number of types of economic zones to encourage foreign investments. Two important types of economic zones are:

- Philippine Economic Zone Authority (PEZA) locations. It is important to note that PEZA is a government corporation established through legislative enactment known as “The Special Economic Zone Act of 1995,” and there are numerous PEZA zones in the Philippines.
• Special economic zones (i.e., former American military bases). These are comprised of two former U.S. military bases (i.e., Clark and Subic) that were re-purposed as facilities for MNC and service providers. They are located two to three hours outside Manila.

Entities must meet at least the following qualifications as part of these economic zones:

• Filipino corporations, partnerships or associations (i.e., at least 60 percent Filipino-owned) must export at least 50 percent of their production output.

• Foreign entities (i.e., more than 40 percent foreign-owned) must export at least 70 percent of total production.

• If the activity is pioneering in nature, 100 percent of production may be sold to the domestic market.

There are a number of options and related investment incentives related to each type of special economic zone and free port, including:

• Companies that establish operations in the Philippines have available to them a four-year to eight-year income tax holiday (ITH) for corporate income tax. After the ITH lapses, a special 5 percent tax rate in lieu of all national and local taxes can be obtained for enterprises located in a government-declared ecozone or free port.

• Tax and duty-free importation of machinery, equipment, spare parts, raw materials and supplies

• Tax credit on domestic capital equipment

• Additional deduction for labor expense up to 50 percent

• Additional deduction for training expense up to 50 percent

• Exemption from export taxes, wharfage dues, imposts and fees

• Allowance for the employment of foreign nationals

• Permanent resident status for foreign investors and immediate family members

1.4 Government Support

As the new Philippine government under President Arroyo has come into power, it appears that there is a renewed sense of interest and focus on promoting the IT industry. The Philippine government has embraced the IT industry as the economic driver and is taking an active role in working synergistically with the private sector in technology-enabled services industries. In later sections of this report, a detailed description of the specific IT-industry initiatives is reviewed. However, three broader examples of government support include:

• Deregulation: To encourage IT investments, the Philippine government supported the deregulation of key industries and services (i.e., telecommunication) and the privatization of government corporations.

• Government organizations: The Philippine government has a number of dedicated agencies, e.g., the Board of Investment (BOI) Department of Trade & Industry, to facilitate setting up operations for back-office, shared service centers in short time frames (e.g., as quickly as 45 to 90 days in some instances).
Government task force: The Information Technology and E-Commerce Council (ITECC) was formed to oversee and update the national strategy for Information and Communication Technology (ICT). President Arroyo chairs this government/private council.

1.5 Labor Force

Currently, the size of the total labor force of the Philippines is approximately 29 million with close to 380,000 college graduates each year. The Philippines has a relatively large pool of technically proficient workers with regard to computer science and programming (i.e., estimated at 30,000 to 50,000 graduates per year). There is also a high concentration of workers that can achieve the desired level of expertise in U.S. business processes, i.e., accounting and human resources (HR), and industry specific knowledge (i.e., medical terms for transcriptions). In addition, given that the accounting regulations in the Philippines are the closest to generally accepted accounting principles (GAAP) standards outside the United States, a trained accountant in the Philippines has a significant advantage.

Similar to many Asian cultures, Filipino professionals are extremely grateful to be gainfully employed; and they come with a passion to learn and succeed that translates into a dedication to long hours and hard work. The level of employee loyalty and dedication in the Philippines results in low turnover rates. The overall turnover rates reported by MNCs and service providers operating in the Philippines remain quite low. For example, the level of attrition was consistently listed as less than 15 percent in the application services and contact center services sectors. This results in significant cost savings (e.g., recruiting, training and productivity) and retained organizational knowledge for the respective organizations.

Although the desire to succeed is cited as a positive, the focus on new opportunities and learning is a double-edged sword as it is also the root cause for attrition rates. The primary reason for employee departures in the Philippines is for opportunities outside the country. Many Filipinos seek out opportunities to work in the United States either within their present employers in the form of transfers or through new employers. All of this is compounded by persistent “poaching” of employees by numerous U.S. staff augmentation firms that focus on application development.

1.6 Telecommunication

Relative to other countries in the Asia/Pacific region, the Philippines is considered to have a solid power and telecommunication infrastructure (i.e., voice and data). There is redundant international connectivity, including fiber optic cable and satellite communication. As a result, a significant amount of trans-Pacific data communication bandwidth is easily available.

A solid telecommunication infrastructure needs to be placed in context to manage expectations compared to standards that U.S. enterprises are accustomed to. In the Philippines, most entities plan and design architecture with an expectation of some type of “brown-out” approximately once or twice per quarter. This has been significantly reduced from the previous weekly issues experienced five years ago. Generally, most of the organizations interviewed by Gartner reported no disruption in service, as most major office buildings are already equipped with back-up generators for all tenants. Clearly, this should be an evaluation criterion for enterprises seeking services in the Philippines.

With regard to telecommunication, a majority of the organizations interviewed routinely contract with more than one telecommunication carrier for redundancy. This is because the major telecommunication carriers in the Philippines frequently have conflicts with regard to their provisioning, which results in a temporary lack of service for customers. Hence, most enterprises assure connectivity by contracting with multiple carriers. It is a straightforward solution but clearly one that must be addressed in the planning and design of the infrastructure business case and the implementation of plans.
In addition, another critical area for evaluation by enterprises is to carefully consider the specific office building selected for operations to ensure available connectivity. Although most major buildings in the major business district (i.e., Makati), as well as others, are “telecommunication-ready” with service delivered directly to the leased floor space, Gartner analysts interviewed several organizations that unfortunately selected buildings that had numerous “last mile” issues. A “last mile” issue essentially translates to huge amounts of additional installation costs to bring service directly into the leased space as the “last mile” of line has not been made available.

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

- Fixed line
- Cellular
- Cable TV
- Over the air TV
- Radio
- The very small aperture terminal (VSAT) system

It is interesting to note that bandwidth cost have declined by 70 percent during the past four years, according to local IT service and contact center providers. In addition, there are a number of international carriers for telecommunication services providing a solid competitive landscape for buyers. These include:

- Bayan Tel
- Digitel
- Globe Telecommunication
- Philippine Long Distance Telecom (PLDT)
- SMART Communications

As a result, telecommunication rate structures are competitive (see Figure 1)
Telephone rental

<table>
<thead>
<tr>
<th>Residential</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Installation</td>
<td>US$38 (i.e., pre-paid landline)</td>
<td></td>
</tr>
<tr>
<td>• Monthly billing</td>
<td>$12 plus 10% VAT</td>
<td></td>
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Business

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<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>• Installation</td>
<td>US$70</td>
</tr>
<tr>
<td>• Monthly billing</td>
<td>US$24 plus 10% VAT</td>
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</table>

Mobile phone charges

<p>| |</p>
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<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Monthly billing</td>
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</table>

Source: BOI Web site (www.boi.gov.ph)

<table>
<thead>
<tr>
<th>International calls</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>ASEAN: Association of Southeast Asian Nations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VAT: Value-added tax</td>
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<table>
<thead>
<tr>
<th>Area</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASEAN, Hong Kong and Japan</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
<tr>
<td>Macao and South Korea</td>
<td></td>
</tr>
<tr>
<td>Australia and New Zealand</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
<tr>
<td>United States and Canada</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
<tr>
<td>France, Germany, Italy, Spain and the United Kingdom</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
<tr>
<td>China and India</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
<tr>
<td>Kuwait/United Arab Emirates, Bahrain and Saudi Arabia</td>
<td>US$0.40 first and succeeding minutes</td>
</tr>
</tbody>
</table>

These are the current PLDT rates (i.e., US$1=Php50) as gathered by BOI as of 15 June 2002.

1.7 Real Estate Options

Although the Philippines consists of a large archipelago consisting of more than 7,000 islands, the primary physical locations where enterprises would most likely place operations are focused in and around the capital city of Manila. The options are primarily focused in three physical locations:

- The commercial district of the city limits of Manila
- Technology parks located within the Metro-Manila area (i.e., predominately suburban locations just outside Manila)
- Two re-purposed military bases located two to three hours outside Manila

As a national development strategy, the government designed and promoted the establishment of economic zones in the form of technology centric corporate parks all over the country to respond to demands for ready-to-occupy locations for foreign investments. The options include:

- Philippine Economic Zone Authority (PEZA) locations
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- Special economic zones and freeport zones (i.e., former American military bases)

A sample of these technology centric corporate regions in the Philippines include:

- **ASEANA Intelligent Technologies Plaza**
  - Developer: ASEANA IT Plaza Consortium
  - Location: Aseana Business Park, Boulevard 2000, Paranaque City, Metro Manila, Philippines
  - Land area: 12.3 hectares (i.e., 30.4 acres)
  - Telecom facilities: 43,216 installed lines; 142,029 available phone lines; leased lines, ISDN and fiber optic

- **Bonifacio Information Special Technology Zone**
  - Developer: Bases Conversion and Development Authority
  - Location: Fort Bonifacio, Taguig, Metro Manila, Philippines
  - Land area: 25.0 hectares (i.e., 61.8 acres)
  - Telecom facilities: 187,414 installed lines; 53,882 available phone lines; leased lines, ISDN and fiber optic
  - Tel: (632) 551-3006 or (632) 555-0001

- **CCTC IT Park**
  - Developer: Cebu Property Ventures & Development Corporation
  - Location: Barangay Lahug and Apas, Cebu City, Philippines
  - Land Area: 23.7 hectares (i.e., 58.6 acres)
  - Telecom facilities: 30,967 installed lines; 119,777 available phone lines; leased lines, ISDN and fiber optic
  - Tel: (032) 231-5301 to (032) 231-5309

- **Cebu Cybertown IT Park**
  - Developer: First Centro, Inc.
  - Location: Lapu-Lapu City, Mactan, Cebu, Philippines
  - Land area: 11.5 hectares (i.e., 28.4 acres)
  - Telecom facilities: 16,950 installed lines; 22,512 available phone lines; leased lines, ISDN and fiber optic
  - Tel: (632) 867-8526 or (632) 636-7934

- **Eastwood City Cyberpark**
  - Developer: Megaworld Properties and Holdings, Inc.
  - Location: Bagumbayan, Quezon City, Metro Manila, Philippines
  - Land area: 13.3 hectares (i.e., 32.9 acres)
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- Telecom facilities: 53,000 installed lines; 277,777 available phone lines; leased lines, ISDN and fiber optic
- Tel: (632) 634-0348 and (632) 634-0349; also (632) 867-8826 to (632) 867-8840

**Fort Bonifacio E-Square**
- Developer: Fort Bonifacio Development Corporation
- Location: Fort Bonifacio Global City, Taguig, Metro Manila, Philippines
- Land area: 24.4 hectares (i.e., 60.3 acres)
- Telecom facilities: 187,414 installed lines; 53,882 available phone lines; leased lines, ISDN and fiber optic
- Tel: (632) 867-3988

**Northgate Cyber Zone**
- Developer: Filinvest Alabang, Inc.
- Location: Alabang, Muntinlupa City, Metro Manila, Philippines
- Land area: 18.7 hectares (i.e., 46.2 acres)
- Telecom facilities: 38,886 installed lines; 142,543 available phone lines; leased lines, ISDN and fiber optic
- Tel: (632) 809-5478; (632) 842-6827; or 807-6729 local 226 or 267

**PBCom Tower**
- Developer: Filinvest Asia Corporation
- Location: Ayala Avenue corner Herrera Street, Makati City, Metro Manila, Philippines
- Building floor area: 11.748 hectares (i.e., 29.0 acres)
- Telecom facilities: 421,942 installed lines; 239,606 available phone lines; leased lines, ISDN and fiber optic
- Tel./fax: (632) 840-4436

**RCBC Plaza IT Park**
- Developer: RCBC Realty Corporation
- Location: Ayala Avenue corner Sen. Gil J. Puyat Avenue, Makati City, Metro Manila, Philippines
- Building floor area: 15.04 hectares (i.e., 37.2 acres)
- Telecom facilities: 421,942 installed lines; 239,606 available phone lines; leased lines, ISDN and fiber optic
- Tel: (632) 887-1350

The bottom line with regard to the availability of “ready-to-occupy” locations is that they are in abundance. Due to the Asian economic crisis of 1997, the Philippines has an over capacity of real-estate space. As a result, the price of commercial real estate is extremely low compared to equivalent options in India (e.g., Bombay). All other destinations compare favorably with the Philippines (see Figure 2). Figure 2 outlines key information on the real estate market in the Philippines.
### Lease Rates of Lots in Export Processing Zone/Industrial Estate

<table>
<thead>
<tr>
<th>Source</th>
<th>Cost Range</th>
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<tbody>
<tr>
<td></td>
<td>US$0.17–2/square meter</td>
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### Selling Rates of Industrial Lots

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<tr>
<th>Source</th>
<th>Cost Range</th>
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<tr>
<td></td>
<td>US$40 – 700/square meter</td>
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### Standard Factory Building in Export Processing Zone/Industrial Estate

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<th>Source</th>
<th>Cost Range</th>
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<tbody>
<tr>
<td></td>
<td>US$2 – 6.39/square meter</td>
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### Office space rental (monthly)

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<th>Source</th>
<th>Cost Range</th>
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<tbody>
<tr>
<td></td>
<td>US$8 - 9/square meter (Makati)</td>
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<td></td>
<td>US$6 – 7/square meter (Ortigas)</td>
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### Office space sales

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<tr>
<th>Source</th>
<th>Cost Range</th>
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<tbody>
<tr>
<td></td>
<td>US$600 – 1,000/square meter (Makati)</td>
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<tr>
<td></td>
<td>US$600 – 760/square meter (Ortigas)</td>
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### House rental (monthly)

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<tr>
<th>Source</th>
<th>Cost Range</th>
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<tr>
<td></td>
<td>US$600 – 4,400 (Makati)</td>
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<td></td>
<td>US$400 – 3,000 (Ortigas)</td>
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### Residential condo rental

<table>
<thead>
<tr>
<th>Source</th>
<th>Cost Range</th>
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<tr>
<td></td>
<td>US$600 – 1,000 (Makati)</td>
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<td></td>
<td>US$360 – 800 (Ortigas)</td>
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### Three-Star Hotel

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<tr>
<th>Cost Range</th>
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<tr>
<td>US$72 – 100</td>
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### Four-Star Hotel

<table>
<thead>
<tr>
<th>Cost Range</th>
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<tbody>
<tr>
<td>US$122 – 156</td>
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### Five-Star

<table>
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<tr>
<th>Cost Range</th>
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<tr>
<td>US$180 – 250</td>
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*Prices are exclusive of 10% service charge and 10% value-added tax (VAT).

**Philippine Hotels also offer corporate rates that are much lower than the quoted rates.

### Car rental with driver (AVIS)

<table>
<thead>
<tr>
<th>Cost Range</th>
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<tr>
<td>US$90 – 150</td>
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Source: BOI Web site except for office space/rental and house/residential condo rental

### Figure 2. Real Estate Costs in the Philippines

#### 1.8 Political Climate

Regardless of the region of the world, enterprises and vendors must create and apply a framework for assessing the risk, measuring their enterprise threshold for accepting risk and manage the decisions accordingly. Unfortunately, it is difficult — and subjective — to make a clear assessment of the consistent references in the press with regard to “terrorism” and “kidnappings” in the Philippines. It is clearly a continued source of questions, fear and uncertainty among potential end-user buyers. Moreover, the perceptions alone have inhibited organizations from more actively pursuing opportunities in the Philippines. As a result, the government must continue to address this issue.

Generally speaking, the large majority of reported terrorist activities are concentrated in a small island region that is 600 miles south of the Metro-Manila area. As a result, a predominant number of enterprises conducting business in the Philippines — as well as clients in the United States — have reported the business and commercial climate of executing operations in the country has not caused any major disruptions with regard to day-to-day operations. Nevertheless, there are a number of documented and confirmed reports of kidnappings and killings of foreigners. For example, a first time visitor from the United States to the Philippines may find appearances alarming as almost all office buildings, major hotels and even some of the local McDonalds have armed guards that keep constant watch. Bag searches and metal detectors are also commonplace in all office buildings and major hotels.

All of this information — coupled with anecdotal evidence and reports from expatriates — certainly warrants organizations to be vigilant in their due diligence analysis. All of the key risk factors must be assessed and managed accordingly.

Although Gartner does not take a position on these matters, the entire issue of terrorism in the Philippines is a constant source of concern and remains highly speculative. Thus, these risks must be carefully
considered in the planning of any offshore services strategy based on the unique characteristic of each organization. Enterprises should take guidance from reputable sources and clearly understand the specific risks to their personnel and operations.

1.9 Specific Government Initiatives

The Philippine government has undertaken a number of significant initiatives to work with the private sector and support business growth. In this overall plan, the focus is on five specific areas of business and IT services:

- Contact centers
- BPO, including shared service centers for MNCs
- AO (i.e., includes application development, maintenance and management)
- Animation services
- Transcription services

2.0 The Contact Center Industry

In the contact center industry, U.S. enterprises are focusing on several countries as potential bases for offshore contact center outsourcing; however, India and the Philippines appear as consistent names on the short lists of many prospective clients, based on their large, skilled and inexpensive English-speaking labor pools. Although this market is still in its early stages, a few large enterprises have been very successful in leveraging offshore resources for outsourcing operations, and they contribute to the increasing interest in outsourcing contact centers offshore.

The contact center is defined as a model for multipurpose (i.e., selling, servicing and marketing), multichannel (i.e., Web, e-mail, chat, voice, fax and mail) interaction that serves the needs of the various constituents of an organization — customers, prospects, suppliers, distributors and employees. A call center may be considered a contact center with only one channel of interaction.

In the Philippines, the contact center outsourcing competitive landscape is composed of three primary groups of players:

- The insourced contact centers, dedicated to the parent company (e.g., AOL and Citibank)
- The American contact centers with a presence in the Philippines (e.g., Sykes, TeleTech, PeopleSupport and SourceOne)
- The Filipino contact centers, e.g., PLDT, Vocativ Systems Inc. (VSI), e-Telecare and C-Cube

Insourced centers are distinguished by the fact that they are operations of an MNC designed to bring competitive parity or competitive advantage for delivery of a specific business function to that organization internally.

The remaining two categories are service providers that have two forms of legal ownership or business models. The first category represents facilities owned by U.S-based companies that have branched out to offshore, and the second is local companies headquartered in the Philippines seeking U.S buyers.

The line between these three groups of players is not clear-cut, as several local providers partner or act as contractors for U.S.-based providers for a portion of their business. To date, the contact center
providers are showing a strong level of cooperation through industry consortia to drive interest in the Philippines as a platform for the contact center industry.

The industry has two consortia associations:

- Contact Federation Philippines (CFP), the umbrella organization composed of insourced contact centers and outsourcers
- The Contact Center Association of the Philippines, the association that represents outsourcing service providers

There were more than 20 outsourcing service providers in the Philippines as of March 2002, representing a capacity of approximately 3,000 seats. This number is expected to grow to 6,500 by the end of 2002.

The Philippines presents several advantages as a location for contact centers:

- A qualified labor pool in business and communication, coming from several high-quality universities (e.g., University of the Philippines, Ateneo University and De La Salle University). All contact center agents in the Philippines hold at least a bachelor’s degree.
- An English-speaking labor force with good knowledge of American vernacular, which is a strong advantage for voice call centers activities.
- An affinity to the American culture. Beyond the language factor, the Philippines education system was strongly influenced by the American occupation during the 1900s; and Filipino children also grew up with television access to U.S. cable stations such as Nickelodan and ESPN. All of these elements create an awareness of — and interest in — American culture among the Filipino population that allows them to relate to Americans easily. In the contact center industry, the ability not only to speak the language but to “connect” with the culture of the customer in the United States is a competitive advantage for outbound as well as inbound calls.
- Strong interpersonal skills: Contact center providers established in the Philippines have reported that it is quite easy to recruit agents with strong interpersonal skills and problem-resolution skills.
- Low turnover rates: The turnover in the Filipino contact center industry ranges from 10 percent to 15 percent, although most centers operate during the night. These turnover rates are considerably lower than in the United States (i.e., approximately 25 percent, going up to as high as 60 percent in poorly managed call centers). The turnover in the Philippines is usually due to departures by employees leaving for employment abroad and also because Filipinos see such jobs as career opportunities, unlike in the United States where they are viewed as more part-time employment options.
- Due to the affinity for U.S. culture, coupled with the English language proficiency, a number of providers cited that their up-front investment in people is lower compared to India because two entire phases were not required:
  - Cross-cultural training
  - Language training
- Expatriates from the United States generally rate the Philippines with high levels of satisfaction. The quality of life for expatriates in the Philippines is an advantage in attracting high-quality expatriate managers to run contact centers.
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- The availability of telecommunication infrastructure, as indicated above, is a key component of delivery for contact center services, which need reliable voice and data telecommunication services to the United States.

- The availability of real estate, as indicated above, enables contact center providers to establish large facilities in downtown Manila in prestigious districts, thus attracting a larger number of contact center professionals.

- Government incentives: The PEZA zones and the Clark and Subic ecozones are able to offer large sprawling facilities at a low cost, which are more conducive to contact center activities than fragmented multifloor buildings.

In the long term, the Philippines may face several challenges for sustainable growth in the contact center industry, but these challenges are not insurmountable. Ultimately, however, these challenges include:

- The “ability to scale” in the long term is clearly not as large as India or China with regard to the availability of contact center professionals

- The availability of power and telecommunication infrastructure is high in Manila downtown but lower in other parts of the country. Access to reliable power is still problematic in most areas, which requires contact center providers to invest in back-up generators in all their locations.

- Although there is an abundance of customer service representatives in the Philippines, the availability of contact center managers in a position to manage a several hundred-seat facility is low. Most contact center providers hope to train staff to take over this position during the next three years, but there are few qualified professionals who can fill a contact center management position today. In addition, the high satisfaction rating of expatriates from the United States provides an option for contact center management positions.

- The level of confidence in offshore BPO is low — in general — today, and concerns in the areas of security and political stability may slow down adoption of contact center outsourcing services during the next few years.

Below are some examples of contact centers established in the Philippines. These examples are not meant to be an exhaustive or comprehensive list but, rather, a representative sample of providers.

- AOL’s contact center was among the first to be set up in the Philippines. Established in 1998 in the former Clark U.S. military base, it is dedicated to e-mail support and Web chat and holds approximately 400 seats in a 24-hour operation. Today, more than 90 percent of all of AOL’s live e-mail and chat for U.S. customer support is performed out of the Philippines.

- C-Cubed, in addition to its partnership with SourceOne, also runs six of its own call center facilities, totaling almost 900 workstations, primarily in Metro Manila and Cebu in the Philippines. C-Cubed provides end-to-end customer relationship management (CRM) solutions, including voice, e-mail, fax and Web. C-Cubed is part of the Lopez group, the largest infrastructure conglomerate in the Philippines, and was formed in 2000 when Lopez consolidated its CRM operations.

- e-Telecare was founded in 1999 by two former U.S. McKinsey consultants. Although the company’s corporate headquarters is in Los Angeles, the e-Telecare holding is registered in the Philippines; and the contact centers are run by Filipino managers. In addition, e-Telecare operates a 400-seat (i.e., 800 agents) facility in Eastwood CyberPark, dedicated to voice services for the U.S. market, primarily for inbound calls (i.e., 80 percent). E-Telecare generated revenue of $20M in 2001.
PeopleSupport is an American contact center, headquartered in Los Angeles, California, that delivers customer care outsourcing solutions from contact centers in Missouri, USA and Manila, the Philippines. PeopleSupport reports more than 600 agents in Manila with a focus on being a multichannel provider offering support via voice, e-mail, real-time chat and its proprietary self-help system. PeopleSupport’s vertical focus includes: travel and hospitality, technology, financial services, retail and entertainment, and telecommunication.

PLDT is the primary telecommunication carrier in the Philippines. PLDT, through its subsidiary ePLDT, is involved in several IT initiatives in the contact center and BPO arena. In the contact center business, ePLDT runs two 100 percent wholly owned call center businesses: Vocativ/Teletech Holdings (i.e., 700 seats) and Parlance (i.e., 500 Seats). In addition, PLDT is involved in a joint venture call center, Contact World (i.e., a joint venture between ePLDT and Salmat of Australia). Of these, ePLDT is interested in investing more resources in the BPO market, particularly in the HR domain, during 2003.

Software Ventures International (SVI), is one of the most recognized application development providers in the Philippines. SVI owns a contact center division with more than 600 professionals in its Metro Manila facility and more than 400 professionals in North Carolina and New York. SVI also acquired the New York-based Telemarketing Concepts, Inc. (TCI), which is reported to be ranked as one of the top 50 teleservices agencies in the United States. The objective of this acquisition is to leverage TCI’s telemarketing experience to strengthen SVI’s offshore call center offering.

SourceOne is a Tier-2 American contact center that established its presence in the Philippines through a joint venture with Customer Contact Center (C-Cubed), a local contact center provider. The joint venture, SourceOne Asia, is one of SourceOne’s seven global centers. It services international clients with voice, e-mail, fax and Web support in an 850-seat facility in Eastwood, one of Manila’s newly created Cyberparks.

Sykes established its presence in the Philippines in 1997. The Manila facility was Sykes’ first contact center in the Asian region. Today, Sykes also operates a contact center in Shanghai, which opened in 2001. The two Manila contact centers have a capacity of 1,150 agents, serving primarily Asian countries in a multilingual environment; but it also derives approximately 40 percent of its business from the United States, with expectations for further growth. The Sykes contact center in Manila supports outbound and inbound contacts (i.e., with a majority of inbound contacts), primarily in voice and e-mail support. Approximately 70 percent of contacts are for technical support, and the other 30 percent are for customer service.

TeleTech did not have a direct presence in the Philippines as of March 2002. It has a subcontracting agreement with Vocativ Systems Inc. (i.e., a subsidiary of ePLDT) to be its exclusive provider for three years. The Vocativ center holds more than 700 seats and began operations in April 2002. It will be dedicated primarily to inbound contacts for voice, e-mail and live chat for TeleTech’s U.S. clients.

3.0 The BPO Industry

Gartner Dataquest defines BPO as the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administers and manages the selected process(es) based on defined and measurable performance metrics. Examples of business processes that are outsourced to an ESP include logistics, procurement, HR, finance and accounting, CRM or other administrative or customer-facing business functions (see Figure 3).
Figure 3 represents the traditional way in which enterprises have evaluated the buy-vs.-build decision. "Noncore, yet critical" processes have been most frequently targeted for BPO.

An Enterprise View: Deciding Which Processes to Outsource

- **Core business:**
  - Managing market image or trademarks
  - Caring for patients
  - Find or sell oil and gas
  - Manufacture products

- **Likelihood to outsource:**
  - Low today
  - Future ++

- **Non-core, yet critical:**
  - Accounting
  - Contact center services
  - Human resource administration
  - Claims administration

- **Likelihood to outsource:**
  - Moderate today
  - Future ++++

- **Non-core, non-critical:**
  - Landscaping
  - Cafeteria
  - Laundry

- **Likelihood to outsource:**
  - High today

*Source: Gartner Research*

**Figure 3. The Buy vs. Build Decision Process in BPO**

The market for back-office BPO in the Philippines is less mature than the contact center services, and it is composed primarily of internal back-office processing centers providing services to a parent company. There is a limited number of external BPO providers in the Philippines today, although several IT service providers and contact center providers are in a position to enter this market within the next few months.

The BPO competitive landscape (i.e., defined loosely as internal and external service providers) is comprised of two groups of vendors:

- The internal shared service centers of large U.S. and global corporations, e.g., Caltex, and Procter and Gamble (P&G)
- The IT service companies with data entry capabilities and business process expertise (e.g., SVI and SPI Technologies)

To date, there are a limited number of pure-play BPO providers in the Philippines. This represents an important difference with India, where local or U.S. BPO vendors (e.g., Wipro.Spectramind, Infosys/Progeon, ItAccounts, India-Life, eFunds, iEnergizer and EXLServices) are beginning to actively position themselves as independent providers of back-office processing services.
A third group of players is likely to emerge during the next year. As many contact center companies begin to establish their credibility as third-party providers, they will move into the BPO market to extend their penetration of established clients and increase the usage of their facilities in the daytime (i.e., which are currently only operating at night). However, to do so, they will need to acquire business process experts in accounting, HR and transaction processing.

Ultimately, U.S.-based IT service providers (e.g., Accenture) that have been established in the Philippines for more than 20 years are in a position to grow their BPO presence in the Philippines by leveraging their offshore IT outsourcing centers, if the market demand accelerates.

The Philippines present several potential strengths as a platform for BPO services:

- A low-cost labor pool already with experience in data entry functions and transaction processing tasks
- A pool of qualified labor composed of university graduates that have the “potential” to provide sophisticated transaction analysis
- Accounting systems that are modeled after the U.S. GAAP regulations
- Capabilities in imaging that can be leveraged for transaction processing engagements
- Local IT service providers that can integrate offshore, back-office processing systems with U.S.-based enterprise resource planning (ERP) applications
- Availability of a telecommunication infrastructure for data transfer from the United States through fiber optic networks
- Availability of low-cost facilities in downtown Manila and in technology CyberParks. For example, the established facilities of contact center outsourcing companies could be leveraged in the daytime for BPO services because the contact center activities are only conducted in the nighttime.

Some of the challenges that the Philippines may face in expanding its BPO presence include:

- The immaturity of the BPO market in the United States will limit the demand for large-scale offshore BPO services, except for the transaction-intensive processes in specific industries (e.g., insurance and banking).
- The BPO sales process involves a high-touch, consultative approach, which requires a local presence in the United States to manage the front-end aspects of BPO (i.e., business process modeling, change management and transfer of knowledge).
- The level of confidence from U.S. clients is still a source of concern with regard to the Philippines in the areas of security and political stability.

The opportunity for the Philippines to leverage its skills in accounting and transaction processing is twofold:

- The Philippines could become the preferred platform for internal shared services centers (i.e., following the model of Caltex and P&G)
- The Philippines could stimulate the emergence of a local outsourcing industry providing back-office processing services to multiple clients in the United States.

The first opportunity is easier to target in the short term, and it follows the life cycle of business process sourcing in the United States. Indeed, even in the United States, companies started by established
internal shared service centers and only began to outsource comprehensive back-office processing toward the mid-1990s. The Filipino Department Of Trade has a demonstrated track record of helping companies with getting their back-office up and running quickly (i.e., approximately 90 days for P&G). The Philippines has an established base of U.S. multinationals — particularly in the manufacturing sector — that might be interested in setting up back-office operations in the country. These companies are already familiar with the Philippines and can appreciate the quality of labor and infrastructure available to them. However, the real decision-makers for locating shared services offshore are usually in the United States; therefore, a commercial presence in the Philippines does not necessarily translate into interest for locating back-office operations in the country.

The opportunity for creating a local outsourcing industry would require building a front-end presence in the United States for marketing and selling BPO, which could be the result of organic growth, acquisitions or partnerships. In addition, the creation of an industry association of BPO companies, similar to the contact center association, could stimulate the development of new companies in this market.

There are several examples of back-office processing operations in the Philippines, and the following list is not meant to be comprehensive.

- Caltex, the downstream energy distribution company created by the joint venture of Chevron and Texaco, established its Filipino back-office operations in downtown Manila in 1999. The unit now employs 200 people, focusing on finance (i.e., payroll, disbursements and corporate accounting), IT, HR and internal audit. Caltex also has a small team of internal consultants working on complex business process re-engineering projects (e.g., initiatives in e-procurement or call centers). All of the Caltex employees in the Philippines, with one exception, are Filipino nationals with several years of experience in the banking and auditing industries. Approximately 75 percent of the finance staff are CPA’s.

- P&G established its Filipino back-office operations in downtown Manila in September 1999. It is one of P&G’s three worldwide, shared service centers (i.e., the other two are in Cost Rica and Newcastle, U.K.). The Manila center serves P&G’s Asia-Pacific subsidiaries primarily (i.e., except for a pilot IT project for the United States) and employs a staff of 440 people in finance and accounting, HR and IT.

- SPI Technologies is also a leading IT service provider in the Philippines. Although SPI is not delivering full BPO services today, it is involved in content conversion and transcription services, in addition to more sophisticated IT service implementations.

- SVI is a leading IT service provider in the Philippines with a staff of 11,000 employees. SVI has a BPO unit of 1,500 professionals involved in data entry, database content conversion and build-up, document imaging and indexing, image archival, accounts payable/accounts receivable reconciliation, supply chain reconciliation, order entry and tracking, and customer billing. Although most of SVI’s BPO clients are domestic (e.g., the National Home Mortgage Finance Corporation), SVI is developing prospect relationships with large U.S. companies to deliver BPO in an offshore environment.
Table 1: Sample Labor Pool Statistics

<table>
<thead>
<tr>
<th>Labor pool</th>
<th>380,000 university graduates per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of graduates:</td>
<td>380,000</td>
</tr>
<tr>
<td>Business Administration &amp; Bachelor of Arts and Science</td>
<td>127,000</td>
</tr>
<tr>
<td>Mass communication:</td>
<td>4,500</td>
</tr>
</tbody>
</table>

Source: BOI

Table 2: Sample Statistics for Contact Center and BPO in the Philippines

<table>
<thead>
<tr>
<th>Wage rate for contact center agent</th>
<th>$200 — $300 per month (i.e., entry level)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$300 — $380 per month (i.e., with some type of vertical expertise)</td>
</tr>
<tr>
<td>Wage rate for accountant</td>
<td>$300 — $500 per month</td>
</tr>
<tr>
<td>Wage rate for accounting clerk</td>
<td>$150 — $200 per month</td>
</tr>
</tbody>
</table>

Source: BOI and CFP

4.0 Application Services

During the past decade, offshore service offering options of application services have continued to evolve with regard to their adoption and acceptance among U.S. clients. In the late 1990s, these options were in their infancy and began gaining more “mind share” of IT staffs as significant year-2000 initiatives were gearing up. This move continued forward and gained more traction through technology booms, e.g., client/server computing and enterprise resource planning (ERP). An examination of the current state reveals that some Indian IT service providers are enjoying high growth rates in a down economy, compared to many similar Philippine vendors, which generally experienced flat growth rates. With approximately 80 percent to 95 percent of total revenue, India dominates the market; and Gartner predicts that it will continue to dominate the offshore market for application services to U.S. buyers. India will retain its lead; however, for specific areas, the Philippines can emerge as a niche player by carving out specific roles for certain services.

Consequently, enterprises must examine how the Application service offerings are defined and — more specifically — the current state of the market in the Philippines along with opportunities for the future.

4.1 A Definition of Application Services

The definition of application services is the provisioning of all or part of the work effort from a third party. These application services include:

- Application development
- AO
- Applications management outsourcing (AMO)
- Data or code conversion
Migration
Application integration
Legacy extension
Portfolio renewal

The distinction between AO and AMO is that AO can refer to the maintenance and upgrade of legacy applications or the development of new applications. AO will often involve the transfer of people and application software to the AO vendor.

AMO is the ongoing maintenance, management, conversion, enhancement and support of an application portfolio by a third party. AMO includes changes that generally take less than some predefined period of time (e.g., 10 days to 30 days) to implement.

Examples of maintenance include regulatory changes, software upgrades or new release installations and “fix it if it breaks” troubleshooting. AMO does not imply anything about the delivery of the applications. These typically continue to be hosted at the client site or at an outsourcing vendor’s facilities. AMO may involve the transfer of people and application software to the AMO vendor.

Examples of companies operating in the application services market include native Filipino vendors (e.g., SVI, Trend Micro and WeServ) as well U.S. providers with application services resources in the Philippines (e.g., Accenture and Headstrong).

4.2 The Current State

The following represents a summary of the key characteristics of the current environment and landscape for AO services in the Philippines:

- **Heritage** — The Philippines have been in the application services market for more than 25 years. There are several service providers that have been operating with a long-term presence. In addition, there has also been a long heritage of supplying programmers. This heritage serves to place the Philippines as a consistent presence on the short list of many enterprises as a destination country for evaluation.

- **Labor pool** — The skilled labor pool statistics as presented in the country-specific section of this report describe a major reason for the level of buyers exploring options in the Philippines.

- **Skilled labor** — The excellent educational training and background is also another demonstration of the Philippine market’s strength.

- **Less emphasis on the Capability Maturity Model (CMM)** — The Philippines does not put as much emphasis on CMM certification and the rigorous adherence to quality standards as its counterparts in India. A majority of the ESPs in the Philippines are Level 3. The general approach of the majority of vendors is that additional investment in more rigorous standards does not yield an incremental benefit as it is not recognized as valued by the buyer. However, due to the “trust” hurdle that must be overcome with U.S. buyers of offshore services, a certain limited “certification” standard has served to help overcome fear, uncertainty and doubt.

- **Competitive pricing structure** — The Philippines provides competitive wage rates for AO services, particularly the service rates for programmers (see Figure 4).
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### Figure 4. Philippine Service Rates — Programmers

Another aspect of the Philippines AO services includes the competitive salaries for systems analysts (see Figure 5).

<table>
<thead>
<tr>
<th>Systems analyst years of experience:</th>
<th>Local salary (monthly):</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 2</td>
<td>$500 - $700</td>
</tr>
<tr>
<td>3 - 5</td>
<td>$700 - $1,000</td>
</tr>
<tr>
<td>6 - 9</td>
<td>$1,000 - $1,500</td>
</tr>
</tbody>
</table>

Source: Philippine Government

### Figure 5. Philippine Service Rates — Systems Analyst

Yet another aspect of the Philippines AO strength is the salaries for project managers (see Figure 6).

<table>
<thead>
<tr>
<th>Project manager years of experience:</th>
<th>Local salary (monthly):</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 2</td>
<td>$700 - $825</td>
</tr>
<tr>
<td>3 - 5</td>
<td>$825 - $1,150</td>
</tr>
<tr>
<td>6 - 9</td>
<td>$1,150 - $1,875</td>
</tr>
</tbody>
</table>

Source: Philippine Government

### Figure 6. Philippine Service Rates — Project Manager

- **Staff augmentation vs. discrete projects or outsourcing** — The Philippine AO market delivery to the United States buyers is still much more skewed toward staff augmentation and supplying contract programmers than moving toward delivering services through discrete project-based contracts or longer-term outsourcing contracts for application maintenance or management.

- **Indirect vs. direct sales** — A large number of Philippine ESPs have focused on working through other U.S.-based ESPs as subcontractors — thus, functioning as an indirect source of services — rather than contracting directly with buyers. As a result, it is difficult for the ESPs to provide references and directly demonstrate a track record.

- **Low name recognition** — The combination of the indirect nature of the business model as well as the staff augmentation delivery mechanism leaves the Philippine ESPs with limited name recognition among U.S. buyers.
5.0 The Animation Industry

The animation industry in the Philippines is going through a crisis after years of growth. The industry is facing three simultaneous forces:

- A slow down in demand from the large U.S. studios Increasing competition from lower cost Asia/Pacific neighbors (e.g., China, Korea and India)
- Transitioning from low-end cell animation (i.e., labor intensive) to high-tech, 3D end-to-end animated film delivery capability
- The industry valued at US$21 million annually (i.e., last year’s exports) is currently centered on “the Animation Council of the Philippines” and consists of 23 studios employing approximately 4,000 artists.

The animation provider landscape is composed of three primary groups of vendors:

- The in-house animation studios, dedicated to the parent company (e.g., Japan’s TOIE)
- The American or international studios in the Philippines, e.g., Philippine Animation Studio, Inc. (PASI) and ImagineAsia
- The Filipino studios (e.g., Phil Cartoon, Animasia, Animates and Artfarm)

The main competition today is between the U.S. or International studios and those set up by local Filipino promoters with the former enjoying an edge due to their knowledge and representation in the market. Although both offer animation facilities for hire, there are areas for cooperation in training and filling short-term supply gaps for large projects. With increasing competition from Korea, China and India, local Filipino studios will have to invest more in the United States to attract business to the Philippines, as the international studios already are beginning to enjoy the privilege of exploiting multicountry studios.

The Philippines presents several advantages as a location for animation studios:

- The Filipinos are traditionally a very creative and artistic people. Although animation is not taught in schools, there is a vast pool of highly skilled, creative and low-cost cell animators.
- An American English-speaking labor force is a key advantage, allowing for nuances to be understood and incorporated into the animation, which is very important when creating animation content for foreign markets.
- A strong affinity to the American culture: beyond the language factor, the Philippines education system was strongly influenced by the American occupation during the 1900s, which creates an awareness and interest in American culture among the Filipino population.
- Availability of telecommunication infrastructure
- Availability of facilities
- Government incentives

However, the Philippines may face challenges in growing the animation industry in the long term due to several factors:

- The creative ability of the people needs to be harnessed and channeled in the right direction. Currently, most animators are self-taught. The government needs to introduce more courses and labs
in elementary schools, and offer counseling (i.e., through colleges and universities) for career choices (i.e., none are available today).

- The availability of power and telecommunication infrastructure is high in Manila downtown but lower in other parts of the country. Thus, there is a need for new infrastructure investments in areas favored by animations companies. Access to reliable power is still problematic in most areas where animation companies have chosen to locate, which requires companies to invest in back-up generators and T1 lines in all their locations. In some areas, even T1 lines are not possible. Large bandwidth is particularly important in the animation industry due to the size of graphics and full-motion video files.

- Although it is fairly easy to find qualified “cell” animators today, there is a dearth of qualified digital animators and 3D animators. This is cause for serious concern if the government does not work with the education board to plan for the future.

- The Philippines also faces a severe resource crunch in trained and experienced post-production talent. To move up the value chain, the Philippines needs to offer the ability to create end-to-end animated films for the international market in cell and 3D versions.

- The level of confidence from U.S. clients is still low with regard to the Philippines in the areas of security and political stability, which is more a result of concern about potential delays in delivery rather than infrastructure issues.

- Lack of a strong, motivated coordinating body to represent the industry at the government level as well as the international level. Cooperation among vendors and an association to register animators will help the industry tremendously in lean and boom periods.

There are a number of animation companies in the Philippines, and the following is a representative sample rather than an exhaustive list.

- Animasia Inc. — Animasia is a digital production house that was set up in 1993. It specializes in digital interactive multimedia production for corporate and institutional, marketing and training and other applications. Animasia has also produced games for pre-school children aged three to six. It has also been contracted to create a CD for Entrepreneurs for the Asian Institute of Management (AIM).

- ArtFarm Asia — ArtFarm Asia is an animation training operation and service provider that makes use of IT and other technologies to create content for various media. ArtFarm develops original content for business, education and entertainment applications.

- Avalon Interactive Inc. — Avalon Interactive is a multimedia services company. It provides practical and innovative multimedia-based solutions using industry-standard tools and distribution media. Avalon’s focus is to approach work from a client’s perspective and ensure a close working relationship with clients in promotion, communication or training.

- Digital Multimedia (DIGIMAC) — DIGIMAC is an authorized Apple and Canon training center in the Philippines. DIGIMAC provides training and seminars on popular multimedia software in graphic design, desktop or e-publishing, animation, Web development and digital video editing.

- Ecommsite Solutions Inc. — Ecommsite Solutions offers services in the areas of BPO, application system development, database design and management, animation and graphics.

- EEI-TOEI 1 Animation Corporation — TOEI is a 100 percent Japanese-owned company responsible for producing the majority of Anime series being aired worldwide. TOEI has trained a significant
number of artists to develop animation very specific to the Japanese market. TOEI counts the following titles among its accomplishments: Dragon Ball Z, Transformers, G.I. Joe and SailorMoon.

- **Fil-Cartoons Inc.** — Fil-Cartoons offers services ranging from layout, animation, clean-up and digital background, as well as scanning to pre-compositing, which is creating an image by combining two or more components (e.g., two different image sets or image and sound). The studio has been involved in television series and theatrical productions; and it has animated more than 60 half-hours of TV animation annually for clients located in France, England, Germany, Canada, Australia and the United States.

- **Greatoons Creative Studio** — Greatoons provides 3D animation from layout to production.

- **Holy Cowl Animation** — Holy Cowl is a full-fledged animation house specializing in the production of TV commercials for local and the Asia/Pacific markets using state-of-the-art software and hardware, which include Softimage for 3D and USAnimation for digital ink and paint. It also produces animated series, shorts and specials.

- **ImagineAsia Inc.** — ImagineAsia considers itself to be a pioneer in 3D animation and was set up more than five years ago, with the goal of becoming a complete end-to-end, full-service 3D animation studio. ImagineAsia employs more than 200 full-time animators and has a full-service studio in the Philippines (i.e., it claims to be the only one with a motion-capture studio in Los Angeles). ImagineAsia focuses on producing its own properties and offering its services in large studios in the United States.

- **PASI** — PASI was among the first animation studios to have set up operations in the Philippines twelve years ago (i.e., in 1990). Throughout the years, it has produced several episodes for the U.S. marketplace, focusing on cell animation; and it also offers end-to-end expertise in producing films. Currently, 98 percent of all PASI’s business originates from the United States and Canada. PASI prides itself in being a full-service animation house and employs more than 300 people during peak capacity.

- **Peg Bar Animation** — Formed in 1998, Peg Bar is one of the pioneers of the Philippines animation industry and provides high-quality animation services to the industry. Peg Bar has co-produced two independent animation shorts with the National Centre for Computer Animation (NCCA).

- **Philippine Guild of Digital Technology** — The Philippine Guild is an association of animation firms that promotes the work of member companies and gathers a database of prospective members.

- **Quanxi Communications Inc.** — Quanxi offers services ranging from English to Chinese translation, 2D and 3D animation, Web development and call center operations. Its clientele includes multinational companies and local firms with global perspectives in the fields of mobile operation, advertising, movie production and banking.

- **ToonTime Animation Studio** — Toontime Animation Studio is a total animation studio that supports multimedia education, entertainment and related industries locally and internationally. Toontime was set up in 1995 and, since then, has been engaged in sub-contract unit production of TV series and cinema animated features with exceptional expertise in character designs and 3D animation.

- **Top Draw Animation** — Launched in 1999, Top Draw offers full studio services ranging from development of storyboard, location, design, character and prop design, color and styling, background color key, lay out, scanning, and ink and paint. Top Draw relies on a small number of experienced full-time employees and a pool of 400 contractor artists. Top Draw counts among its successes the
award-winning production of Kampung Boy. In the future, Top Draw is planning on participating in the co-production market through international partnerships.

- **Top Peg Animation & Creative Studio Inc.** — Top Peg Animation is a creative studio and specializes in animation and design. Top Peg is an all-Filipino company that aims to promote the talent and creativity of Filipino artists and quality workmanship, locally and globally.

### 6.0 The Transcription Services Industry

Although the Filipino people show strong skills in transcribing American spoken English, the transcription services industry is significantly smaller than many other IT services sectors. The industry has already been through the cycle of over capacity and price undercutting due to low entry barriers, leading to a quality slump and a loss of confidence for clients. Having undergone this shakeout, the Philippines is reemerging as a favored destination for transcription services. Although the numbers are small now with approximately a 1,000-seat capacity, the industry is trying to organize itself and has formed an association to address capacity issues and consolidation. The creation of the Medical Transcription Association will also ensure co-operation between providers, and should regulate and assist in maintaining quality and cost at sustainable levels. Although a finite opportunity — as speech to text software becomes more sophisticated — there is still a significant market in the medical and legal transcription businesses.

There are only a few vendors in this market — all of whom rely on intermediaries in the United States to pass on business — and none of them have a direct presence there. To remain competitive, the industry must control its development to avoid quality problems and undercutting. Medical transcription is priced per line of speech converted into text (e.g., typically around $0.10 to $0.15 per line). There is significant temptation for small shops to undercut on price just to get business, but this eventually leads to a loss of quality and buyer confidence. The industry must also define standards and promote awareness of possible revenue-earning extension of medical personnel, especially in the nursing industry within and outside the country.

### 7.0 Conclusion

The Philippines has significant potential to improve its position through a variety of opportunities, including:

- **Evolve offerings** — One of the keys to the success story of the Indian ESPs providing application services in the United States is the shift from “body shopping” or contract programming to end-to-end services. Thus, it is clear that global sourcing with a hybrid delivery model of “on-site/offshore” virtual teams will be the new IT paradigm for providing application solution services. As a result, the Philippine ESPs must focus on building the operational models to deliver in this manner.

- **Shift from indirect to direct** — One of the most critical factors for success in the services business is a track record and references. As a result, the ability to demonstrate this to prospective buyers by having a direct relationship is an area that must be a focus for Philippine ESPs.

- **Connect with other countries** — There are clear opportunities for the Philippine application sector to create synergies with China. The key areas of strength for the Philippines are a source of weakness and need for China and vice versa. Language skills and knowledge of U.S. culture, where Filipinos excel, is a much-needed area of development for China. China can offer a larger pool of labor and larger markets that can clearly open new doors for the Philippines. This would be an interesting
combination and create important synergies. There is also a potential to partner with India IT service and BPO companies on an operational level, and leverage their experience and global reach.

- **Connect with large global ESPs** — The movement in the market is that large global ESPs are seeking to establish capabilities overseas to “extend” their offerings. These efforts are primarily focused in Asia/Pacific with some small efforts in Latin America. This — along with increasing interest in outsourcing overseas — will foster a new wave of mergers and acquisitions in the AO market, as the large global vendors acquire smaller local firms that can provide strong skills and an abundant labor pool at a cost-efficient price.

Ultimately, Gartner sees potential for the Philippines to become a contender in the IT services market within the next five years, particularly for BPO and contact center services. Its capabilities in call center outsourcing and its skills in back-office finance and accounting position the country to address the emerging demand for offshore BPO while there is still no “country of choice” for U.S. enterprises. The Philippines can seize this opportunity to create a presence in a number of niche portions of these service sectors. Gartner does not expect the Philippine success story to happen overnight, particularly because other countries (e.g., India) are aggressively targeting the BPO market and already have a strong hold on the application services market. To become a leader, the private sector and the government will need to continue their efforts — and enhance them — toward common goals. During the next few years, how the Philippines responds to changing geopolitical events, emerging competition and the need for more brand equity for Filipino vendors will determine whether it capitalizes on its infrastructure and its talent.
## Appendix A: Acronym Key

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AO</td>
<td>Application outsourcing</td>
</tr>
<tr>
<td>AIM</td>
<td>Asian Institute of Management</td>
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<tr>
<td>AMO</td>
<td>Application management outsourcing</td>
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<tr>
<td>BOI</td>
<td>Board of Investment — Department of Trade &amp; Industry (division of the Philippine Government)</td>
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<tr>
<td>BPO</td>
<td>Business process outsourcing</td>
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<tr>
<td>C-Cubed</td>
<td>Customer Contact Center</td>
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<tr>
<td>CFP</td>
<td>Contact Federation Philippines</td>
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<tr>
<td>CMM</td>
<td>Capability Maturity Model</td>
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<tr>
<td>CRM</td>
<td>Customer relationship management</td>
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<tr>
<td>DIGIMAC</td>
<td>Digital Multimedia</td>
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<tr>
<td>ESP</td>
<td>External service provider</td>
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<tr>
<td>GAAP</td>
<td>Generally accepted accounting principles</td>
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<tr>
<td>HR</td>
<td>Human resources</td>
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<tr>
<td>IPP</td>
<td>Investment Priorities Plan</td>
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<tr>
<td>ITC</td>
<td>Information technology and communication</td>
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<tr>
<td>ITECC</td>
<td>Information Technology and E-Commerce Council</td>
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<tr>
<td>ITH</td>
<td>Income Tax Holiday</td>
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<tr>
<td>MNC</td>
<td>Multinational corporation</td>
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<tr>
<td>NCCA</td>
<td>National Centre for Computer Animation</td>
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<tr>
<td>P&amp;G</td>
<td>Procter &amp; Gamble</td>
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<tr>
<td>PASI</td>
<td>Philippine Animation Studio, Inc.</td>
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<tr>
<td>PEZA</td>
<td>Philippine Economic Zone Authority</td>
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<td>PLDT</td>
<td>Philippine Long Distance Telecom</td>
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<tr>
<td>SPI</td>
<td>SPI Technologies</td>
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<tr>
<td>SVI</td>
<td>Software Ventures International</td>
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<tr>
<td>TCI</td>
<td>Telemarketing Concepts, Inc.</td>
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<tr>
<td>VSAT</td>
<td>Very small aperture terminal</td>
</tr>
<tr>
<td>VSI</td>
<td>Vocativ Systems Inc.</td>
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