Philippine Off-shoring and Outsourcing (O&O) industry: Facing global challenges today

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CEO
Business Processing Association Philippines

Business Processing Association of the Philippines

- Private sector-led organization representing all sectors of the BPO and IT-Enabled Services (ITES) industry and their support industries
  - BPO
    - Voice
    - Non-voice (e.g.F&A, HR)
  - IT services
    - Software development
    - System integration
    - Animation
  - Engineering / R&D services
  - Allied industries (Property, Telecom, Staffing/Training Consultants, Systems integrators
- Created to give the Philippine BPO industry a single point of contact for the world; one-stop information and advocacy gateway
- 210 company members and 5 association members (CCAP, PSIA, MTIAPI, ACPI, GDAP).
- Full-time management team leading the execution of all initiatives

BPAP®

Business Processing Association PHILIPPINES

Off-shoring and outsourcing (IT-BPO) involves IT applications, business process, and design/engineering services

Outsourcing and Off-shoring (O&O) Services: Three main sectors

1 IT applications services (ITO)

Application development and maintenance
- Application development
- AD integration and testing
- Application Maintenance

System Integration
- Analysis
- Design
- Development
- Integration and testing
- Package implementation

IT Infrastructure Services
- Help desk
- Desktop support
- Data centre services
- Mainframe
- Network operations
- IT consulting

Software product development
- New product development
- System testing
- Localization/Support
- Gaming

2 Business process services (BPO)

Horizontal processes
- Contact centers
- Human resources
- Finance and accounting
- Supply chain (procurement, logistics management)

Industry/vertical processes
- Banking and insurance
- Telecom
- Public sector
- Utilities
- Health care
- High-tech
- Oil & Gas
- Consumer products

KPO
- Business research, financial research
- Animation
- Data analytics
- Legal process and patent research
- Other high-end processes

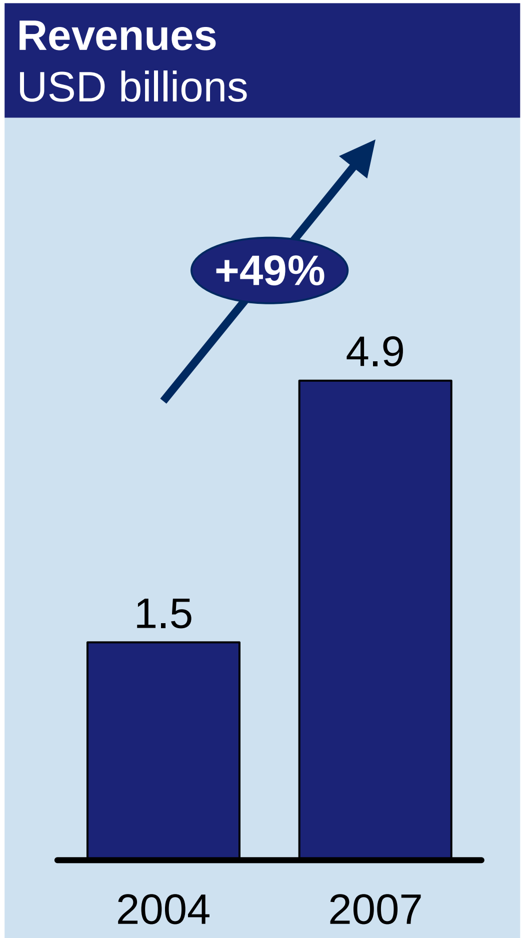
3 Engineering services (ESO)

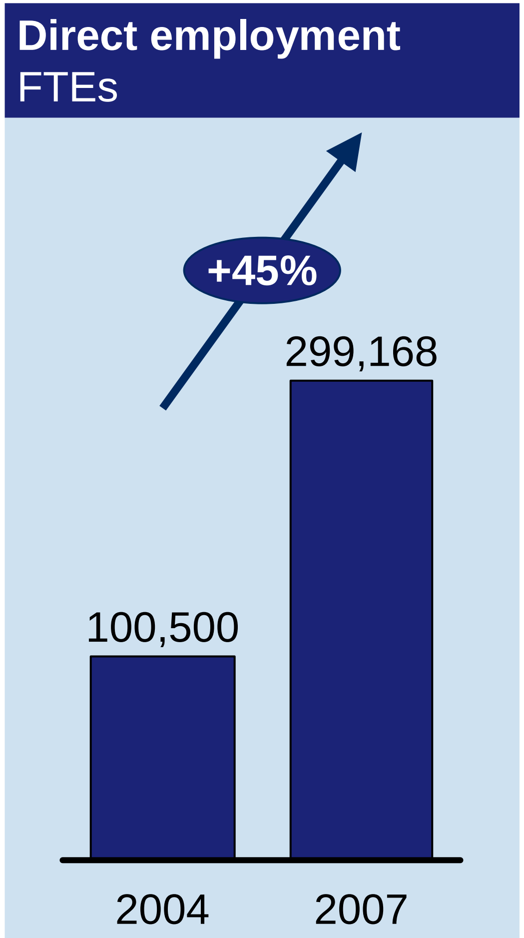
Manufacturing Engineering
- Upstream product engineering
  - Concept design
  - Simulation
  - Design engineering
- Downstream product engineering
  - CAD/CAM/CAE
  - Embedded software
  - Localization
- Plant and process engineering

Architecture design
- Design process
- Building Management models

Source: McKinsey Global Institute; Gartner 2005 database; IDC; interviews

Philippines O&O industry currently has close to USD 5.0 billion in revenues





- **Strong intrinsic skills**
  - **English language**
  - **Cultural affinity to US**
  - **Large pool of talent**
- **Competitive factor costs**
  - **Labor**
  - **Real estate**
  - **Telecom**
- **Best in class incentives**

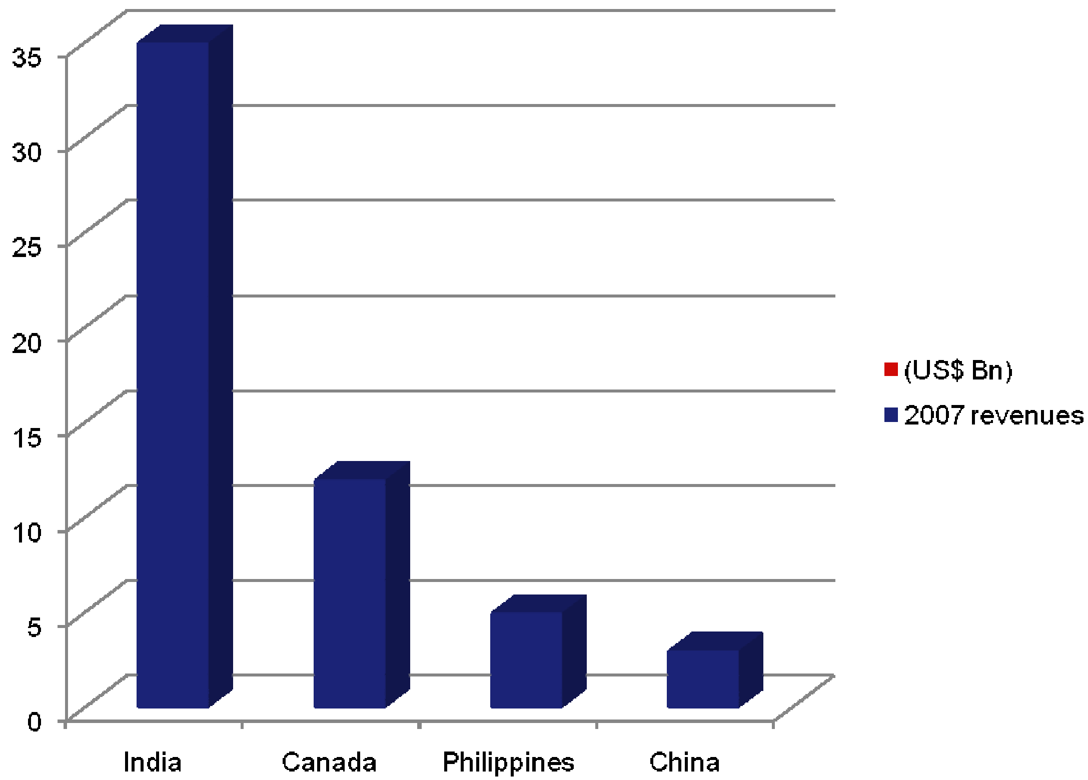
Source: BPAP/McKiinsey Team analysis

Philippine O&O: Growing all sectors at tremendous rate

Sector	2007 Revenues ($000,000)	Past 3 years ave growth
Contact Centre	3,600	52
Back Office (non-voice bpo)	398	46
Transcription (non-voice bpo)	197	24
Animation	105	38
Software	423	35
Engineering/Design Process	152	55
TOTAL Philippine IT-BPO (export only)	**4,875**	**50**

Source: Joint BPAP/BOI/PEZA/CICT Task Force

Philippines now the third outsourcing destination in the world, 2nd outside of North America



- All sectors growing; **Contact centres** is 2/3 of industry and growing 52%/yr over the past 3 years
- **Back-office** services primarily in F&A, HR, Legal and Health services now 15%, growing 46%/yr
- **Software development** is 10% of industry and continues to grow at 35%/yr

Source: Everest research

High
Low

The foundations of the Philippines' success

Key buy factors	Philippines' performance	Key points
1 Suitable and abundant talent		• Considerable pool of generalist and specialist talent • Strong English skills, both verbal and written
2 Operational performance		• Among the lowest in labor costs • Genuine global reputation in voice with multiple signature locators
3 Quality infrastructure		• World-class telecommunications • Abundant and low-cost real-estate in major urban areas • Accessibility
4 Conducive business environment		• Competitive incentives (e.g., income tax holiday) • Specialized programs addressing near-term issues (e.g., near-hire voucher program) • Local governments and national government supportive

Source: BPAP/McKinsey Team analysis

The Philippine talent value proposition: Large pool of English-speaking talent

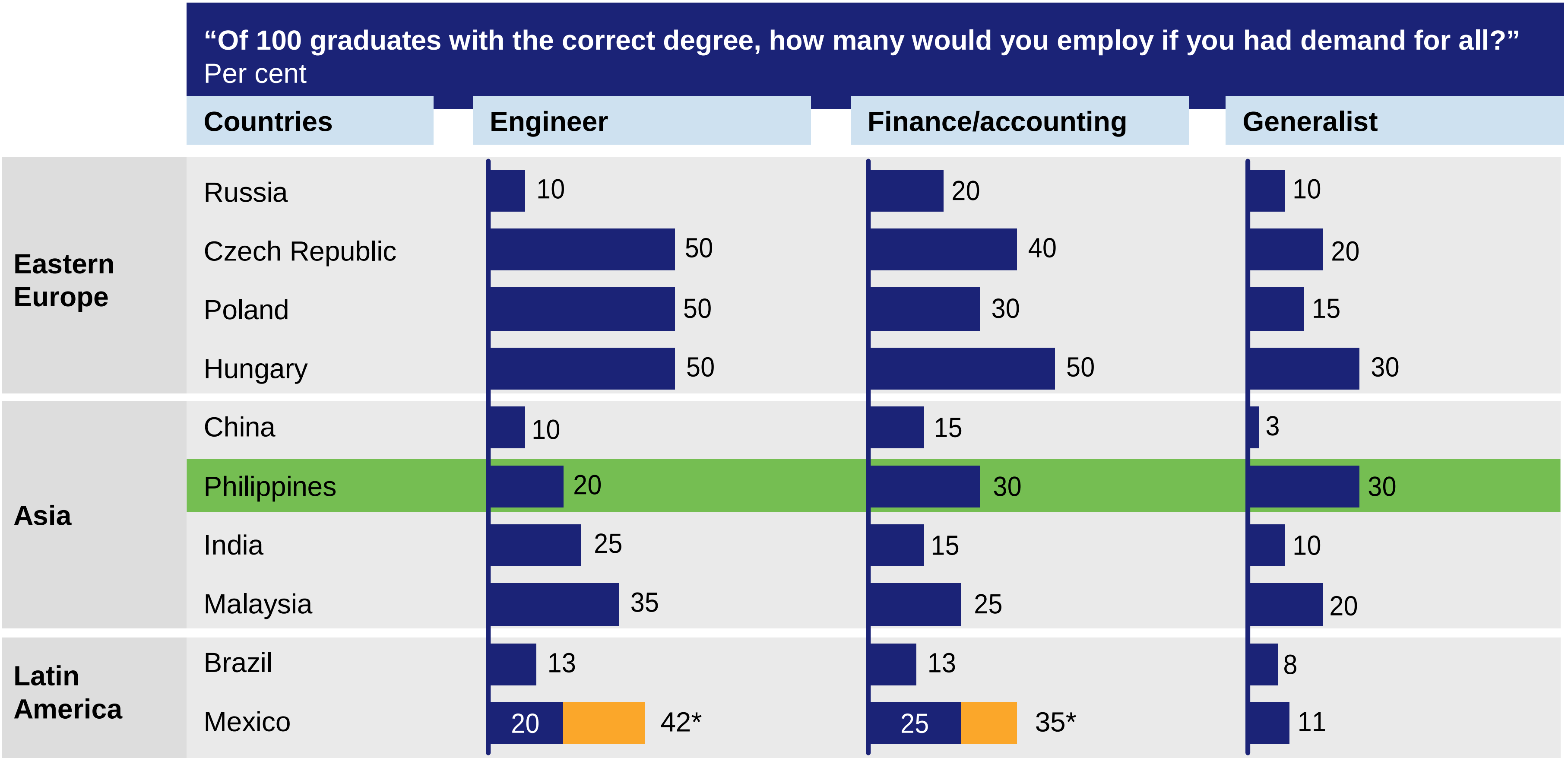
Number of college degree graduates	2007	Annual growth
Business & Accountancy	128,000	
Engineering & Tech	55,752	
IT-related courses	42,047	
Architecture	3,100	
Medical Sciences	31,400	
Fine Arts/Humanities	7,660	
TOTAL Tertiary level	**454,818**	**3.8%**

Over 400,000 college-degree graduates annually out of 90 million population and a 36 million size labour force with literacy rate of 92.6%

	Pop	Labour force	Unemp rate	Literacy
World	6,602M	3,400M	6.3%	82.0%
India	1,130M	509M	7.8%	61.0%
China	1,322M	798M	4.2%*	90.9%*
Brazil	190M	96M	9.6%	88.6%
Philippines	90M	36M	7.9%	92.6%

Source: Phils Comon Higher Education : CIA World Factbook 2007; *China data for unemp and literacy is major Cities only

The Philippine talent value proposition: Quality



Suitability rates are empirically based on a total of >80 interviews with HR professionals working in each country

* Mexico is the only country where interview results (higher number) were adjusted ex-post since interview base was thinner

Source: Interviews with HR managers; HR agencies and Heads of Global Resourcing centers; McKinsey Global Institute

Awards and Distinctions

NOA
NATIONAL OUTSOURCING ASSOCIATION

Offshoring Destination of the Year: Philippines

IDC
Analyze the Future

Top 10 Outsourcing Cities in Asia Pacific:
#2 Manila

THOLONS

GLOBAL SERVICES
The gateway to the global sourcing of IT and BPO services

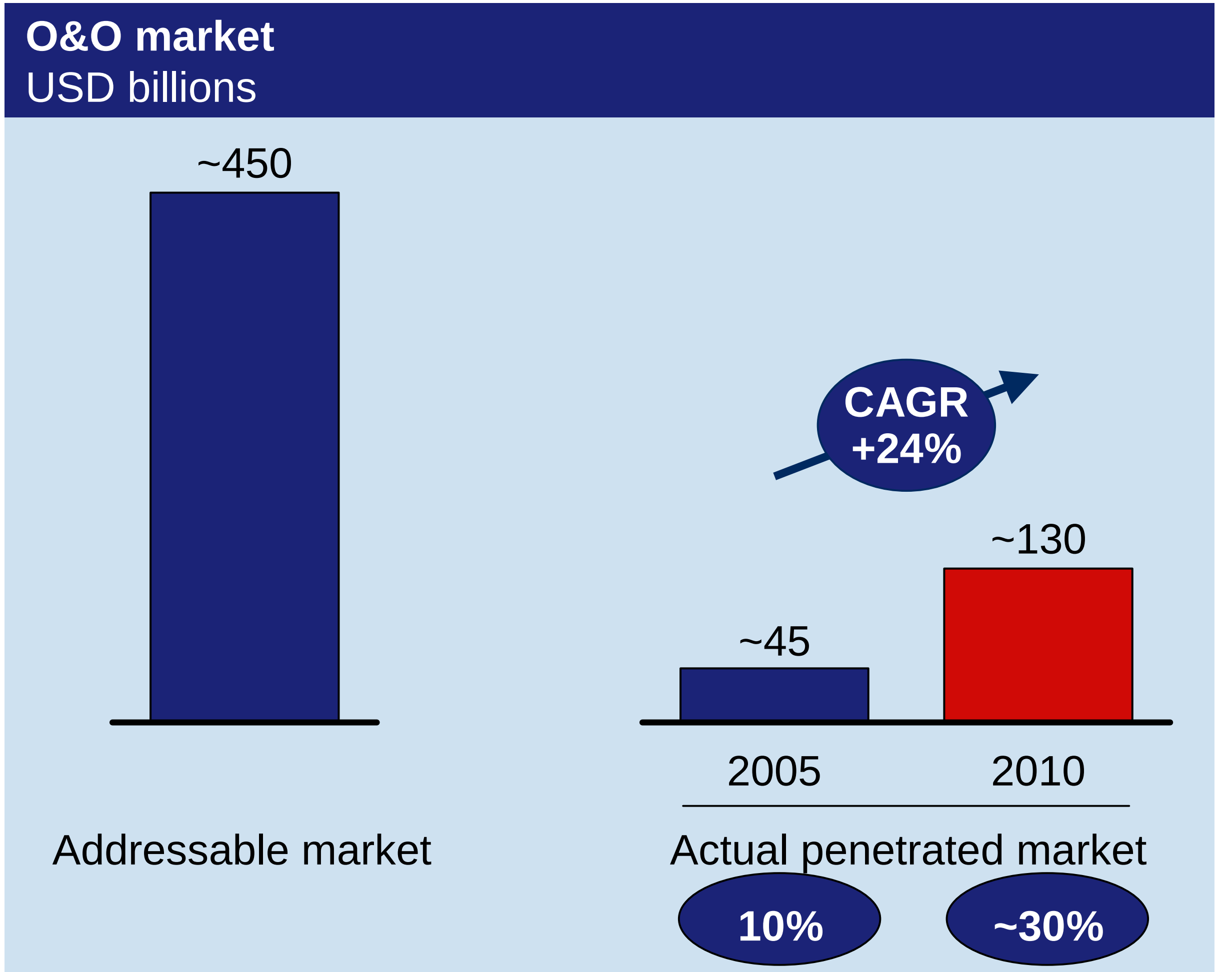
Top 50 Emerging Outsourcing Cities:
#4 Cebu
#23 Pasig
#36 Baguio

FT
FINANCIAL TIMES

fDi
ForeignDirectInvestment

Top 10 Asian Cities of the Future:
#7 Quezon City
#8 Cebu
#10 Davao

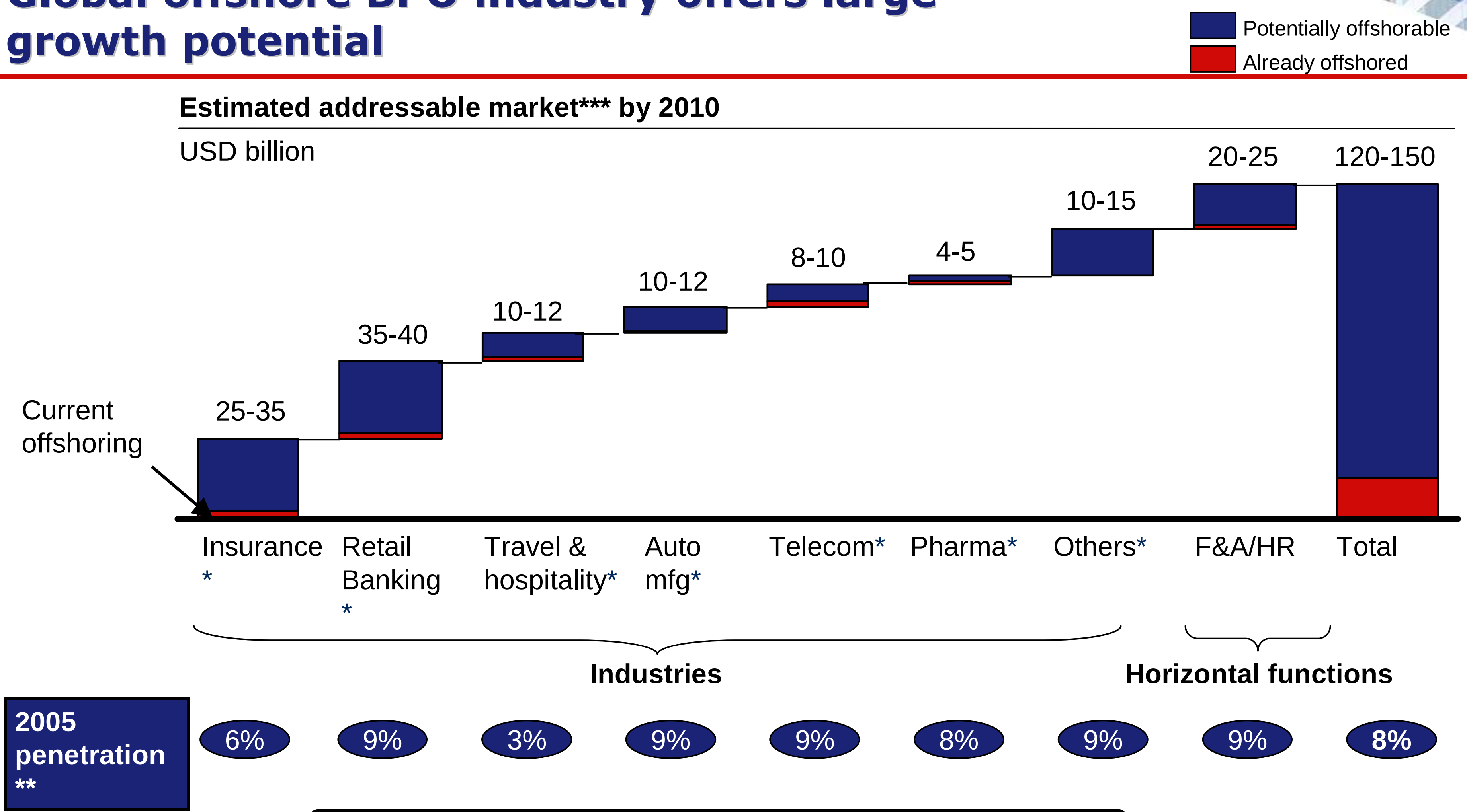
Offshoring and outsourcing is a large and growing market



Source: Team analysis

Global offshore BPO industry offers large growth potential

Estimated addressable market* by 2010**



Innovation can further expand the addressable market

* Including call centres, procurement opportunities; excluding opportunities in horizontals, e.g., F&A, HR

** Proportion of addressable market offshored today; India share assumed as 46%

*** Includes addressable markets in currently offshoring industries

Source: McKinsey Business Technology Office; McKinsey Global Institute; McKinsey Outsourcing & Offshoring practice; Gartner 2005 database; IDC; NASSCOM Strategic Review 2005

Cebu O&O industry has taken off rapidly

	Companies	FTEs
ITO	12	889
ESO	4	191
BPO	36	15,066
Total	52	16,156

- Out of the 15,066 BPO workers, 10,013 are “voice-based” and 3,943 are “non-voice”
- Biggest concentration of O&O workers outside of NCR; about as big as Clark, 1/3 of QC
- Major O&O captives and Service Providers have established strong sites – Sykes, Convergys, eTelecare, Teletech, IBM, PeopleSupport, Accenture
- Major BPO companies like Wipro have set up their first Philippine operations in Cebu

Cebu has good talent pool, far from saturation point

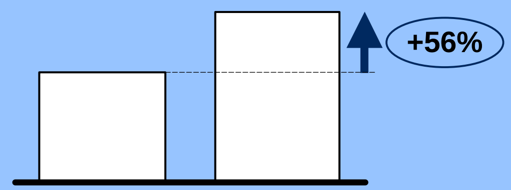
- Over 18,000 College graduates annually
- Abundant pool from O&O-critical courses – Business (8,000+), Engineering and IT (5,600+), Math and Sciences (2,800+), Fine Arts (83), Medical services (2,800)
- Major schools (e.g. USC, USJ-R, etc) are Centres of Excellence for Business ; many Universities already have partnerships with industry
- Can attract workers from Visayas and Mindanao provinces

	Ratio of O&O FTEs/graduates
Cebu	89
NCR	214
Clark	422
Baguio	35
Bacolod	52

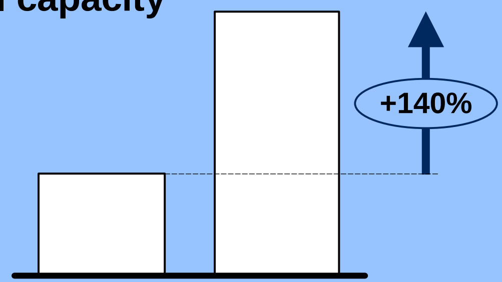
Cebu has many of the ingredients to succeed

- 21 IT Parks and buildings; 2nd largest concentration in the country (NCR is 78)
- World-class Telco infrastructure; fully redundant, managed lines
- About 15% savings in wages versus NCR
- Challenge in fast-tracking development of middle managers to offset cost of importing experienced managers from NCR
- Leadership from provincial and city ICT Councils in such areas as IT education, Telco infrastructure, IT Parks and property development to cater to O&O Industry requirements
- CEDF-IT leading collaborative work with industry associations like BPAP in promoting investments in and over-all mission of the Off-shoring and Outsourcing sector

Median basic pay vs NCR
Pesos/month



Saturation vs NCR
FTEs/theoretical capacity



Industry is supply driven, no visible demand constraints leading to a unique opportunity for Philippines, especially in customer care focused on N. America and N. Asia

Demand:

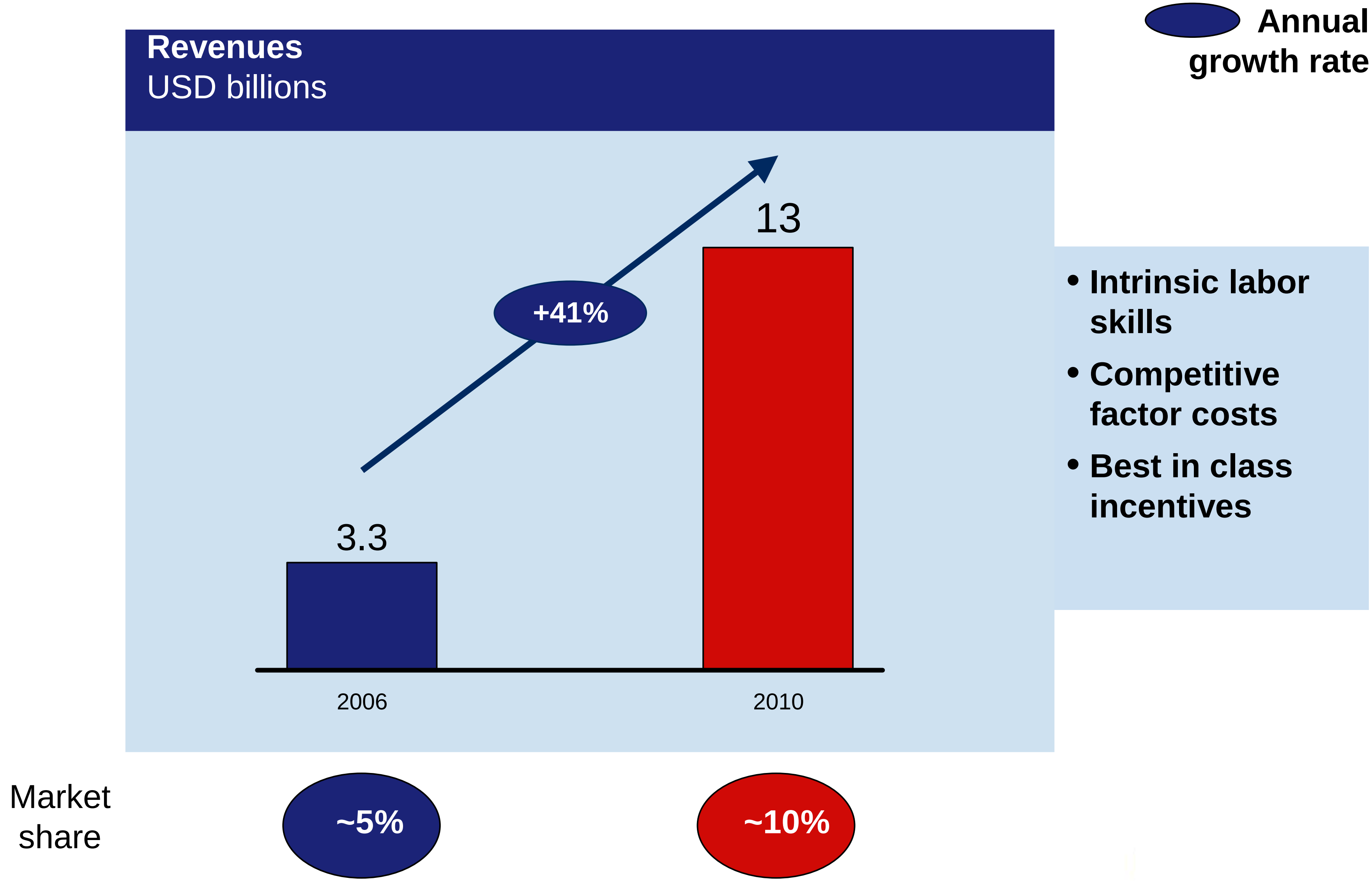
- Only 11% of global addressable market currently captured
- Offshoring and outsourcing sold stories with firms no longer doubting their value
- Offshoring moving away from labor arbitrage to tapping global talent
- Organizations are looking for new processes / services to offshore (e.g., engineering services, R&D)
- New source markets are emerging (e.g., North Asia)

Philippines in a sweet spot to capture more market share

Supply:

- India already facing tremendous pressure on talent and infrastructure
  - Rising salaries and attrition levels
  - Quality issues in "Voice" services
  - Infrastructure bottlenecks
- Competitors still way behind India in BPO and IT services
  - China, Vietnam way behind in English skills,
  - South Africa not very cost competitive compared to Asia so focusing on Europe and UK
  - Philippines has a distinct advantage in English and several fast growth, high skill based slivers (e.g., F&A, Animation)

Our goal is “10% by 2010”



- Intrinsic labor skills
- Competitive factor costs
- Best in class incentives

Source: BPAP Roadmap 2010 Report

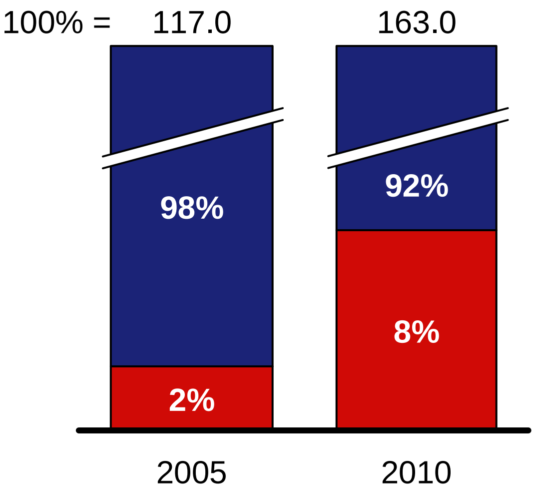
Achieving these aspirations would have a major impact on the Philippine economy

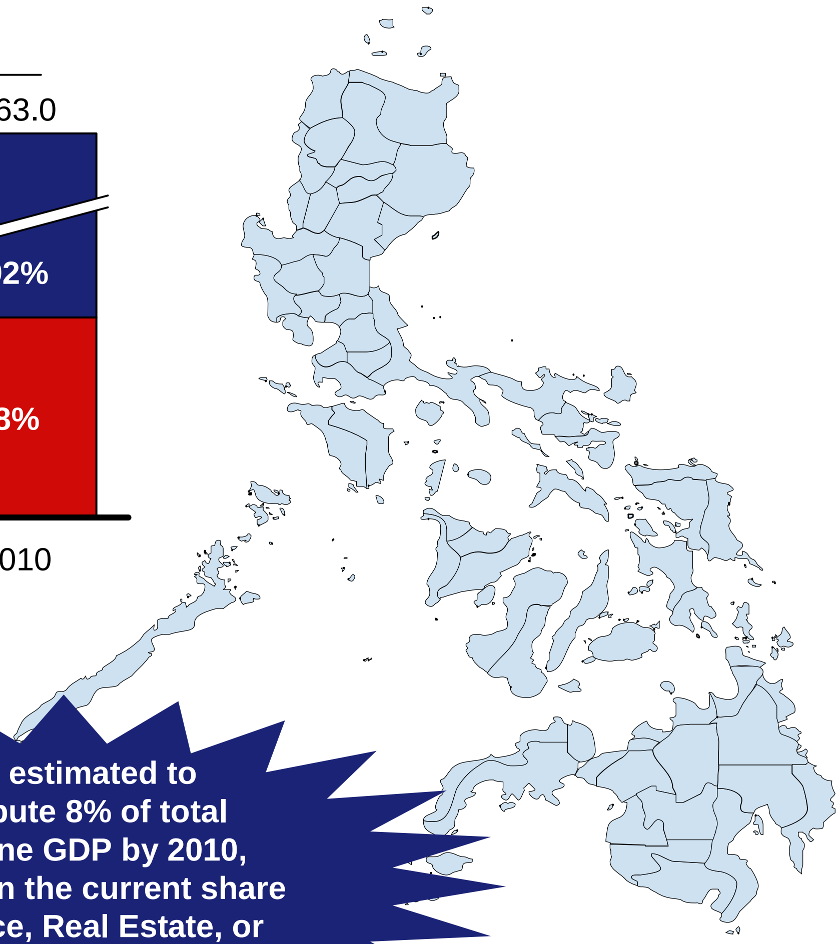
PRELIMINARY

Others

O&O

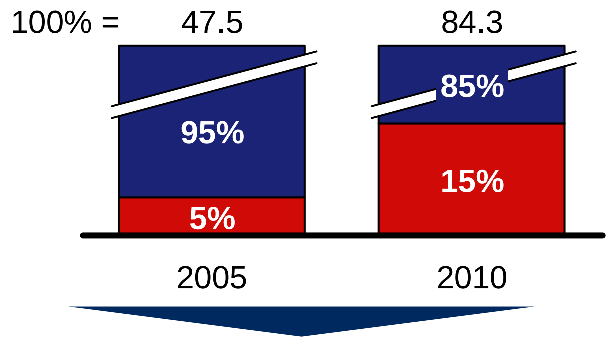
GDP
USD billions





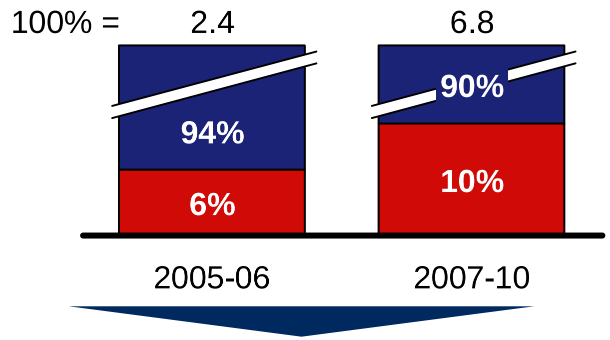
BPO estimated to contribute 8% of total Philippine GDP by 2010, higher than the current share of Finance, Real Estate, or Transportation and Communication

Exports
USD billions



Industry's five year 40% CAGR to outstrip 12% average for exports

Employment creation
Million jobs



Industry to provide one of every ten jobs created in the Philippines in the next 3-4 years

Note: GDP estimates are at 2005 prices and PHP 46.30 (May '07) forex.

Source: NSCB Economic Accounts; NEDA-MTDP; team analysis

The same key drivers of the industry are our own challenges

- Talent
- Business Environment
- New sites for expansion

Inability to meet these challenges can seriously affect our competitiveness

Challenge #1: Can talent supply be sustained?

	Factors affecting the supply of employees
Availability	• Lack of funding and perceived low pay-out on education are resulting in high fall-out rates – Only 40% of all students entering grade one complete high school – Only 60% of high school grads enroll in college, only 60% graduate
Suitability	• Applicants' skill levels do not meet work requirements • Insufficient English proficiency for work with MNCs • Yields in 6-10%
Willingness	• There is a negative perception of O&O industry employment as only "call center" work
Accessibility	• Most players are in Metro Manila and recruitment has mostly been in NCR • Metro Manila (MM) has 42% of graduates, but 82% of BPO employment • Around 40% of graduates in MM are recruited to the industry, compared with only ~6% of graduates outside MM
Stickiness	• There is a high exit rate in the industry (~18% annually) • Lack of "stickiness" due to absence of clear career growth path

Source: BPAP Research and Interviews; Department of Education (Dep Ed); Commission on Higher Education (CHED); McKinsey Global Institute (MGI); Business Processing Association of the Philippines (BPAP)

Challenge #2: Can we create the right environment for industry growth

Key issues in the Philippines business environment

1. Lack of institu-tional framework during set-up
2. Weak risk perception
3. Mixed messages on government support

Three key intervention areas

Public policy
- Can incentive regime be sustained
- Labour laws supportive?
- Can we implement data protection regulation

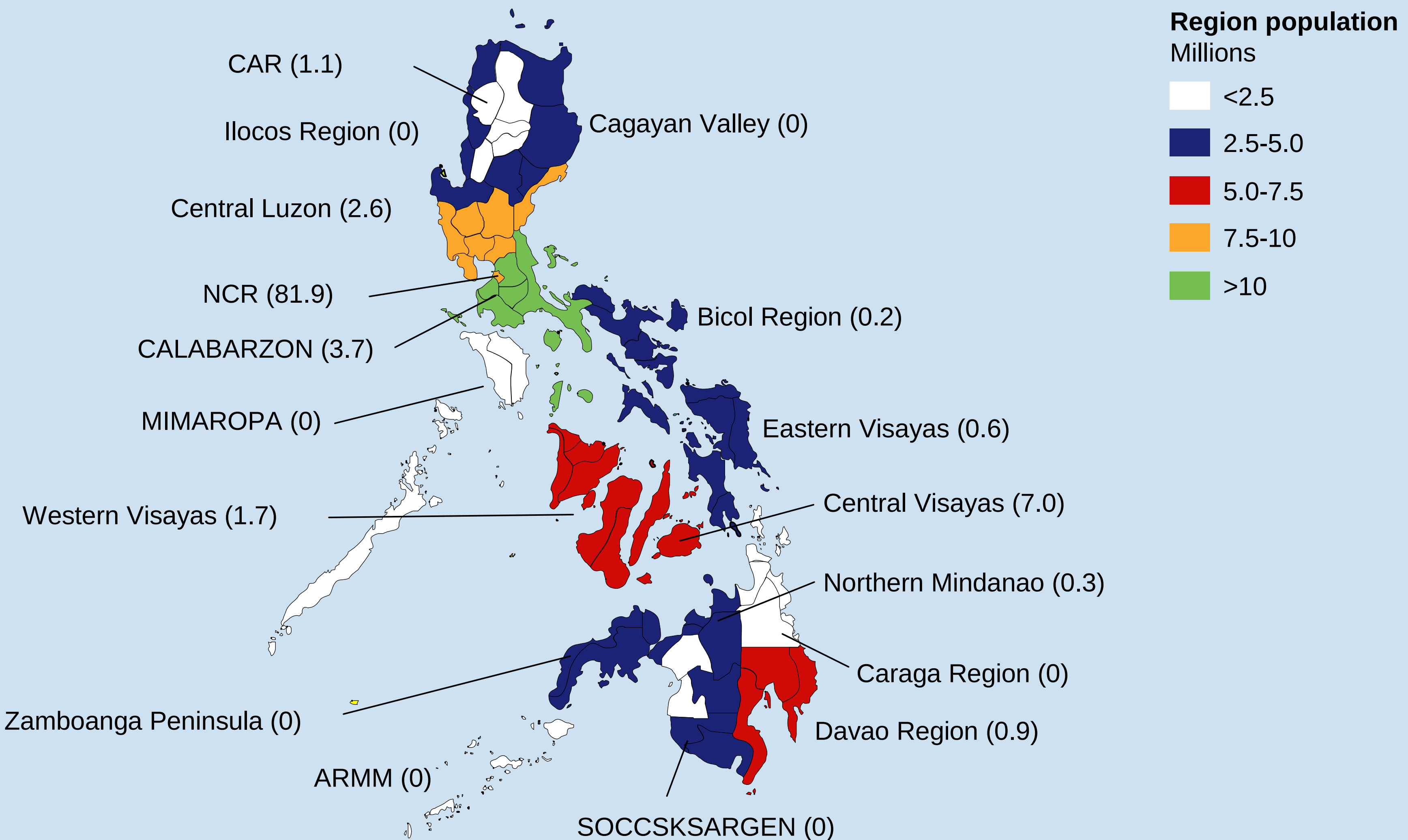
Promotion
- How do we change the negative image of the country?
- How do we address investor questions on security?

Investor support
- How to assist investors
- Can govt bureaucracy and transparency be addressed?

Source: May 9 sponsor workshop; interviews; team analysis

Challenge #3: Can we develop new investment destinations?

By region share of O&O employment (percent)

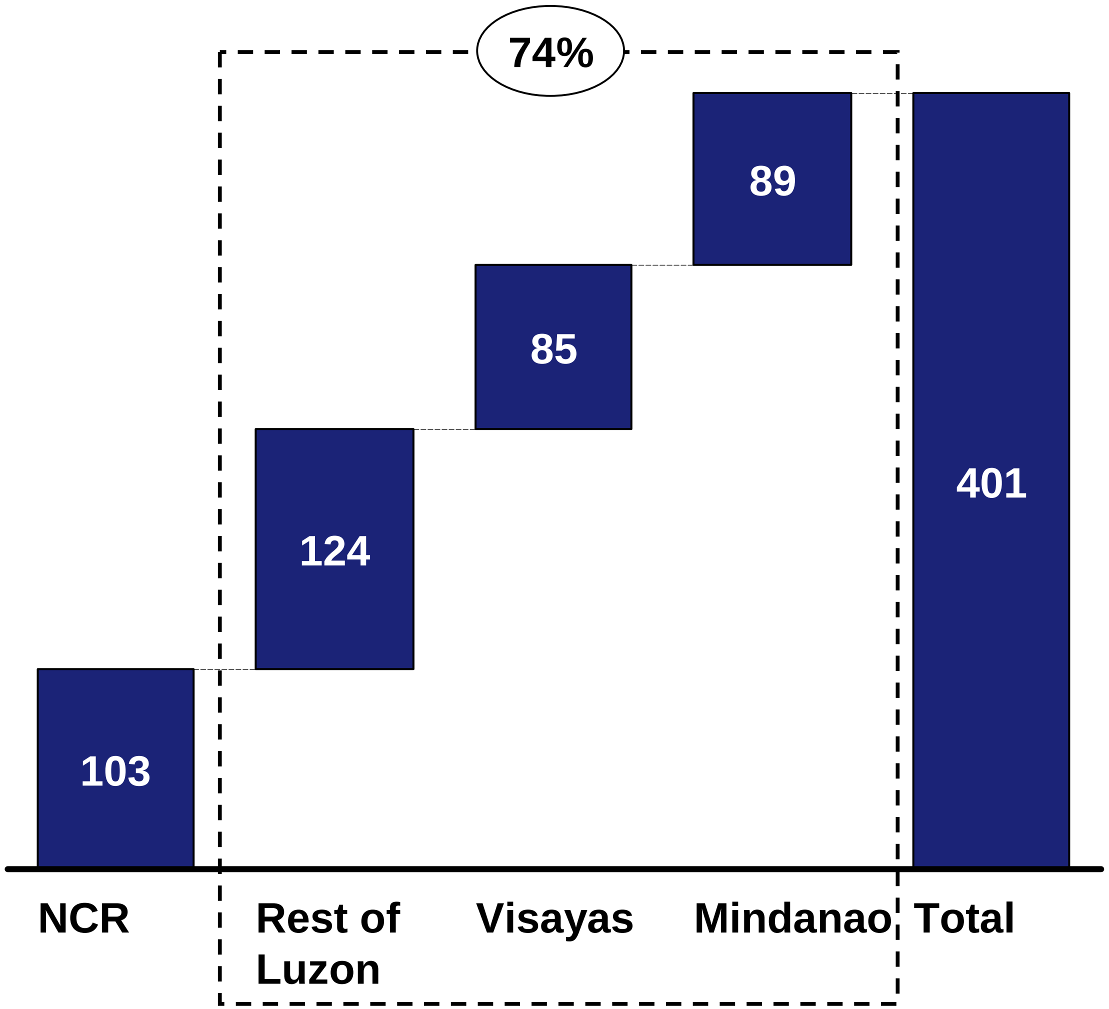


82% of O&O activity takes place in NCR

Source: 2000 Census; BPAP Inventory

Sustained growth requires tapping talent across the country

Annual Graduate Population (000)



NCR has only 25% of the country's graduating population but 80% of the O&O jobs

Source: CHED

Aggregate real estate gap to be filled by 2010 is ~1.8M sqm.

Key assumptions

Total real estate demand by 2010

- 892K FTE required
- 50% of companies operating 2 shifts
- 6 sqm/FTE typical requirement

End2006 occupancy

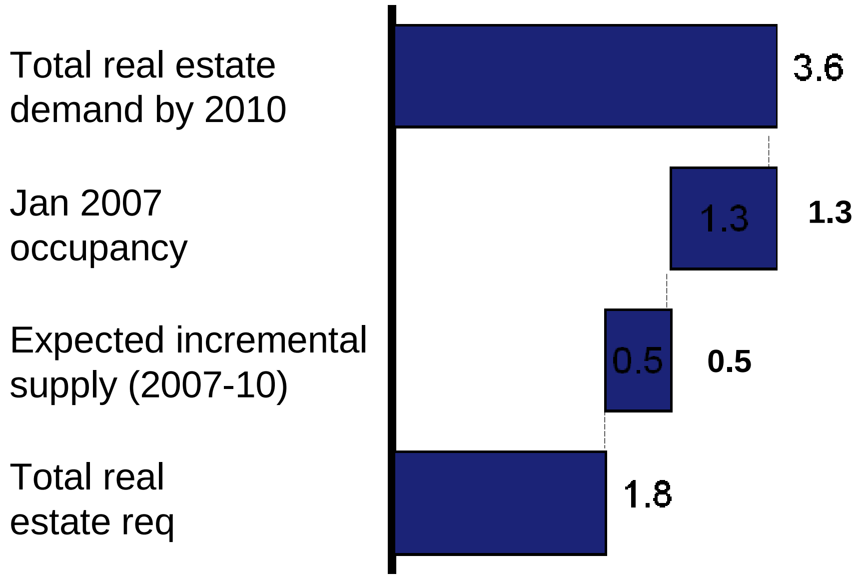
- 780K sqm. (end-2006) occupied by O&O companies in Metro Manila
- 80% of current O&O real estate in Metro Manila

Expected incre-mental supply (2007-10)

- Based on projects currently planned
- 80% of incremental available real estate supply in Metro Manila
- 37% of available real estate to be occupied by O&O (current occupancy rate)
- Including pre-committed real estate

Additional real estate required

Million sqm.



Source: BPA/P; Leechiu and Associates; Ayala Land;

Roadmap 2010 launched Oct 2007

BPAP and McKinsey &Co developed the Philippine IT-BPO "roadmap" to achieving strong global #2 position in the world

Sec Ray Anthony Roxas-Chua appointed as the Philippine Government's "Outsourcing Czar"

President Arroyo announced the release of $10million worth of Scholarship grants for deserving students to be employed in BPO

Roadmap 2010 focusing on four broad themes

	Key issues
Suitable and abundant talent	• Need to recruit over one … to the industry to reach 10% market share • High percent of top tal… bound to other markets (e.g., nurses, engineering, accountan… • Mismatch in location density … ders and labor. Smaller labor pools not tapped
Operational performance	• Wage pressures emerging, reflecting accelerating growth and lack of transparency on wages • Competitiveness relative to established players (e.g., India) and emerging players (e.g., Vietnam) at-risk • Wage appear to be growing faster than billing rates, creating imperatives for operational excellence, scale and migration to high value services
Quality infrastructure	• Availability emerging as major issue – NCR rental space only available to reach 68% of reven… – Given market uncertainty, facilities being built only on commitm… …ing time-to-market • Rental rates rising sharply in Makati Central Business District
Conducive business environment	• Need to ensure that current incentive regime continues to sustain competitiveness • Most locators concentrated in NCR; other cities may not be O&O-ready • Under resourced industr… • Good investor support … otential to improve in execution phase
Risk management	• Persistent issues around critical risk factors that affect outsourcing decision (e.g., IP protection, data privacy)

Talent

Next wave cities

Business environment

BPAP Team 2010

Source: Team analysis

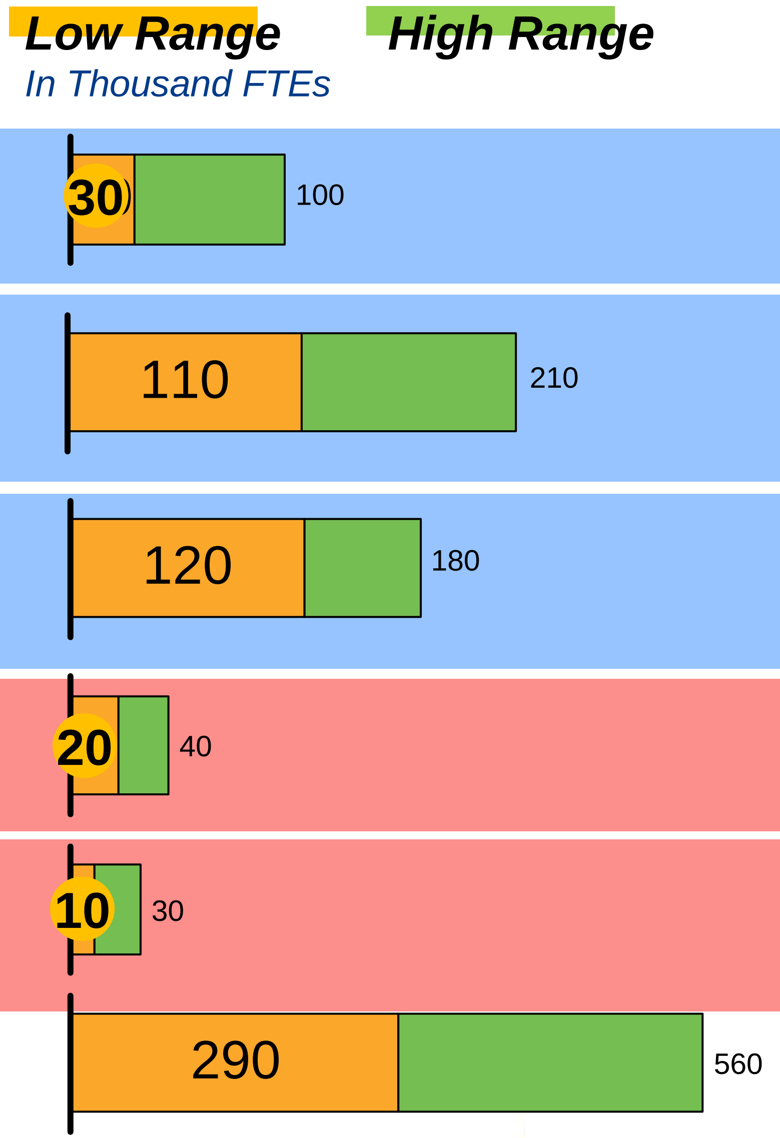
Talent

5 Thematic Programs to draw an additional 290 – 560 thousand employees

Estimated Impact (2007-10)

1. **Comprehensive assessment and training program**
2. **Promote awareness on career opportunities in O&O**
3. **Tap alternative talent pools**
4. **Improve “ability to fund”**
5. **“Responsive” curriculum change**

Total Impact



Develop a comprehensive assessment and training program to help improve suitability of talent for the industry

Talent

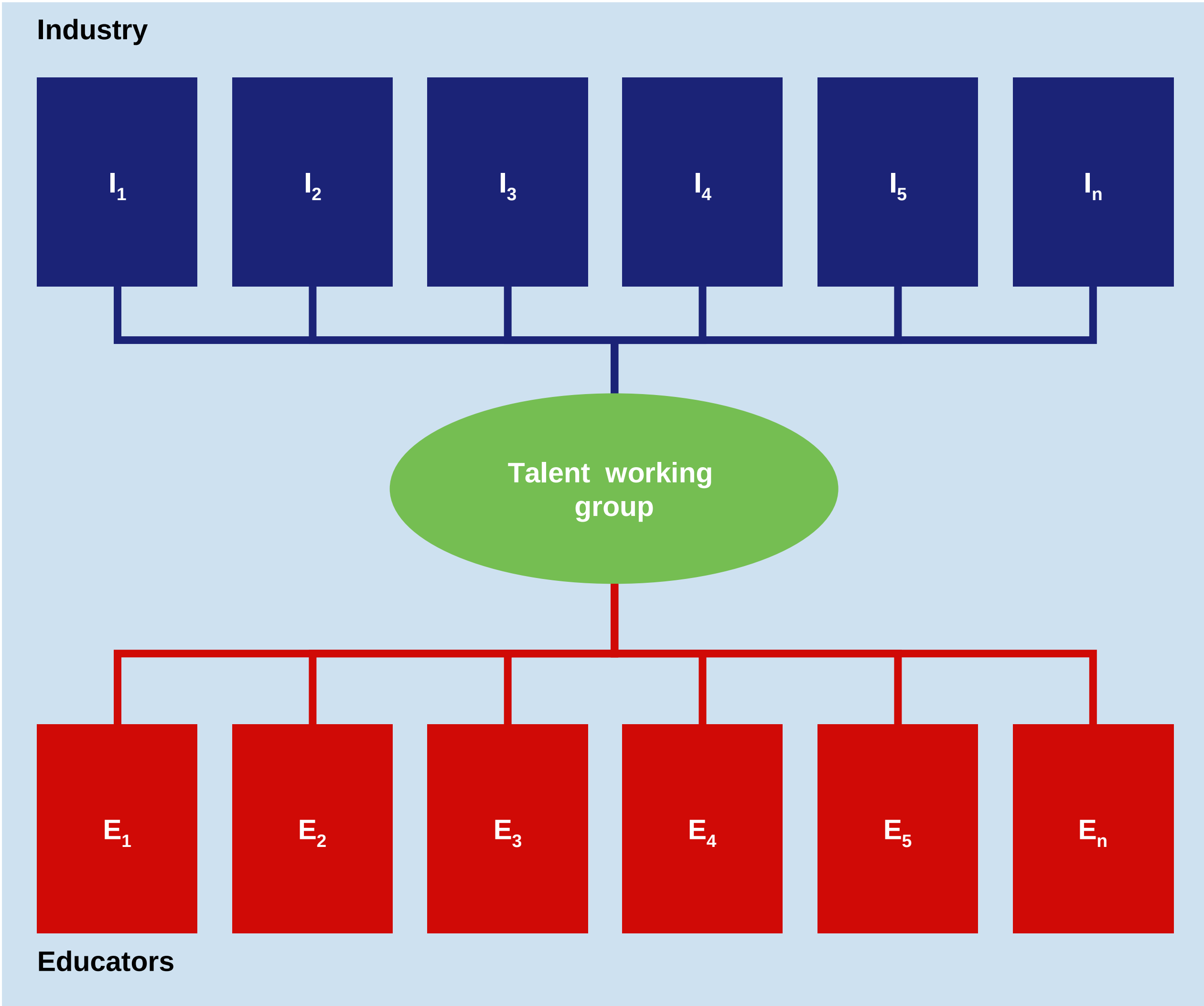
Initiatives	Actions
Develop standard competency tests	• Develop standard competency tests for O&O and use it for filtering applicants • Explore integrating the test into collegiate curriculum
Improve training programs for near-hires and middle manage-ment	• Develop O&O curriculum for near-hires and distribute to schools • Develop training programs for middle managers • Improve yield on TESDA scholarship program • Implement finishing programs (or adopt-a-college)
Develop training programs for faculty/trainers	• Execute "train-the-trainer" programs for key O&O sectors • Provide industry-based faculty for the program
Increase awareness of O&O among potential applicants	• Conduct targeted O&O road shows • Cultivate key local influencers • Create road shows with job fairs/walk-in interviews

Source: BPAP team analysis

Talent Management Partnerships program to pilot and scale educational initiatives

Value added

- Test educational/ training initiatives
- Distribute development costs
- Vehicle for scaling up
- Funding vehicle (BET)
- Model for other industries



Source: BPAP team analysis

BPAP initiatives to help create the right environment for industry growth

Business environment

Key issues in the Philippines business environment

1. Lack of institutional framework during set-up
2. Weak risk perception
3. Mixed messages on government support

Three key areas for BPAP

Public policy
- Protect current incentive regime
- Simplify incentive process
- Expedite data protection regulation

Promotion
- Position Philippines as "destination of choice"
- Risk survey
- Information Security campaign

Investor support
- Set-up advisor certification
- BPAP portal and helpdesk
- Operational excellence program

Source: May 9 sponsor workshop; interviews; team analysis

BPAP to provide services that would encourage development of Next Wave Cities

Next wave cities

Information "demands"

- Investors/locators
- Real estate developers
- Utility providers
- Colleges and universities
- National government
- LGU's
- Others

Topics

City readiness

- Which cities are ready?
- What are the gaps?
- Where is specific expertise?

Penetration

- Who is operating here today?
- What activities do they undertake?
- Where are they located?
- How many FTEs?

Segment readiness

- How have various slivers fared in the Philippines?
- Which slivers have natural fit for the Philippines, i.e., growth prospects?

Information Services

- BPAP city scorecard
- BPAP Inventory
- Case studies

Source: Team analysis

O&O Scorecard

Next wave cities

Talent
- College and high school graduates
- Professionals
- Schools and degree programs

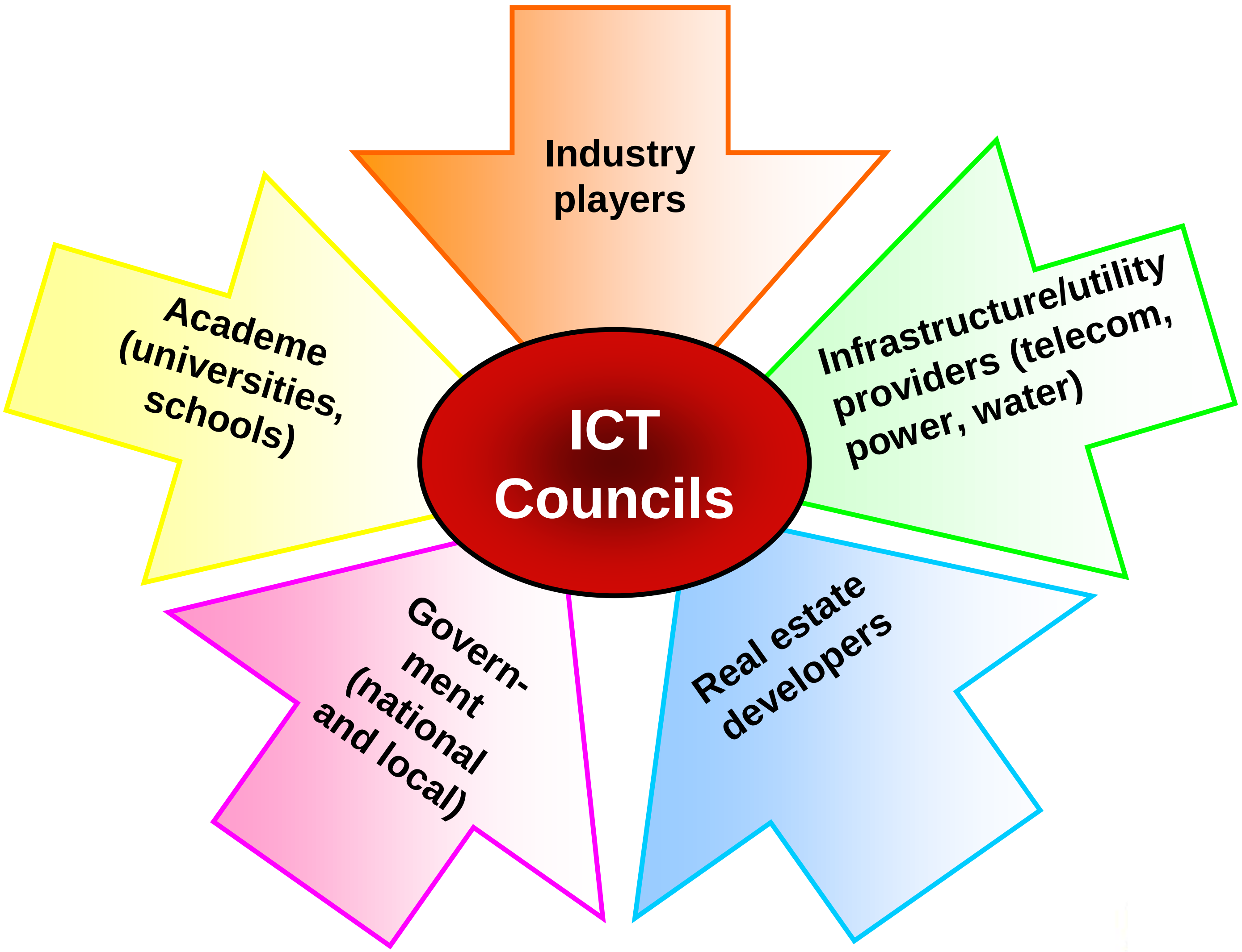
Infrastructure
- Airports
- Roads
- Utilities (telecom, power, water)
- Real estate

Cost
- Rental
- Regulatory fees and taxes
- Median pay
- Utility costs

Business Environment
- PEZA-approved facilities
- ICT Council
- Real estate developers

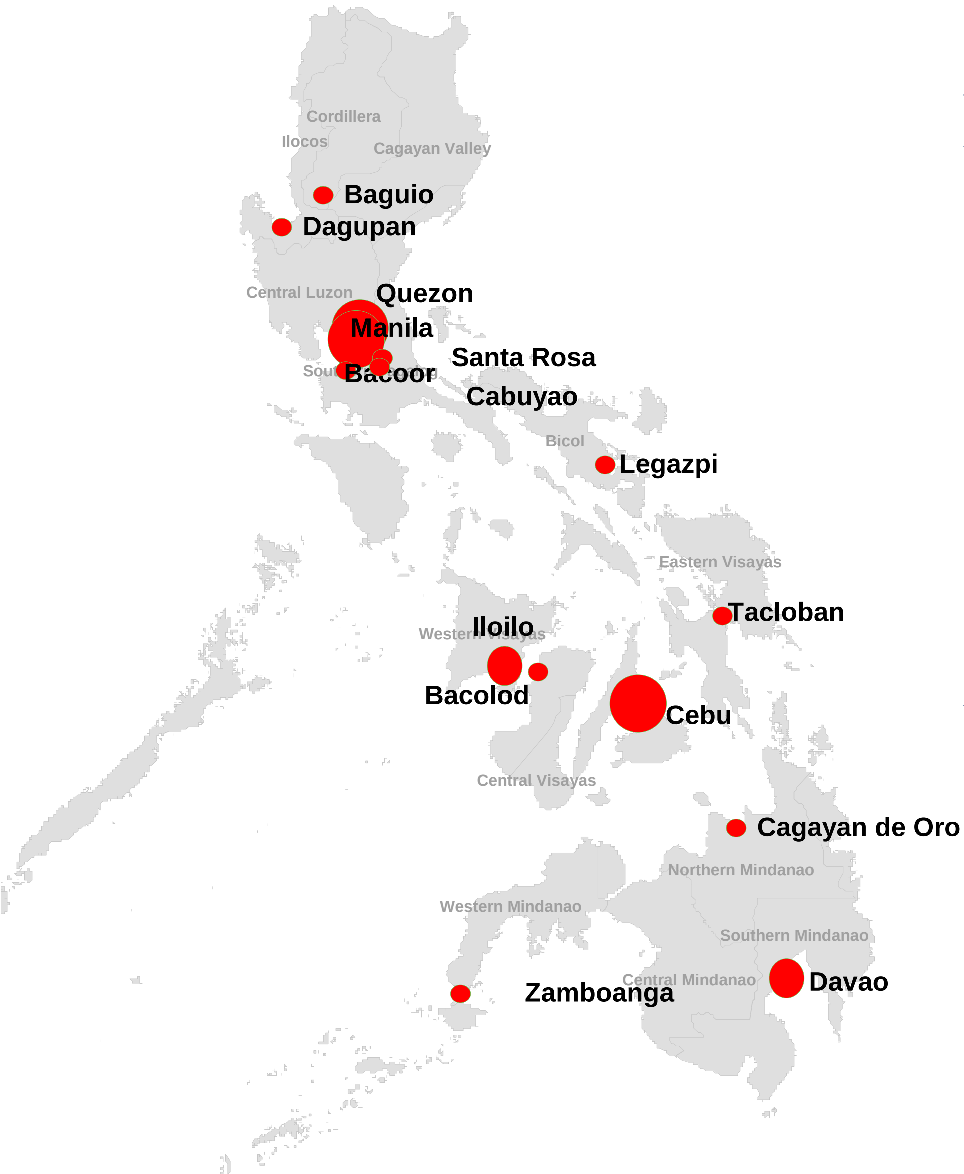
Regional ICT Councils

Next wave cities



BPAP/CICT leading the work with ICT Councils and private sector to prepare the new sites for IT-BPO

Next wave cities



Albay	Albay ICT Association
Angeles	Angeles City ICT Council
Bacolod	Bacolod Negros Occidental Federation for IT (BNEFIT)
Bohol	Bohol ICT Council
Cagayan	Cagayan (Tuguegarao) ICT Council
Cagayan de Oro	Cagayan de Oro ICT Business Council
Cebu	Cebu Educational Development Foundation for IT (CEDF-IT)
Dagupan	Dagupan ICT Council
Davao	ICT Davao
General Santos	ICT Solutions Association of Region 12 – General Santos City (ISA12 GENSAN)
Iligan	Iligan ICT Council
Iloilo	Iloilo Federation for IT (IFIT)
Koronadal	Technology of Information and Communications in Koronadal (TICK)
Laguna	Laguna ICT Council
Quezon City	Quezon City ICT Council
Urdaneta	Urdaneta City Council for ICT (UCC-ICT)

Roadmap 2010: Continuing Challenges

- Talent development: effectiveness of long-term interventions like curriculum development programs, faculty training and management development
- Talent: how can we help overhaul our general education system
- Talent: how can we increase our recruiting yield from campuses? How can we attract recruits from nearby provinces?
- ICT Councils: how can we further accelerate their effectiveness
- Next Wave Cities readiness: how do we join forces with public and private sector
- Market development: how market Cebu to target investors

So is it Fight or Flight? -

How should Cebu respond to these challenges?