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**The Global Financial Crisis and  
Business Process Outsourcing  
in the Philippines**

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## Summary of Key Findings

Despite the financial crisis, the Philippines still remains an attractive destination for BPO operations due to:

- Low-costs business environment, business-friendly tax regime, and quality supply of labor
- Sentiment towards the Philippine economy improved in the 3<sup>rd</sup> quarter and businessmen and investors are optimistic in the last quarter of 2008.
- Demand for outsourced services is expected to increase in 2009 and the Philippines is expected to benefit from it.
- Some BPO companies operating in the Philippines revealed plans to expand their operations in the country even if there are economic uncertainties brought about by the financial crisis.

## Introduction

The effects of the global financial crisis could be felt in different economies of the world. Firms all over the world are declaring huge losses and some even closed shop. Also, economic indicators point to a global slowdown. The Philippines is not spared from the said effects. Recent data suggests that growth is affected. Is the Philippines still an attractive place for operations in the business process outsourcing industry (BPO) despite the uncertainties brought about by the financial crisis? This is the question that the report will try to answer. Part I tackles Philippine economy's performance last year and the effects of the financial crisis to this year's performance. Part II discusses the viability of the Philippines as a destination for BPO services. The report will specifically look into the advantages of the Philippines in relation to the BPO industry and the current sentiments of investors and businessmen.

## Part I. The Philippine Economy

### The Philippine Economy in 2007

The year 2007 is a great year for the Philippine economy. The country's gross domestic product (GDP) grew by 7.3% for the whole 2007 above its 5.2% average rate during the past five years. The services sector contributed the most in the country's GDP making up 54% of the total output. The agriculture and industry sector contributed 32% and 14% respectively. Inflation was controlled and average only 2.8% for the whole year, the lowest in 21 years. The year was also better in terms of job creation. Unemployment rate decreased to 7.3% compared to 2006's 8.0%.

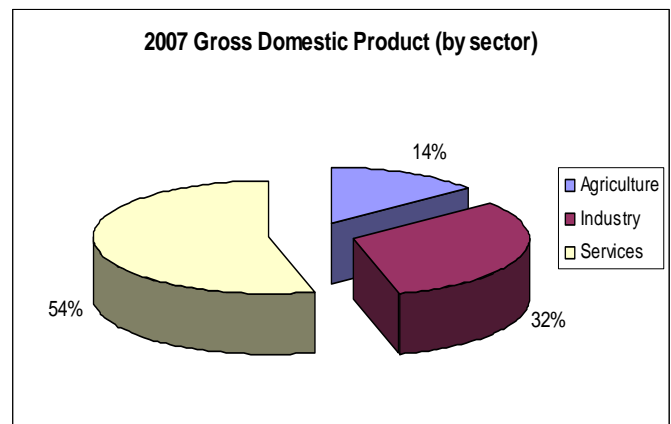


Figure 1: 2007 Gross Domestic Product  
Source: National Statistical Coordination Board, 2008

### Effects of Credit Crisis to Philippine Economy

The impact of the global financial crisis is evident in the first half of 2008. As of 2<sup>nd</sup> quarter, GDP growth slowed 4.6% compared to 7.6% performance during the same period last year. Also, projection for GDP growth in 2008 has been lowered from 5.5% to 6.4% to 4.4% to 4.9%. All three sectors namely agriculture, industry, and services experienced slowdowns in the first half of 2008. The services sector slowed from 8.4% last year to 5.4% while the industrial sector decreased to 3.9% compared to last year's 8.3% growth. The deceleration in the

growth of the country's GDP shows both slowing demand and output. Firms cut their production as demand for goods and services dwindle. Lower output means lower revenues for business firms.

The global financial crisis also made its impact on prices in the Philippines. At the start of 2008, the country's inflation rate has been steadily increasing and it reached its highest in 17 years at 12.5% last August due to rising food and energy costs. This could translate to higher operating costs for companies. Continuous price increases has led to a slowdown in consumption. Private consumption slowed to 5.3% in the 1<sup>st</sup> quarter and further fell to 3.4% in the second quarter. Consumption could further be affected if the flow of remittances from overseas Filipino workers is disrupted. Remittances of overseas Filipino workers are vulnerable as most of it comes from areas hit hard by the global financial crisis such as the United States and countries in Europe. If the industries that employ a lot of Filipinos are affected, then we could definitely see a slowdown in the flow of remittances. This is vital as most Filipino families depend on remittances for the consumption of basic needs.

The Philippine economy may have been hit but the effects are not severe. The economy is still growing and inflation rate is now going down. And prior to the financial crisis, the macroeconomic fundamentals of the Philippine economy are in good position. After the crisis, the Philippines is set to take off again.

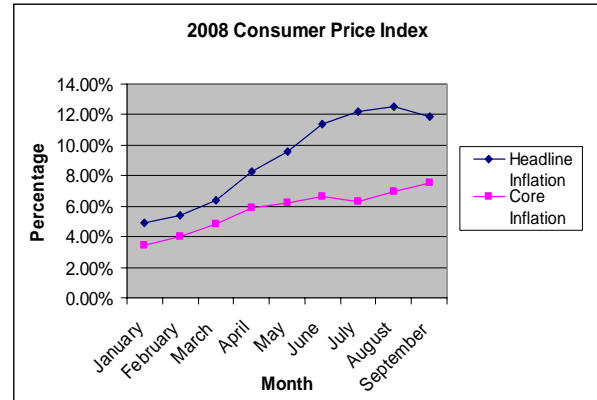


Figure 2: 2008 Inflation Rate  
Source: National Statistical Coordination Board, 2008

## Part II. The Philippines as a Destination for BPO Services

As companies try to reduce costs and respond to the ongoing financial crisis, demand for outsourced services is expected to pick up in 2009. Demand for outsourcing would increase as companies who were hesitant in the first half of 2008 due to uncertainties brought about by the crisis could turn to outsourcing some of their non-core processes in order to drastically reduce costs and survive. The Philippines is expected to benefit from this projected surge of demand. Everest Research Institute believes that the Philippines will be able to increase its market share. This is now a great time to invest in BPO industry in the Philippines and capitalize on the projected increase in demand in 2009.

### Competitive Advantages of the Philippines

#### *Low-cost Business Environment*

The Philippines have competitive advantages that makes it an attractive place for BPO operations. The Philippines has consistently been cited as one of the top destination for outsourcing. One of the most often cited reason is that costs in the Philippines are relatively lower compared to other countries. Labor costs for one is estimated to be just less than 1/5 compared

to labor costs in the United States and other developed countries. Also, cost of living, real estate, construction, and utilities are almost 50% lower compared to developed countries. Telecommunications costs are relatively lower compared to its neighbor and very efficient. Despite reaching the highest inflation rate 17 years last August, there is still no evidence that the costs of factors vital to the BPO industry such as real estate, telecommunications, and utilities will increase. Table 1 shows the recent rental rates in Makati City. Also, the continuing decline in the prices of oil and commodities would guarantee that price increases are not imminent in the near future.

<b>Office Rental Rates Makati CBD (in Php)</b>			
	<b>3Q 08</b>	<b>2Q 08</b>	<b>% Change</b>
<b>Premium</b>	<b>895- 1,229/sqm</b>	<b>949- 1,340/sqm</b>	<b>- 7.2%</b>
<b>Grade A</b>	<b>482- 1,050/sqm</b>	<b>505- 1,094/sqm</b>	<b>- 4.2%</b>
<b>Grade B</b>	<b>424- 506/sqm</b>	<b>447- 514/sqm</b>	<b>- 3.1%</b>

Table 1: Rental Rates in Makati CBD  
Source: Colliers International Philippines, 2008

<b>Comparative Rental Rates</b>	
	<b>Average Annual Quoted Rent (US\$ per square feet)</b>
<b>New York, USA</b>	<b>73.10<sup>1,2</sup></b>
<b>San Francisco, USA</b>	<b>56.20<sup>2</sup></b>
<b>Mumbai, India CBD</b>	<b>64.38<sup>3,4</sup></b>
<b>Bangalore, India CBD</b>	<b>25.56<sup>4</sup></b>
<b>Makati, Philippines</b>	<b>22.22<sup>4</sup></b>

Table 2: Rental Rates in Different Cities  
Source: Colliers International  
1 – Average for DT Manhattan, MT Manhattan, MTS Manhattan  
2 – as of September 30, 2008  
3 – Average for all areas of Mumbai  
4 – Forecast for 2008

### *Supply of Quality Labor Force*

The Philippines has a steady supply of labor. Almost 360,000 graduates enter the workforce per year and almost half of these graduates have skills that are vital to the BPO industry. Furthermore, majority of the graduates are proficient in English. Being more specific to the BPO industry, the attrition rate of 10-15% in the Philippines is lower compared to a global average of 20-25%. Filipinos are also known to be very service-oriented. This makes Filipinos particularly fit in doing BPO jobs that are in the area of customer service. This is reflected by what outsourcing companies operating in the Philippines are saying. American outsourcing firm DDC HRO says that “the key differentiator of the Philippines lies in the people themselves and a cultural predisposition for service provision and customer care that is now sorely lacking in many western market (Kinnear, 2005).”

### *Favorable Tax Policies*

The Philippine government also has a tax regime that is considered to be business-friendly. Tax breaks and holidays are given to investments in business activities that are listed under the country’s Investments Priorities Plan or if the business would locate in areas that are designated as economic zones. On average, companies get 4 years of tax holiday and a constant 5% rate after 4 years (Philippine Economic Zone Authority, 2008). Furthermore, companies could get further tax break depending on the policy of the local city it chooses to locate to. To add more incentives, companies would not be required to pay import duties if the materials they would import are vital inputs to the functioning of its business activity. This tariff policy would definitely reduce production and operation costs that would translate to higher profits.

## **Confidence in the Philippine Economy**

The global financial crisis has definitely affected the sentiments of investors and businessmen towards the Philippines. A survey conducted by ING Group revealed that sentiment during the first half of 2008 dipped. However, the latest surveys show that sentiment is improving. In the latest ING Investor Dashboard Sentiment Index, investor became more optimistic in the 3<sup>rd</sup> quarter of 2008. On a scale of 0-200, 200 being the most optimistic, the Philippines improved from 110 in the 2<sup>nd</sup> quarter to 138 in the 3<sup>rd</sup> quarter. Figure 3 shows the results for the Philippines.

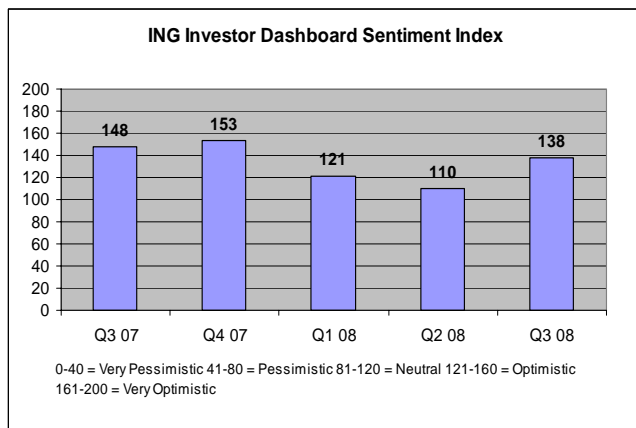


Figure 3: ING Investor Dashboard Sentiment Index  
Source: ING Investor Dashboard Q3 2008

The survey also revealed a more neutral view on the economic situation. The latest data showed that those who view a deteriorating economic situation decreased from 62% in the 2<sup>nd</sup> quarter to 30% in the 3<sup>rd</sup> quarter. Also those who see an improving economic situation increased from 14% to 30%. Figure 4 shows the complete results. As for the effect of inflation on investment decision, ING's survey also shows improvement. In the 2<sup>nd</sup> quarter 82% said that their investment decisions were affected by inflation. This number decreased to 67% in the 3<sup>rd</sup> quarter.

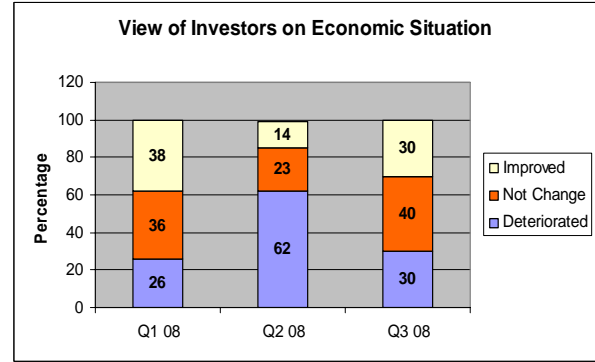


Figure 4: Investors' Sentiment on the Economy  
Source: ING Investor Dashboard Q3 2008

The Bangko Sentral ng Pilipinas' Business Expectations Survey revealed a bearish sentiment during the 3<sup>rd</sup> quarter of 2008. Businesses that have a negative outlook outnumbered those that have positive outlook giving the Overall Business Confidence Index a score of -12.9%. The factors that mainly influenced business sentiment were inflation and the economic slowdown in the country's major trade partner, the United States. However, businesses that were asked have a more favorable outlook on the coming 4<sup>th</sup> quarter. The score for the 4<sup>th</sup> quarter registered at 16.6%.

The improving sentiment towards the Philippines among businessmen and investors indicates that there is confidence that the Philippine economy would withstand the negative effects of the global financial crisis.

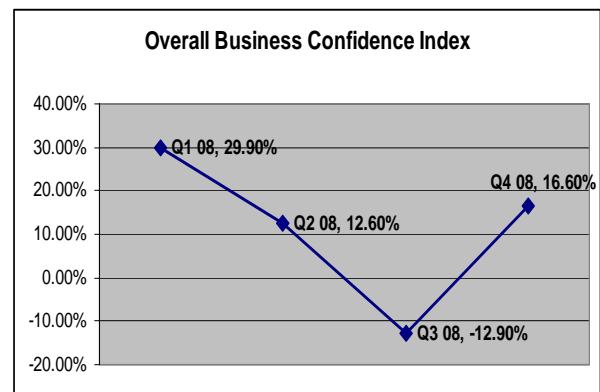


Figure 5: Overall Business Confidence Index  
Source: Bangko Sentral ng Pilipinas, 2008

## BPO Firms Expanding Operations in the Philippines

Some companies in the BPO industry operating in the Philippines are expanding despite the financial crisis. People Support recently announced that it will hire 5000 more employees to expand its operations. Last October, American outsourcing firm Convergys Corp. opened a new call center site in the southern part of the Philippines where it plans to be operated by 1000 people by yearend. Convergys also said that it plans to open five more call centers in the country and hire 6,000 more employees in 2009. Also, another American outsourcing firm will open a call center in the southern part of the Philippines. APAC Customer Services will spend about US\$ 100 million to build its call center facility in Leyte.

## Final Thoughts

The global financial crisis may have impacted the Philippine economy but data suggest that the effects are not severe. The economy is still growing although at a slower rate. This just shows that economic activity is still expanding despite the uncertainties. The Philippines could weather the global economic storm.

As for the BPO industry, there are no proofs to suggest that the advantages of the Philippines are affected. Factors vital to the BPO industry such as labor costs, real estate costs, and telecommunications costs did not experience price increases. Furthermore, inflation rate is now steadily decreasing after reaching its peak last August.

This is now a great time to invest in the Philippine BPO industry. Demand for outsource services is expected to increase in 2009 and the Philippines is expected to benefit from it. Certain BPO companies in the Philippines are expanding their operations. To add to that, sentiments by businessmen and investors shows a more optimistic outlook towards the economy and business

environment. The global economic situation may be bad but there is confidence that the Philippines would be able to withstand the economic storm.

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## About Headway

Headway is a management and strategy consultancy that operates in the Philippine market. Global enterprises that desire to establish an operating footprint or expand current business in the Philippines engage Headway Business Services. Headway navigates enterprises from entry strategies involving acquisition, build, build-operate-transfer and outsource options to growth and business recovery strategies. Customized investment time lines involving relevant business dynamics are developed and interpreted resulting in high granularity perspectives for executive management consideration, decision and disposition.

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