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IT-BPO Industry's Direct & Indirect Economic Impact

The Outsourcing Multiplier applied to the
Philippines and Indian Economies

July 2011

Introduction

Much has been discussed about the rapid development of the IT-BPO industry over the last decade. Particularly for mature destinations such as India and the Philippines, the topic revolves around analyzing their steady rise from the nascent stages in the 1980s to the 1990s, up to their rapid growth in the last decade. Today, the *impact* of the industry has resonated across the global scenario changing the dynamics of both *locations* - on how each position and markets itself in the outsourcing space - as well as *companies*, and how they are best able to harness and maximize the true benefits of the outsourcing model.

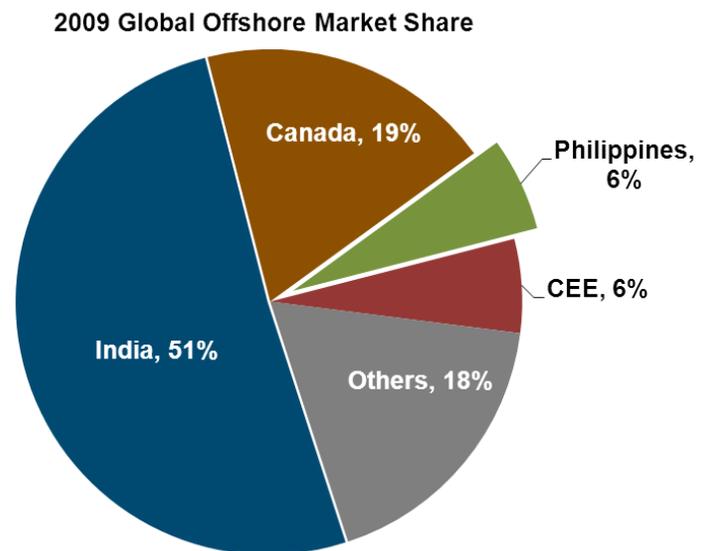
With the perceived stability and sustained growth of the industry, one cannot discount the fact that the IT-BPO industry has now become an evolution in modern day business that affects the entire ecosystems of both global and local economies. This paper specifically attempts to expound on this notion and the underlying thesis of the direct, indirect and induced effects of the IT-BPO industry to the local economies of India and the Philippines.

State of the Philippines and Indian IT-BPO Industries

There is little doubt that India and the Philippines have capitalized well on their first mover advantage in the global outsourcing space – both countries representing a combined ~60% of total global Offshore market share by end of 2010.¹ The inherent question is – have these two destinations reached their service delivery limits, and if so, will this pave the way for other emerging destinations to capture greater market share?

For both countries, reaching “economies of scale” is not a question of when but rather a question of how. Instead of viewing the total addressable IT-BPO marketable market as a pie getting smaller because of more competitors entering the fray, a more realistic perspective would be to see that total market size is in fact growing, as more companies globally adopt the outsourcing and offshoring models into their practice. Simply put, demand created is expected to outpace supply capabilities. Chart 1 illustrates the current Global Offshore Market share by end of 2009.²

Chart 1: Global Offshore Market Share



Source: NASSCOM 2010

¹ NASSCOM Strategic Review 2010, Tholons Estimate

² NASSCOM Strategic Review 2010

While total Global Offshore revenue is estimated to have increased to US\$110 billion in 2010 and expected to increase 3 fold in the next 5 years to US\$300 billion, India and the Philippines are taking decisive measure to allow them to keep pace with market demand. For these two nations, the most pressing question is hinged more on “how to keep up with demand” rather than “have we reached our limits?”

Philippines

With an estimated US\$8.9 billion in export revenues representing approximately 4.8% share of GDP in 2010, the Philippine IT-BPO industry is the second largest contributor to the local economy next to remittance inflows.³ Interestingly, during the period of the global economic crisis from 2008-2009, the industry still managed to post a robust 17% growth in revenues, while adding an additional 70,000 people in the workforce – showing the local industry’s resilience. Moreover, the industry recovered fairly quickly as figures for 2010 and estimates for 2011 show 26% and 30% growth rates respectively, projected to reach US\$11.6 billion by end of 2011.

Figure 1: Philippine IT-BPO Revenue and Growth Rate



Source: Business Processing Association of the Philippines 2011

A recent study by the World Bank also cited the Philippines among the fastest growing Asian economies in terms of export services. The study showed services exports as a percent of total exports increased from 9% to 21% in a span of 10 years (1999 - 2009), a YoY growth rate of 3.5% - significantly higher than the average of Asia as a whole which stood at 1.5% YoY.

With the expected addressable market in the IT-BPO industry to balloon from US\$500 billion in 2009 to US\$1.5 trillion by 2020⁴ - the Philippines, leveraging on its current momentum - is in a strong position to reinforce its stature as one of the most significant offshore IT-BPO destinations. Today, the main changes lie in how government and the industry can react to the *escalating demands* of the industry – in terms of addressing talent pool capabilities, government policies and industry derived socio-political issues.

³ IMF 2010, Tholons Estimate

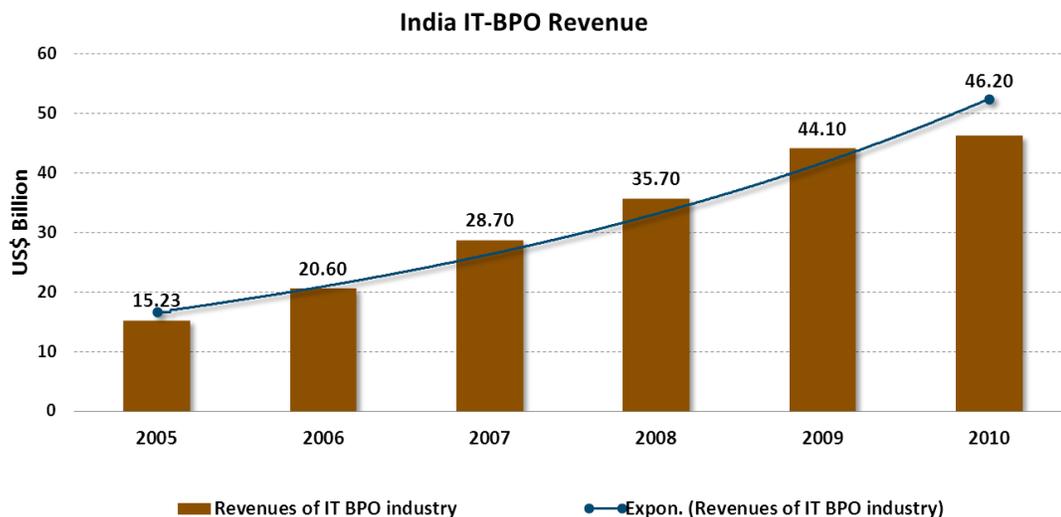
⁴ Nasscom Strategic Review 2010

India

The outsourcing era in India can be traced to the early 1980's. Initially, India's value proposition to the global outsourcing market centered on two primary draws – cost arbitrage and its large, English-speaking talent pool.

The first major steps of the local outsourcing could be attributed to British Airways and American Express starting their back office operations on a small scale and then expanding rapidly in the early 1980's. During this period, Jack Welch of GE validated his proposition of 'optimizing operations' by allowing GE to focus more on its core competencies and moving non-core functions to developing economies like India. During this Services Industry boom, IT Service companies began to emerge from India with the setup of the Indian IT providers like Infosys Technologies, Wipro, Tata Consultancy Services, to name a few. The Business Process Outsourcing (BPO) sector, now an integral part of the Indian Outsourcing Story, also began to take form, with the formation of providers such as Spectra Mind, Daksh, EXL Services and others.

Figure 2: Indian IT-BPO Revenue and Growth Rate



The Indian IT-BPO story has been nothing short of phenomenal since, with revenues reaching US\$46.2 billion in FY2009-2010 (includes domestic and offshore IT-BPO outsourcing) and a cumulative growth of 20.3% from 2004-2010.⁵ In 2010, the IT-BPO workforce in India was estimated at 2.2 million⁶ and it is expected to grow to 10 million by 2020. Further, it is estimated that these 2.2 million direct jobs are creating 8 million indirect jobs in India – in line with the concept of the **Outsourcing Multiplier**, which will be discussed in the next section.

⁵ NASSCOM India BPO Study Roadmap 2012, Tholons Estimate

⁶ NASSCOM Strategic Review 2010

The Outsourcing Multiplier

What are the parameters / factors in analyzing the impact of the outsourcing industry in a Macro and Micro scale?

This section analyzes the value multiplier that individual parameters of an outsourcing industry have, and their effects in propagating economic impact in a business ecosystem. This section will likewise discuss the framework utilized for computing for employment.

IT-BPO industries have transformed many outsourcing destinations and have served as catalysts for growth. In the Philippines and India, the respective IT-BPO industries have in fact, played a major role in fueling recent economic development. A number of factors contribute to creating the overall economic impact on the destination and these influencing factors can be termed as the ***Outsourcing Adjacencies*** - or those individual components which compose the entire outsourcing ecosystem.

Based on the impact and breadth of these factors, we have classified the Outsourcing Adjacencies into 4 broad categories which in turn are comprised of related and supporting micro level components. The four categories of the Outsourcing Adjacencies that define the economic impact of the particular IT-BPO industry on the destination are summarized in the diagram below:

Figure 3: Outsourcing Adjacencies



Let us now consider each of the macro level Outsourcing Adjacencies in detail and identify the micro level components they are comprised of.

1. Resourcing Requirements:

This adjacency considers the labor or *people intensive* nature of the outsourcing domain considered. E.g. BPO is a people intensive industry that requires a large number of people to be present in a location, and thousands more to support and sustain these resources within a location.

The people intensive nature of the industry in turn impacts related micro parameters such as:

- a. **Housing and Infrastructure:** The creation of direct outsourcing jobs would drive the needs of the employed to stay close to the service delivery centers and also make property investments around the area. Further, the growth of these centers will necessitate the development of infrastructure in and around the area to enable a functional transportation and commuting systems. This implies the building of roads, railways, and other transport-related connectivity platforms. This sector, which includes among others, property development & maintenance personnel, and infrastructure laborers - has seen a tremendous generation of jobs in the Philippines and India.
- b. **Transportation:** This component would directly follow from the development of the infrastructure, roads, connectivity, etc. This would boost the types and scale of mass transportation and increase supporting employment tributaries.
- c. **Food & Commodities Supply Chain:** The resourcing requirements of the IT-BPO industry directly impact the development of the supply chain around food & basic commodities. The demand for food supply would increase in and around the outsourcing hub and also increase the demand from the agricultural sectors supplying the given area. Employment at restaurants and convenience stores around the area will likewise increase and create employment for ancillary services from related sectors of commodities and other retail goods. In the Philippine scenario, the proliferation of 24-hour convenience stores around service delivery centers has been a notable and recent phenomenon.
- d. **Lifestyle and Entertainment:** The growing population in an area will necessitate the surge of options for lifestyle and entertainment venues such as malls, recreation venues, and movie houses. This in turn will again demand employment to increase as resources will be required to provide support services for these venues.

This adjacency can be considered to be by far the most critical of the Outsourcing Adjacencies and thus would carry a higher weight in the framework in estimating the impact of a given outsourcing industry.

2. Communication, Collaboration & Technology:

The IT-BPO industry is composed of remotely located parties (client & service provider), often in different time zones and geographies, and therefore heavily leverages on effective collaboration and communication tools.

To enable the process of real time updates, status calls, project monitoring, milestone mapping and other collaborative tools – technology is a prerequisite for any outsourcing operation.

Thus the constant innovation and newer technologies required to support the needs of the outsourcing industry, has fostered technology companies to look at developing improved communication and collaboration tools. With the pool of talent that the outsourcing hubs already boast of, the engineering and development of these communication technologies are also largely done out of these outsourcing destinations - creating more jobs. Thus the outsourcing industry promotes growth of jobs in its own and related industries - creating a virtuous cycle.

Also the number of people being employed in the IT-BPO industry who are tech-savvy and are looking at adopting the latest communication technologies e.g. mobile/wireless technology for their personal communication as well as the client communication is increasing. Thus mobile technology firms, mobile handset manufacturing industry and the mobile service providers in India and Philippines have seen a huge transformation in the past decade to cater to the needs of the increasing customer base from the outsourcing sector with higher spending power. Many mobile technology startups, handset manufacturing centers are increasingly having their development centers/manufacturing facilities in India and Philippines. Also with Foreign Direct investments of many international mobile operators like Vodafone, Uninor, Singtel, etc. into India and Philippines - the mobile service provider industry is also seeing huge growth. The increasing young urban users employed in the IT-BPO sector are capable of paying for the high quality data/voice services provided by the international mobile operators are indirectly fuelling the growth of the mobile operator industry and jobs in the sector.

These sectors today employ a large pool of people and are an indirect effect of the growth of outsourcing industry and the spending power of the population it has created.

3. Globalization:

The IT - BPO industry has moved us towards the phenomenon of a *flat world*. Today globalized teams and processes make the interactions seamless and near real-time.

Outsourcing lends itself to and purports servicing client requirements round the clock i.e. globalized operations. Today, India and Philippines are servicing clients across the US, Europe, and Asia Pacific. The diverse time zones these countries are located in require the employees of the service providers from the provider countries to work in shifts to accommodate client needs. Thus the IT-BPO industry typically has 3 shifts of 8-9 hrs. Each with some overlap. The morning shift (9am- 5pm) works well for the APAC clients, the afternoon shift (2pm - 10pm) for the Europe clients and the night shift (8pm – 4am) for supporting US clients.

This requires that the destination offering the outsourcing services also has the support services to enable the 24-by-7 delivery model. Public transport, restaurants, hospitals and other emergency facilities are some of these essential support services. Thus it is not only the outsourcing sector workforce working round the clock but also the *support service personnel* to be deployed round the clock – thus bringing in the concept of working in shifts and round the clock availability. Take for example that a 100 member BPO company would require at least 2-3 restaurants to be open round the clock, an average of 2 buses for transportation to be available at hourly intervals, cabs available intermittently and emergency healthcare services like an ambulance and doctor on call, pharmacy etc. Thus this Outsourcing Adjacency on an average would generate close to 125-140 additional jobs and having a multiplier effect of 1.4 through indirect job creation.

4. Skill Development & Propagation :

Outsourced jobs are generally jobs requiring specialized skills and job profiles and outsourcing hubs require a constant pool of resources with these specialized skills. Thus, the process of skill development/enhancement becomes a critical need of the industry and improving the pool of employable talent becomes the biggest challenge for any outsourcing destination.

This enables skill development/training schools to thrive and creates many more ancillary jobs revolving around technical training, curriculum and content development, speech and language training, and other process-specific education and formation.

Thus skills propagation among the largest pool of talent to improve the levels of employability in the IT-BPO industry acts as a multiplier on job creation.

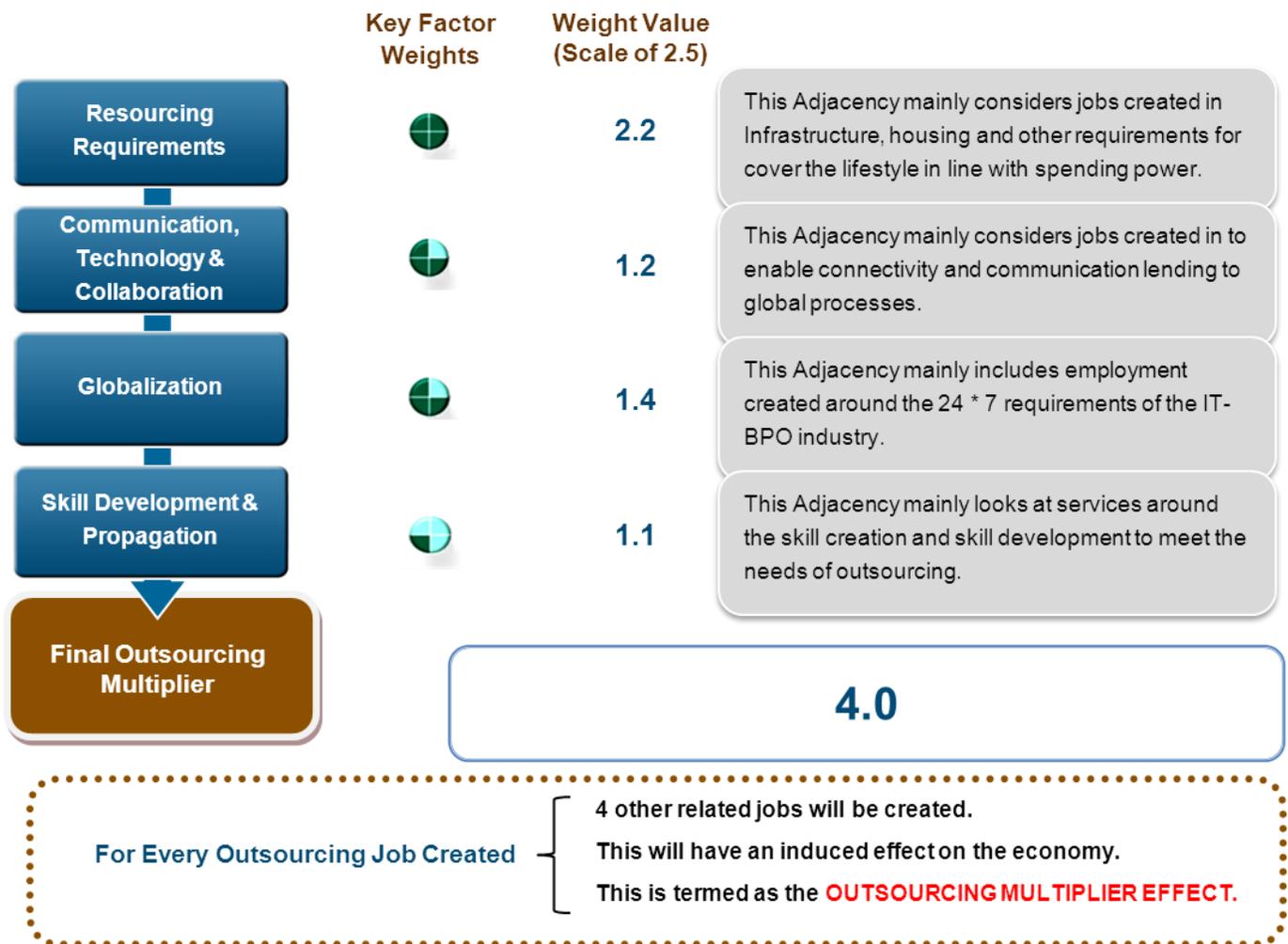
Arriving at the Outsourcing Multiplier

This framework looks at how to quantify the effect of the different **Outsourcing Adjacencies** as a multiplier towards job creation.

On the assumption that each Adjacency by itself can generate a maximum of 2.5 jobs for every single outsourcing job, the job creation capability for each parameter is thus considered on a scale of 2.5 and scaled to the appropriate weights.

The Outsourcing Adjacency “Resourcing requirements” has the sub-parameters like Housing & infrastructure, Transportation, Food and Commodities supply chain, which in turn can be assigned different sub-weights depending on the economy under consideration and how they would impact the outsourcing and job creation.

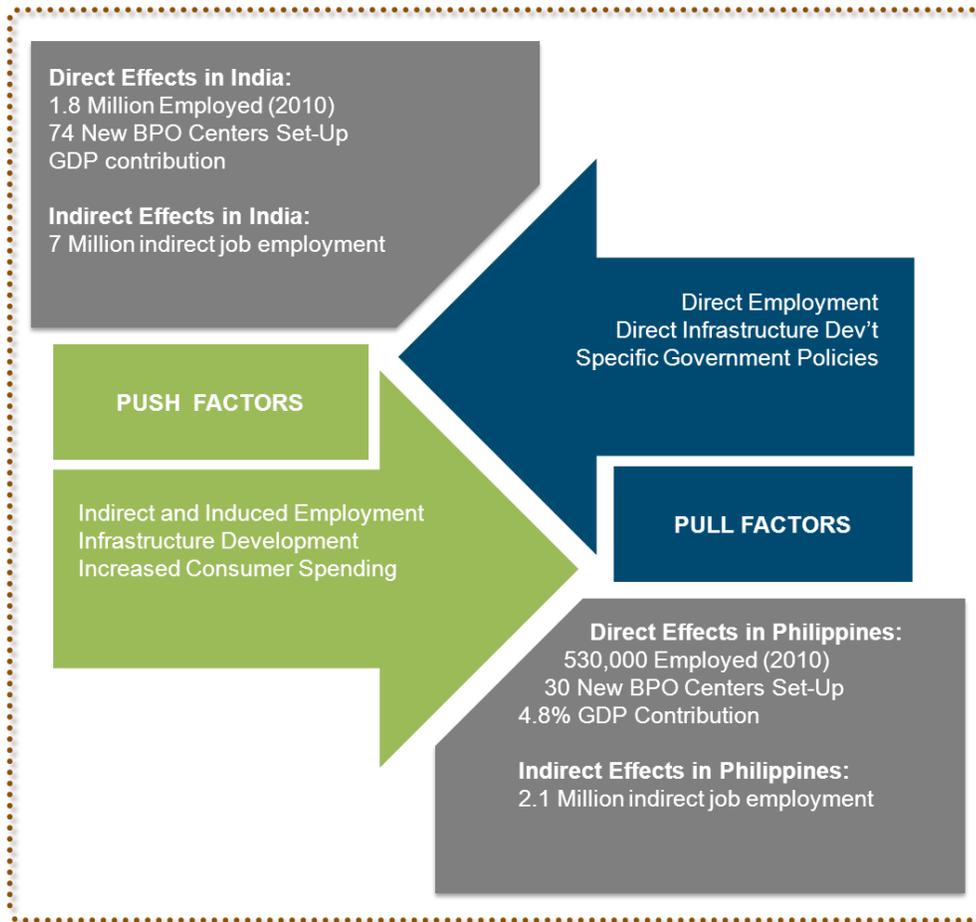
Figure 2: Outsourcing Multiplier Framework



Outsourcing: *Push –Pull Principle*

The current outsourcing dynamics of India and the Philippines are likewise subject to *pull - push* factors that affect the local economy. In theory, the pull-push principle of the IT-BPO industry creates pull factors which directly affect the industry, while the push factors create the indirect effects via the Outsourcing Adjacencies. This principle can broadly be described as the direct, indirect and induced impact of the industry to the local economy.

Figure 3: Pull-Push Principle



While we correlate the direct and indirect impact of the industry to the number of jobs created, there are several factors that are also affected by the industry as illustrated in Figure 3 above.

For instance, with the marked impact the respective industries have been making to the local economies, policy makers have been implementing specific government policies and financial incentives such as special policies governing free trade zones that give preferential incentives to service providers. In the private sector - the increasing number of convenience stores and food

outlets which offer 24 hour service to and around IT-BPO delivery centers – illustrate the symbiotic relationship between local industry and the IT-BPO sector.

Philippines

The direct impact of the Philippine IT-BPO industry can be captured in two major focus areas – *revenue and employment* – both of which have experienced double digit growth over the last 5 years. With the resilience shown by the industry during the global economic crisis, one can argue that the industry has not yet reached its plateau, and on the contrary, is perceived by analysts to accelerate growth in the short term as worldwide IT spending and BPO spending is forecasted to grow 5% and 6% respectively in 2010⁷.

Table 3: Philippines IT-BPO Revenues and Employment

Year	IT-BPO Export Revenue (US\$ Billions)	Revenue Growth Rate	IT-BPO Employment	Employment Growth Rate
2006	3.21	35%	240,000	47%
2007	4.82	50%	300,000	25%
2008	6.06	26%	370,000	23%
2009	7.09	17%	440,000	19%
2010	8.90	26%	530,000	20%

Source: Business Processing Association of the Philippines 2011

While direct effects of the IT-BPO industry are widely experienced by the Philippine local economy, there are several impact areas where IT-BPO indirectly affects the economy. The following are some of the specific areas influenced by the industry:

- Indirect Employment:** The outsourcing multiplier suggests that with about 530,000 employed by the industry, there are 2.1 million indirect jobs created. This comes from the growing retail and food & beverage industries which supplies the demand coming from the youth and middle age sectors (ages 18-30) which comprises half of the direct outsourcing employees.
- Quality of Life:** The change in the quality of life aspect, particularly for people employed in the IT-BPO industry has also seen a major change over the last decade. With the average basic income of entry level outsourcing employees approximately 50-60% more than the minimum wage (US\$210 – 220 per month vs. US\$330-340), this translates to higher per capita income for these employees – likewise providing higher levels of disposable income and generating increased consumer spending. This in turn also directly impacts GDP as more and more rest and recreation activities flourish. In Manila NCR alone, there have been more than 20 major (large) shopping malls that have been built in the last ten years.

⁷ NASSCOM Strategic Review 2010

- **Government Policies:** A number of special government policies have also been created to assist in the development of the industry, which in turn has also increased technical skills sets of graduating labor pool. In particular, several local government units in the Philippines have provided scholarships for training near-hires to be deployed in the IT-BPO space. For instance, the Quezon City local government provides a program called the Free Basic English Training (FBEST) which aims to give English proficiency training for Quezon City residents.
- **Infrastructure:** There are also a number of infrastructural changes that are attributed indirectly to the industry, most of which are associated with road rehabilitation and construction, metro rail development as well as improvement on telecommunication infrastructure. Perhaps the most significant infrastructure development is seen on capital investments allocated to building IT parks in the Philippines. To date, there are already 152 IT parks across the nation while 60 additional IT parks are currently being developed.⁸

India

The emergence of India as a leading outsourcing destination has created tremendous job opportunities for the Indian populace. Today, its IT-BPO industry is a flourishing bed for *young India* and one of the highest employment streams in urban India. The growth of the jobs in the outsourcing sector has had a significant impact on the lifestyle of the common Indian; the impact on the different facets is:

- **Indirect Employment:** The Indian IT-BPO industry directly creates (through its requirements) software programmers, BPO workers, management and related personnel. On the other hand the increasing spending power of the people and advent of foreign goods & services in the Indian market also has seen indirect employment created in huge numbers in other sectors. The total number of indirect jobs created in India, as a result of its IT-BPO industry, is estimated at around 7 million jobs.
- **Quality of Life:** Today the average urban Indian has higher disposable income. This has increased his spending power and India is moving from a middle class, *savings mindset* to a consumerism based economy. The liberalization of the economy which has opened doors to IT-BPO also has enabled various foreign companies in terms of automobiles, apparel and other consumer goods for selling their goods - and it has been a very rewarding proposition thus far.
- **Capital Investments:** The Foreign direct investment in sectors like telecom, infrastructure, manufacturing etc. has also increased in India, as these are all necessary ecosystem components necessary to sustain its fast-growing IT-BPO industry. Vodafone, Telenor and other foreign companies have envisaged a huge growth story for telecom in India, with the growing population of mobile users and established themselves in the Indian market with merger and acquisitions in the market. These sectors have created employment in the millions for the Indian market. In many aspects, this employment

⁸ Philippine Economic Zone Authority 2011

generation can be attributed in part to the local IT-BPO sector as the vast majority of IT-BPO professionals are themselves the most avid consumers of mobile services.

- **Infrastructure:** With the development of upwardly mobile urban population, developing nations investing in the India growth story – the infrastructure and technology available in these destinations has also undergone a sea change. The improvement of infrastructure in terms of six lane highways, metro rail, hyper malls etc. are enabling the quality of life deemed necessary for the top destinations on the global outsourcing map.

Given the current dynamics induced by the pull (increased direct effects such as outsourcing jobs and infrastructure development) and push factors (aggressive marketing of the industry, increased spending on support infrastructure, increased retail spend, etc.) for both economies – we believe that it will reach a point where the pull and push effects will be sustainable and independent to each other. While the obvious pattern is seen where direct employment generated by the outsourcing industry indirectly provides employment to other industries, these other supporting industries are being independently developed as well. In the long term, the indirect effects or push factors will thus contribute to the growth of the pull factors, and vice versa, creating a perpetually (and mutually) beneficial relationship.

Points to Consider

The direct impact of the IT-BPO industry is most often seen on its revenue contribution to country GDP and employment generation it provides the population. On the other hand, indirect effects can be seen across ancillary sectors that continue to reap benefits from the IT-BPO industry.

Given this impact to the local economies, several points can be raised:

- In the cases of India and the Philippines, are we starting to see successful transition of previously agriculture and/ or manufacturing based economies to ITeS-based economies?
- If so, can these new ITeS based economies sustain and induce the necessary impact to create this wide-scale economic transformation?

While the multiplier effect of the IT-BPO industry present several positive effects relating to the indirect and induced economic impact of the country, like all developments and growth, the IT-BPO industry is prone to multiple caveats as well. In this context, IT-BPO fueled economies often become export focused and highly dependent on external markets for growth. Thus, any global undercurrent would often have immediate fallout on the dynamics of the economy of the local IT-BPO industry.

There are also other adverse considerations related to export driven services. It has been studied for example, that employees in the IT-BPO space who are tasked to work during the so-called 'graveyard shifts' have acquired physiological, and negative medical conditions, such as insomnia, disturbed sleep patterns and other maladies which in turn may often lead to conditions related to heart attacks and poor nutrition, especially among younger employees. Further, some studies have warned that the newfound 'economic freedom' and increased earning power in the

youth may directly contribute to less than positive lifestyle - drug abuse, increased alcohol consumption, etc. These potential fallouts of the IT-BPO success story should be closely monitored.

Proven that there is continued demand from the IT-BPO industry, pioneer offshore countries such as India and the Philippines have a critical task at hand of making the industry more sustainable so as not to lose its current share of the market. Tholons believes that by addressing the caveats mentioned and at the same time honing existing industry channels that support the IT-BPO industry, both direct and indirect benefits of the IT-BPO industry will continue to be realized by their respective economies.

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