Expanding Global Production Networks: The emergence, evolution and the developmental impact of the offshore service sector in the Philippines

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Contemporary globalisation and the relocation, or offshoring, of services have created new opportunities for economic development in the Global South. Over the past decade, one million workers have found employment in the offshore service sector in the Philippines, primarily in Metro Manila’s call centres. This study investigates the emergence, evolution and the impact of the changing spatial division of service labour from the perspective of firms and subsidiaries located ‘offshore’ in the Philippines. It empirically examines expanding global production networks in services. Theoretically, this work expands the global production network framework by combining its analytical concepts of power, embeddedness and value with existing literatures from economic geography and development studies to understand to what extent services offshoring constitutes a new ‘model’ of economic development.
Expanding Global Production Networks
The emergence, evolution and the developmental impact of the offshore service sector in the Philippines

Jana Maria Kleibert
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Cover image: Statue devoted to BPO workers in the Philippines in Eastwood City Special Economic Zone in Metro Manila, photographed by Jana Kleibert.

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All photos: Jana Kleibert

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Expanding Global Production Networks
The emergence, evolution and the developmental impact of the offshore service sector in the Philippines

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op gezag van de Rector Magnificus
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Faculteit der Maatschappij- en Gedragswetenschappen
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>BCEZ</td>
<td>Baguio City Economic Zone</td>
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<tr>
<td>BGC</td>
<td>Bonifacio Global City</td>
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<tr>
<td>BNEFIT</td>
<td>Bacolod-Negros Occidental Federation for ICT</td>
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<tr>
<td>BOI</td>
<td>Board of Investments (Philippines)</td>
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<tr>
<td>BPAP</td>
<td>Business Processing Association of the Philippines</td>
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<tr>
<td>BPO</td>
<td>Business Process Outsourcing</td>
</tr>
<tr>
<td>BSP</td>
<td>Bangko Sentral ng Pilipinas (Central Bank of the Philippines)</td>
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<tr>
<td>CBD</td>
<td>Central Business District</td>
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<tr>
<td>CCAP</td>
<td>Contact Centre Association of the Philippines</td>
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<tr>
<td>CHED</td>
<td>Commission on Higher Education (Philippines)</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>DoST</td>
<td>Department of Science and Technology (Philippines)</td>
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<tr>
<td>DTI</td>
<td>Department of Trade and Investment (Philippines)</td>
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<tr>
<td>ECCP</td>
<td>European Chamber of Commerce of the Philippines</td>
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<tr>
<td>EPZ</td>
<td>Export Processing Zone</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FTE</td>
<td>Full-Time Employee</td>
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<tr>
<td>GCC</td>
<td>Global Commodity Chain</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GPN</td>
<td>Global Production Network</td>
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<tr>
<td>GVC</td>
<td>Global Value Chain</td>
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<tr>
<td>HR</td>
<td>Human Resources</td>
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<tr>
<td>IBPAP</td>
<td>Information Technology Business Processing Association of the Philippines</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and Communications Technology</td>
</tr>
<tr>
<td>IIT</td>
<td>Indian Institute of Technology</td>
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<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>IT-BPO</td>
<td>Information Technology-Business Process Outsourcing</td>
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<td>ITES</td>
<td>Information Technology-Enabled Services</td>
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<tr>
<td>KPO</td>
<td>Knowledge Process Outsourcing</td>
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<tr>
<td>LGU</td>
<td>Local Government Unit</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
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<tr>
<td>NASSCOM</td>
<td>National Association of Software and Service Companies (India)</td>
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<tr>
<td>NCR</td>
<td>National Capital Region (synonymous to Metro Manila)</td>
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<tr>
<td>NWC</td>
<td>Next Wave City</td>
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<tr>
<td>NWO</td>
<td>Netherlands Organisation for Scientific Research</td>
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<tr>
<td>OFW</td>
<td>Overseas Filipino Worker</td>
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<td>PEZA</td>
<td>Philippine Economic Zone Authority</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>SEZ</td>
<td>Special Economic Zone</td>
</tr>
<tr>
<td>STPI</td>
<td>Software and Technology Parks of India</td>
</tr>
<tr>
<td>TCS</td>
<td>Tata Consultancy Services</td>
</tr>
<tr>
<td>TESDA</td>
<td>Technical Education and Skills Development Authority (Philippines)</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
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<tr>
<td>VAT</td>
<td>Value-added Tax</td>
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<tr>
<td>VP</td>
<td>Vice President</td>
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<tr>
<td>$</td>
<td>US Dollar</td>
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<tr>
<td>₱</td>
<td>Philippines Peso</td>
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CHAPTER 1

Introduction
“The offshoring of services is becoming [...] possibly the critical international economic development issue” (Dossani & Kenney, 2007: 778, emphasis in original)

1.1 Globalisation and services-based economic development

At three o’clock in the morning, the streets of Ortigas central business district in Metro Manila are crowded. Young people with company IDs dangling from their necks stand around in groups, laughing, smoking, drinking coffee and enjoying a break from their work in one of the surrounding office towers. Working night shifts, their task is to answer “1-800” calls from the United States (US), negotiate credit card repayments, troubleshoot the newest electronic gadget, book flights and hotel rooms around the globe, sell faster internet connections on the phone, schedule petroleum lorries in Great Britain, reformat pictures for an online international newspaper, help kids on the other side of the planet with their English homework, transcribe medical statements from a hospital in the US, administer the pay-checks of employees in a New York bank, or develop a new firm’s website. All these services are exported to customers and firms in the Global North, far away from the Philippines’ shores.

In 2013, the Philippines, heretofore recognised as one of Southeast Asia’s economic laggards, achieved gross domestic product (GDP) growth of 7.2%, among the highest in the region (National Statistical Coordination Board [NSCB], 2015). The media celebrated the Philippines’ transformation from “sick man of Asia” to “Asia’s new strong man” (Fensom, 2013). The driver of this economic growth has been the strong services sector. The business process outsourcing (BPO) sector is currently the second-largest contributor to the Philippines’ foreign-exchange earnings (after remittances) and was estimated to employ about 1 million full-time employees in 2014 (Santos, 2014). Advancements in information and communications technology (ICT) have been described as facilitating a more even playing field for developing countries to participate in global competition; arguably a ‘flat world’ (Friedman, 2006). The hopes attached to the offshoring of services are high. The former Philippine President, Gloria Macapagal-Arroyo is quoted to have said: “The Filipino nation should take advantage of the flatness of the world and move into the first world in 20 years” (quoted in Dumlao-Valisno, 2008: 1).

The offshore service sector has experienced high growth rates since its inception two decades ago, and scholars believe that its impact on the global economy will be larger than the earlier relocation of manufacturing activities (Dossani & Kenney, 2007). Indeed, this is seen as “a new chapter in human experience, never before witnessed in history” (Bunyaaratavej, Doh, Hahn, Lewin & Massini, 2011: 71). Global production networks (GPNs) have become increasingly complex, due to unbundling and fragmentation. Codification, standardisation, and digitisation of information has enabled the production of services in one place, and consumption in another, allowing for transnational trade in services1 (UNCTAD, 2004). A geographic extension of GPNs in service delivery to developing countries has ensued.

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1 This study deals with offshoring of service work, not offshore finance and tax havens (see e.g. Shaxson, 2012; Wojcik, 2013).
The so-called “next wave in globalisation” (Dossani & Kenney, 2007) has not been discussed extensively from an economic geography perspective, despite being an inherently spatial phenomenon. Most studies on the offshoring of services stem from the perspectives of management and international business studies; in addition, there is a plethora of ‘how to offshore’ practical guide books for managers. The Offshore Research Network, which was founded in 2004 by Duke University’s Fuqua Business School, conducts surveys among offshoring firms located in the Global North. The network is increasingly funded by the private sector, including both individual offshoring firms and business associations (Bunayrartavej et al., 2011; Couto et al., 2006; Lewin, Massini & Peeters, 2009; Massini & Miozzo, 2011). In the past two years, several books have been published about offshoring, primarily from an economics perspective. Examples include The Oxford Handbook of Offshoring and Employment (Bardhan et al., 2013), Outsourcing Economics (Milberg & Winkler, 2013), and The Third Globalization (Breznitz & Zysman, 2013), and from a sociology perspective, Offshoring (Urry, 2014). These books deal with different kinds of offshoring, are not focused on services offshoring, and are often concerned with the impact on advanced economies. For example, “Can Wealthy Nations Stay Rich in the Twenty-First Century?” is the subtitle of Breznitz and Zysman’s (2013) book.

The impact of offshoring on the service-delivering countries in the Global South is less clear since the literature on offshoring “tends to over-emphasize potential or actual negative impacts being experienced by developed market economies and to neglect impacts on foreign service providers” (Bryson, 2007: 41). An exception to this can be found in the literature on labour in call centres (e.g. Amante, 2010; Beerepoot & Hendriks, 2013; James & Vira, 2012; Ofreneo et al., 2007; Taylor & Bain, 2005). Paus argues that “there is virtually no debate in the existing literature about offshoring’s impact on developing countries. Analysts generally assume, implicitly or explicitly, that developing countries will benefit from offshoring, as a matter of course” (Paus, 2007: 12). Missing in these recent publications, is an empirical, locally-grounded account.

Optimistic accounts of the impact of offshore service sector growth on developing countries dominate the literature on the phenomenon. The offshoring of services is believed to present new opportunities for developing countries to leapfrog industrialisation and to become service-based economies (Dossani & Kenney, 2007; Gereffi & Fernandez-Stark, 2010a). The consensus and practice in development theory has shifted throughout the decades, from import-substitution industrialization (ISI), based on the infant-industry argument in the 1950s and 1960s, to export-oriented industrialization (EOI). Both of these models revolve around manufacturing production. The offshoring of services follows the earlier relocation of manufacturing industries to countries with lower-cost workforces, changing yet again the global division of labour (Fröbel, Heinrichs & Kreye, 1980).

Until now, most studies have focused on the single case of India’s IT and IT-enabled services exports since the 1980s². In 2012, the offshore service sector contributed revenues of almost

² With the exception of studies on Eastern Europe, see the special issue European Planning Studies volume 19, issue 9, 2011.
Introduction

$100 billion to the Indian economy (NASSCOM, 2012). Ghani (2010: 3) writes that “the South Asian experience suggests that a services revolution – rapid growth and poverty reduction led by services – is possible. This can fundamentally change the pattern of development for many developing countries”. Much of the literature on India’s ‘success story’ is written by business practitioners and presents insider accounts of how the sector or a specific firm grew, often hagiographic in nature (Karnik, 2011; Ramadorai, 2011; Rastogi & Pradhan, 2011). India’s success presents a puzzle for development scholar. Does service-based economic development present a new model of development? Can countries leapfrog industrialisation through the use of export-oriented development in services? Can services replace manufacturing as a model of economic development? If the Indian case indeed epitomizes a new model of economic development, the question of replicability arises (Paus, 2007: 16). What kind of opportunities does an economic development strategy based on the offshore service sector present? And is it a fundamentally new strategy or do we witness a replication of the earlier relocation of production, leading to short-term employment creation in a footloose industry?

This research traces the expansion to the Global South of GPNs in service delivery and focuses on the experience of the Philippines. Both the Philippines and India failed to achieve high growth rates and rapid industrialisation in previous decades, but are now exporting a large volume of services to the Global North. The question arises whether contemporary globalisation, and the changing international division of labour in the services sector, leads to economic development. Economic development, in this study, is conceptualised beyond economic growth to include sustainable economic transformation and improving social conditions.

Levy (2005: 685) asserts that offshoring “decouples the linkage between economic value creation and geographic location”. Therefore, the outcomes of globalisation in specific places require further analysis. Economists seem to have largely disengaged from discussing the distribution of benefits and profits, concede Milberg and Winkler (2013: 5); instead other disciplines have taken up this analysis. Economic geographers, for their part, have developed tools to assess regional economic development based on a particular place’s integration into global production networks (GPNs).

This research uses the GPN framework (Henderson, Dicken, Hess, Coe & Yeung, 2002; Coe, Hess, Yeung, Dicken & Henderson, 2004; Coe, Dicken & Hess, 2008) and adapts its concepts, which were previously mainly used for studying cross-firm and cross-border industrial organisation, to the more recent phenomenon of services offshoring. The GPN framework was developed to ‘globalise’ regional economic development (Coe et al., 2004). It allows researchers to trace the production of goods and services in a relational framework that links the Global North and the Global South and includes both inter-firm and intra-firm relations.

I argue that the GPN framework provides a valuable lens to analyse contemporary global production processes and regional development. However, it needs to be complemented with insights from other literatures in order to operationalise its concepts and make the heuristic framework more applicable to explaining contemporary processes of service delivery. The title of this book reflects the aim of this research to, on the one hand, analyse the empirical phenomenon of GPNs expanding into services and geographically reaching
into new places in the Global South. On the other hand, this research aims to expand the GPN framework from its earlier focus on industrial-production processes to services. In order to achieve this, the GPN framework’s three main analytical categories of power, embeddedness and value, are combined and refined using concepts and insights from other literatures. Applying and adapting the framework for offshore services in the Philippines can inform debates about a services-based model of economic development and help to answer the main research question:

**How and why did the offshore service sector in the Philippines emerge, evolve, and how does it impact economic development?**

The research question can be divided into several themes. First, I discuss the emergence of the offshore service sector in the Philippines through an analysis of investment attraction processes and how places become integrated into GPNs. Second, I map the position of corporate subsidiaries operating in the Philippines to understand what functions and powers they hold. Third, I focus on the evolution of the sector. Do firms become increasingly territorially embedded over time, or do they remain footloose? And are firms moving up the value chain into higher value-added services, or do they remain limited to delivering lower-end services? Finally, I address the question of where value is captured within the GPN, which is crucial for assessing the impact on economic development in the Global South.

This study is embedded in a larger research project, and is conducted on the meso-level of the firm and spatially on the city or region of production. Three other PhD projects investigate related aspects of the offshore service sector and its local outcomes in Mumbai (Sandhya Krishnan and Randhir Kumar) and Metro Manila (Leian Marasigan), especially focusing on labour trajectories in the BPO sector and the sector’s low-end support activities.

On a policy level, the findings of this study are relevant to policy-makers dealing with the attraction of foreign direct investment (FDI) and the offshore service sector. It moreover provides an opportunity for policy-makers in other countries and places to learn about the experiences of offshore service delivery beyond the case of India. Many countries around the globe, from Ghana to South Africa, from Egypt to Kenya, from Malaysia to Chile, are trying to develop an offshore service sector and attract multinational firms (Ahmed, 2013; Beerepoot & Keijser, 2014; Benner, 2006; Brooker, 2011; Fernandez-Stark, Bamber & Gereffi, 2010; Graham & Mann, 2013). These countries can benefit from an empirically grounded study of the workings of the sector and its impact on economic development in another late-comer country in the sector.

This research is based on a qualitative case study of the offshore service sector in the Philippines. Extensive fieldwork was conducted in different cities across the Philippines between 2011 and 2013, yielding 106 in-depth open and semi-structured interviews, a survey among BPO firms, in addition to an analysis of secondary sources, and personal observations. In addition, several months of fieldwork were conducted in India, a first-mover country in offshore services, to better understand the workings of the sector better and place the Indian case in a broader perspective.
The introductory chapter of this book contains four parts. Following the current brief introduction, Section 1.2 presents the theoretical framework for the study. Section 1.3 explains the research methodology and Section 1.4 highlights the broader context; namely, economic development in the Philippines prior to the arrival of the offshore service sector. Chapters two to seven form the body of empirical research, followed by the concluding chapter.

1.2 Theoretical foundations: Offshore services, GPNs and economic development

This section defines the core concepts and gives an overview of the overall theoretical framework on which this research is based. It establishes the link between offshore services, GPNs and economic development to assess the new opportunities for economic development in a country like the Philippines.

1.2.1 Service-based economies

What exactly are services? Services are mainly defined as intangible or weightless commodities. Originally, services comprised the share of economic output that could not be attributed to agriculture or manufacturing in developed economies. Since then, services have become more important in the global economy, with industrialised countries seeing a surge in employment in the services sector since the 1980s (Daniels, 2004; Elfring, 1989). Services today make up the biggest share of GDP in developed economies and occupy the largest share of employment. The importance of services has also risen dramatically in urban areas in the Asia-Pacific region. Knowledge-intensive producer services are now considered vital for economic development in the region (Daniels & Harrington, 2007).

Meanwhile, the shift towards a tertiary-driven economy has led to increasing polarisation in developed economies. In US cities, for example, high-paid cognitive-cultural workers coexist with a low-paid underclass of service employees (Scott, 2012). Services, therefore, cover very different sectors and occupations within developed economies. Castells argued that the diversity in services is “in fact so extreme that it forbids considering services as a single, homogeneous sector of economic activity” (1989: 129). Moreover, the distinction between manufacturing and services as two distinct spheres is becoming increasingly blurred, as both are often linked in the production of goods (Daniels, 2004; Zysman, Feldman, Kushida, Murray & Nielsen, 2013).

The share of services in relation to agriculture and industry is usually higher in developed economies compared to developing countries. However, the attractiveness of a service-based economy as a lodestar to economic development has been debated. As the American economist Baumol (1985) pointed out, labour productivity in services is growing slower than in manufacturing. Services alone were considered unable to drive economic growth;

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3 His famous examples include a Beethoven string-quartet, which requires the same number of people and the same time to play in the 19th century as today, showing no growth in labour productivity.
instead they can only follow it. In the export-oriented development strategies of previous decades, services were moreover omitted, since they were believed to be non-tradable, especially since they often require face-to-face contact. However, recent developments have shown that services can take the shape of virtual exports, travelling the world faster and with less transportation costs than associated with physical goods. It remains unclear how far developing countries can achieve economic development on the basis of a strong services sector. Indian economists Chandrasekhar and Gosh (2006) see services as an “exaggerated development opportunity” since they are unable to provide enough employment opportunities for unskilled workers. Rodrik (2014) argues in a recent blog post that the high contribution to GDP in developing countries from the services sector does not indicate economic development but rather results from “premature de-industrialisation”.

1.2.2 Offshoring and outsourcing services

The geography of production is continuously changing and characterised by complex function and spatial reconfigurations. A restructuring of GPNs has led to a more pronounced vertical disintegration of production, to a functional fragmentation and spatial dispersion of work processes. Meanwhile, developments in ICT have enabled the storing, exchange, manipulation and retrieval of information through digitisation, redrawing the geography of service delivery (United Nations Conference on Trade and Development [UNCTAD], 2004).

Generally, three forms of FDI can be differentiated, according to their rationale: market-seeking, asset-seeking, and efficiency-seeking. The latter is also called vertical FDI and is used for achieving cost savings, especially in labour. Reducing costs is a main driving force for firms to offshore services. As UNCTAD states:

Many of the forces that have driven the internationalization of manufacturing are increasingly at play for a growing number of service functions. However, as the offshoring phenomenon may unfold faster, and because it is likely to affect corporate strategies in all sectors, it is all the more important to study carefully its implications (2004: 153).

Milberg and Winkler (2013) note that offshoring is strongly related to companies’ desire to become more cost-efficient and reflects a shift from strategies aimed at retaining and investing profits, to downsizing and distributing profits, although the causal direction is unclear. Global labour arbitrage through the offshoring of services has mainly been driven by US-headquartered multinational corporations (MNCs) under pressure to downsize and maximise shareholder value (Srivastava & Theodore, 2006). Management consultants present services offshoring as the next logical step in globalisation (ibid.). Accordingly, services offshoring follows the general patterns of the discourse on globalisation, namely as a new, but inevitable and levelling process (Sparke, 2012).

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4 For a discussion of the relationship between GPNs and financialisation, see Milberg (2008) and Coe, Lai and Wojcik (2014).
Despite having a long history as a business practice, considerable ambiguity surrounds the terminology that describes services offshoring and outsourcing, as well as the specific activities and sub-sectors that fall under it (see e.g.: Bunyaratavej et al., 2011; Gereffi & Fernandez-Stark, 2010a; Sass & Fifekova, 2011). The media often uses the term outsourcing when the actual process at hand is offshoring; for instance, in election debates about job losses in the US, or in humorous TV shows about cultural misunderstandings in an Indian call centre (such as Outsourced). Despite these terms being used erroneously or interchangeably by different actors, the main distinction between offshoring and outsourcing is a simple one (see Table 1.1).

Table 1.1: Forms of offshoring and outsourcing

<table>
<thead>
<tr>
<th>Home Country (Onshore)</th>
<th>Overseas Country (Offshore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full ownership</td>
<td>In-house, at home (status quo)</td>
</tr>
<tr>
<td></td>
<td>a) Intra-firm (captive) offshoring</td>
</tr>
<tr>
<td>Third-party ownership</td>
<td>Outsourcing to domestic third-party provider</td>
</tr>
<tr>
<td></td>
<td>Offshore outsourcing</td>
</tr>
<tr>
<td></td>
<td>b) To locally-owned company</td>
</tr>
<tr>
<td></td>
<td>c) To affiliate of a foreign third-party provider</td>
</tr>
</tbody>
</table>

Outsourcing refers to the decisions companies have to make concerning the boundaries of their firms, the ‘make-or-buy’ decisions, taking into consideration the transaction costs (Coase, 1937). Outsourcing occurs if a firm decides to buy the service on the market, which means that the ownership of a task is contracted out or outsourced to a third-party provider, independent of the territorial location of the service-delivering firm. Outsourcing can be defined as “the transfer of activities and processes previously conducted internally to an external party” (Hätönen & Eriksson, 2009: 142). The term offshoring, however, implies the movement of a service across national borders. It refers to a change in the location of tasks, independent of whether simultaneous outsourcing (the transfer of ownerships of the tasks) is occurring. Bunyaratavej et al. have defined offshoring as “the transnational relocation or dispersion of service related activities that had previously been performed in the home country” (2011: 71).

This research focuses on the impact of a change in the location of service production to developing countries. Therefore, only the right-hand column of firms in Table 1.1 is studied; namely offshore services (which may, but do not need to be, simultaneously outsourced). In general, this book will differentiate between three types of firms: a) MNC captives, which are directly-owned subsidiaries of foreign firms, b) domestic-owned BPOs, which are local firms in developing countries providing outsourced services; and c) foreign-owned BPOs, which are subsidiaries of foreign-owned providers of outsourced services.

The vertical disintegration of value chains and the reorganisation, restructuring and extension of GPNs facilitates a global ‘trade in tasks’ (Grossman & Rossi-Hansberg, 2008). Fragmenting value chains into ever smaller functions and components allows for a complex functional and spatial division of labour. The sociologists Brown, Lauder and Ashton argue that we are witnessing the industrialisation of knowledge work in the form of “digital
Taylorism”. The knowledge work of professionals is captured, codified and digitised to be “transferred and manipulated by others regardless of location” (2011: 72). The dispersion and recombination of service activities has profound implications for the geographic location of service delivery – and its compensation. During earlier phases of relocating manufacturing production, work was distinguished between ‘offshorable’ (low-skilled) blue-collar work and ‘non-offshorable’ (high-skilled) white-collar work. The relocation of lower-skilled jobs led to the assumption that attaining higher skills would insulate US workers from global competition. With the ability to offshore modern services, also those that require a higher level of skills, this assumption is being challenged (Brown et al., 2011).

Gereffi and Fernandez-Stark (2010: 23-25) from the Center for Globalization, Governance and Competitiveness, have compiled different estimates of the size of the global offshore service sector, which range between $252 million (OECD estimate) to $281 million (Boston Consulting Group estimate) in 2010, of which India holds the largest share globally. Services offshoring is a relatively recent phenomenon and the exact nature of the services concerned remains something of a black box. Most offshore services are offered across different industries, so-called ‘horizontal activities’, and therefore belong to different value chains or GPNs of services (e.g. financial services, legal services, telecommunications, retail) or manufacturing (e.g. consumer electronics). These include, on the one hand, customer-facing activities, such as customer support through contact centres, and on the other hand, basic internal business functions, including IT, and business process outsourcing. Increasingly, also higher-end functions, sometimes considered to be part of the core functions of firms (e.g. research and development) can be offshored (Couto et al., 2007; Lewin et al., 2009). The offshoring of higher-end services is often called knowledge process outsourcing (KPO), though the differentiation from BPO is not clear-cut. In the Philippines, the term IT-BPO is typically used to denote the entire offshore service sector; in India, the term IT-enabled services (ITES) is most commonly used.

The main problem in dealing with terminology that is differently defined and used leads to inconsistencies in definitions and in data collection. Sass and Fifekova encountered this problem when conducting research on services offshoring in Eastern Europe, arguing that “[f]or example, professional services, knowledge services, knowledge-intensive services, knowledge-based services, business services, other business services, IT-related services, computer and business related services are often used inter-changeably” (2011: 1595). The focus of this book is on offshore services in the Philippines, the predominant share of which fall under the category of business process outsourcing. The term BPO is therefore employed throughout the book, and the term offshore services is used when referring to the entire sector. Other abbreviations are only employed when using secondary data classified under alternative abbreviations.

The Business Processing Association of the Philippines (BPAP) refers to the sector as IT-BPO (although IT services comprise only a minor section of total services in the

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5 In late 2013, BPAP officially changed its name to Information Technology and Business Processing Association of the Philippines, abbreviated IBPAP, to signify a shift away from simple processing work. In this study, I refer to the old name BPAP throughout the text.
Philippines). The sector has grown very fast over the past decade. From a mere 100,000 employees in the Philippines in 2004 the sector grew ten-fold, employing close to one million workers in 2014 (see Figure 1.1). The largest share pertains to customer services, mainly conducted from call centres but also including non-voice-based services in the form of customer care delivered by email or web chat. Second in volume are back-office services, which include internal support services for large firms, such as finance and accounting, human resources, and other data processing. Medical and legal transcription, creative services including animation and game development, and engineering services account for a smaller share of overall BPO services.

Figure 1.1: The offshore service sector in the Philippines 2004-2014

1.2.3 The GPN framework and economic development

Analysing the processes of contemporary globalisation and its relationship with economic development in specific places is not an easy task. As places become increasingly inter-connected, forming multi-layered webs of interactions, discerning the individual components and their impacts becomes difficult⁶. Globalisation is an intrinsically geographical phenomenon (Dicken, 2004), in which places should be conceptualised simultaneously “as both territorial sites of global economic change and nodes in a global space of flows” (Coe & Hess, 2013: 8).

Regional development in the ‘new regionalism’ literature has often been understood as based on endogenous factors⁷. Embedded in globalising networks of production, the fate

⁶ Recent books on globalisation have focused on uncovering the inherently negative aspects of economic globalisation (Sassen, 2014; Urry, 2014).

⁷ For a critique see Coe and Hess (2012).
of regions and their opportunities to achieve economic development increasingly depends on global (or extra-local) actors and processes, in addition to endogenous factors. As a result, the GPN approach has been developed by the “Manchester School” of economic geographers (Coe et al., 2004; Coe et al., 2008; Henderson et al., 2002; Yeung, 2009a). The framework aims to conceptualise the connections between globalisation processes, occurring through the extension and expansion of GPNs, and the territorial development outcomes at regional level (Coe et al., 2004).

This study builds upon the comprehensive GPN framework, defined as a “nexus of interconnected functions, operations and transactions through which a specific product or service is produced, distributed and consumed” (Henderson, 2002: 445). The framework builds on the global commodity chain (GCC) and global value chain (GVC) approaches, which originally arose from world-systems theory (Henderson et al., 2002). It also reflects a relational view of the global economy (see also: Dicken, 2004; Dicken, Kelly, Olds & Yeung, 2001).

Companies are the central actors in any GPN and their actions must be understood to make sense of the resulting developmental outcomes in places. Firms continue to be key actors in economic development processes, but according to Henderson et al., insufficient empirical research “has probed the organizational dynamics of TNC [transnational corporations] subsidiaries as they emerge, evolve and impact on particular economies” (2002: 437, emphasis added). Tracing the actions and rationales of companies, their networks and their connectedness to certain places shall provide better insights into opportunities for regional development (see Figure 1.2).

**Figure 1.2: A framework for analysing regional development in GPNs**

![Framework for Analysing Regional Development in GPNs](Source: Coe et al., 2004: 470. Figure reproduced with permission from John Wiley and Sons.)
One of the most important contributions of the GPN approach is the concept of strategic coupling (MacKinnon, 2012). The concept posits that economic development can occur through regional actors linking their regional assets with the needs of producers in GPNs. Regional development depends upon value creation, value enhancement, and value capture within the region; it is not limited to GDP growth (see Figure 1.2).

The GPN framework has several advantages over previous value chain or commodity chain approaches. First, offshore service production can be better envisioned as a network than as a linear chain structure (Henderson et al., 2002). Second, distributions of work within firms and intra-firm relations are given more attention; this is relevant for offshore services, because technically captive offshore service subsidiaries are intra-firm relations. Third, the framework is more inclusive of other actors beyond the immediate production process, including institutional actors, labour groups, consumers and civil society associations (Coe et al., 2008). By adding more layers of complexity, which previous approaches arguably lacked, the GPN has become a heuristic, all-encompassing framework. Lastly, the emphasis on strategic coupling between GPNs and regional assets is useful for analysing the bargaining between ‘regional’ actors and TNCs during initial and later rounds of investment (Yeung, 2009b).

**GPNs: Stages and concepts**

The GPN approach is built around three main conceptual categories: power, value and embeddedness, which can be further divided into different concepts (see Table 1.2). How can these abstract concepts be used for an empirical study? In the following, the three interrelated categories, their different dimensions and their (selective) application to the research questions will be discussed.

<table>
<thead>
<tr>
<th>Power</th>
<th>Embeddedness</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate power</td>
<td>Territorial embeddedness</td>
<td>Value creation</td>
</tr>
<tr>
<td>Institutional power</td>
<td>Network embeddedness</td>
<td>Value enhancement</td>
</tr>
<tr>
<td>Collective power</td>
<td></td>
<td>Value capture</td>
</tr>
</tbody>
</table>

(Based on: Henderson et al., 2002: 448-453)

GPN scholars acknowledge that power relations play an important role in determining the production process. Gereffi's seminal work on governance relations in global commodity chains, places an emphasis on the corporate power relations within global value chains and production networks (Gereffi, 1994; Gereffi, Humphrey & Sturgeon, 2005). The GPN approach adds institutional power, held by regional actors, to this framework. Collective power, held by civil society actors and labour unions, is also thought to influence the organisation of production across geographies (Henderson et al., 2002: 450-451).
Production processes do not happen in a vacuum but are embedded in wider social and spatial relations. Territorial embeddedness denotes the ‘anchoring’ of firms in specific places, for example through the local linkages firms develop within a certain region. Network embeddedness traces connections developed within the production network, also beyond the locality of production (Henderson et al., 2002: 451-453).

Value lies at the core of determining the outcomes of production for localities and is also the core analytical category of the global value chain approach. The GPN approach introduces a more fine-grained understanding of value (understood as forms of economic profit). Value creation is the first step to achieving regional development, followed by value enhancement. However, ultimately value capture determines regional outcomes. As Coe et al. write:

A region may have an advantage in the quantity of labour, but much of the value created in the utilization of this abundant pool may be transferred out of the region through the repatriation of profits (realized value) and eventually the relocation of the production networks to other regions (2004: 474).

The opportunities for value capture are structured by factors such as government policy (e.g. on taxation and repatriation of profits) and the ownership of firms (Henderson et al., 2002: 448-449).

This relatively new approach, developed since 2002, offers great potential for analysing contemporary global phenomena, such as the rise of the offshore service sector in developing countries. The downside of an all-encompassing framework is the difficulty of conducting empirical studies, which the GPN framework creators acknowledge to “pose […] considerable practical problems” (Coe et al., 2008: 280). Therefore, it is no surprise that while the number of publications involving theoretical discussions on GPNs is growing, empirical studies remain scarce. The success of a framework, however, depends on its ability to generate new insights when applied to research.

In order to conduct empirical research using the GPN framework, researchers must make choices about which actors and processes to focus on. Instead of using the complex framework in its entirety all at once, I treat the GPN’s analytical concepts one by one, with an in-depth discussion, while also drawing on other concepts and bodies of literature (see Table 1.3). This approach allows me to address some of the recent, largely sympathetic criticisms of the GPN framework. Although lauded for its more nuanced understanding of power relations compared to earlier value-chain approaches (Dicken, 2004), scholars such as Dawley (2011) and MacKinnon (2012) have criticised it for underplaying power asymmetries between multinational firms and regions. This study remains sensitive of such asymmetric powers, especially in terms of the role of large foreign investors.

With the GPN approach, it is difficult to operationalise the abstract concepts for an empirical study. In this research, I combine concepts that have been studied extensively in economic geography and link these discussions with the GPN framework to expand the approach and

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8 The ‘dark side’ of GPNs is, however, explicitly mentioned in later publications (Coe & Hess, 2011).
gain deeper insights into the processes at hand. Economic geographer Dawley (2011) suggests combining GPN literature with earlier regional studies literature on foreign investment attraction, branch plants, and regional development, which I have taken up (especially in Chapters three, four and five). Other authors, concerned about the operationalization of corporate power and value enhancement, suggest an ‘eclectic’ use of concepts. Parrilli, Nadvi & Yeung (2013) recommend to combine the GPN literature with better-defined GVC ideas on value chain governance and upgrading. I follow their suggestion in Chapter six.

Finally, Kelly (2013) argues that by adopting a GPN approach, certain outcomes of globalisation are highlighted, whereas others remain hidden. In order to understand economic development in a specific place, different types of actors and processes beyond the GPN need to be incorporated into the analysis. I follow this suggestion to look beyond actors directly involved in the GPN in Chapter seven. In addition to value capture, I bring to the fore the spatialities of offshore service production and urban transformations resulting from expanding GPNs. Using the notion of local value capture, I assess the impact of the offshore service sector on economic development. Table 1.3 gives an overview of GPN concepts and their use in this study.

<table>
<thead>
<tr>
<th>Stage of GPN</th>
<th>GPN concepts</th>
<th>Other concepts</th>
<th>Chapter(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emergence of GPN</td>
<td>Strategic coupling</td>
<td>FDI attraction</td>
<td>2, 3</td>
</tr>
<tr>
<td>GPN Position</td>
<td>Corporate power</td>
<td>Branch plants</td>
<td>4</td>
</tr>
<tr>
<td>Evolution of GPN</td>
<td>Territorial embeddedness</td>
<td>Institutional capture</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Value enhancement</td>
<td>Upgrading</td>
<td>6</td>
</tr>
<tr>
<td>Beyond GPN</td>
<td>Value capture</td>
<td>Special economic zones</td>
<td>7</td>
</tr>
</tbody>
</table>

The empirical chapters are organised around different concepts. The chapters are ordered chronologically, based on their stage in the GPN. Chapters two and three deal with the emergence of the offshore service sector and strategic coupling; Chapter four maps the position of offshore firms in the Philippines in the network; Chapters five and six discuss the evolution of networks; and Chapter seven refocuses attention on urban changes as a result of the rise of the offshore service sector, linking back to questions concerning regional development. Each chapter addresses a specific sub-question.

Sub-questions per chapter

Chapter two: Why did India and the Philippines become integrated into GPNs of service delivery and what are crucial differences and similarities?

Chapter three: What role have local institutional actors played in facilitating the strategic coupling of second-tier cities in the Philippines with offshore service sector investors?
Chapter four: What (power) position occupy firms in Metro Manila and second-tier cities in the Philippines in GPNs in services?

Chapter five: How do foreign investors in offshore services gain access to skilled labour, what kind of industry-academe linkages are formed, and what are their implications for economic development?

Chapter six: To what extent has upgrading to higher-end services in the offshore service sector been achieved in the Philippines and India?

Chapter seven: Which urban transformations occur as a result of offshore service sector attraction and who benefits locally from the rise of service-based special economic zones?

1.3 Research area, design and technique

As individually published research articles, the chapters of this book all include a short section on methodology addressing the specific data collected and analysed for each individual chapter. In this section, the larger methodological framework is expounded. I explain the rationale for a primarily qualitative research design, the choice of research sites and fieldwork periods. I then elaborate on and contextualise the processes of data collection in multi-site research, and reflect on its limitations.

1.3.1 A qualitative approach

This study primarily follows a qualitative case study approach to gain an in-depth understanding of the workings of the offshore sector and the dynamics of interaction between GPNs and regional economic development through the examination of the offshore service sector in the Philippines. The case study method is preferable in situations when “how” or “why” questions are asked, when the investigator has little control over the events, when the focus is on a contemporary social phenomenon and when the researcher seeks to understand complex phenomena while retaining the holistic and meaningful characteristics of real-life events (Yin, 2009). This research is based on a multi-site case study, since it aims at understanding processes and interrelations. Secondary quantitative data in this study is only used to indicate the size of the offshore service sector and its sub-sectors, and calculate labour productivity.

1.3.2 Case study and research site selection

The two largest exporters of offshore services are India and the Philippines; both countries together occupy the top eight positions on Tholons’ list of ‘top offshore service destinations’ (see Table 1.4). On the basis of other management consultancy reports, India and the Philippines are defined as the only two “mature offshoring locations”, each hosting more than 50 offshore service firms (Gereffi & Fernandez-Stark, 2010a: 31). Offshore services are an urban phenomenon, locating mainly in large cities with educated labour pools. Most interviews for the purposes
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The research was conducted in the primary cities of Mumbai and Metro Manila. Mumbai, the financial nerve centre of the Indian economy, was chosen as a case study location to focus on business process outsourcing (especially by financial service providers), rather than IT-dominated Bangalore. Within the Philippines, Metro Manila hosted 80% of all offshore service sector employment in 2007 (BPAP, 2009), making it the obvious case study choice.

In order to trace the emergence of the offshore service sector and its extension and expansion beyond metropolitan centres, I selected several secondary cities as additional sites for interviews. Regional economic differences in the Philippines are considerable. I therefore selected second-tier cities from the three island groups: Baguio, in the North of Luzon, Bacolod in the Visayas, and Davao in Mindanao. In India, Pune was chosen as a second, smaller city in close proximity to Mumbai. All of these also feature in the top 100 of Tholons’ ranking and are indicated on the map in Figure 1.3.

Initially, I started the research project with the ambition of completing a comparative case study of the offshore service sector in Mumbai and Manila. For pragmatic reasons, I shifted the focus to the Philippine case study after an initial field visit to both Mumbai (formerly Bombay) and Metro Manila in July and August of 2011. A cross-cultural research by a single researcher can be difficult due to limitations in time, resources and access (Bryman, 2008). The Indian case presented particular problems of access to respondents and difficulty of data collection, which has also been noted in previous studies (Van Riemsdijk, 2013; Wissink, 2008).

Table 1.4: Top 100 outsourcing destinations 2013, fieldwork destinations in bold

<table>
<thead>
<tr>
<th>Rank 2013</th>
<th>Country</th>
<th>City</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>India</td>
<td>Bangalore</td>
</tr>
<tr>
<td>2</td>
<td>India</td>
<td>Mumbai</td>
</tr>
<tr>
<td>3</td>
<td>Philippines</td>
<td>Manila (NCR)</td>
</tr>
<tr>
<td>4</td>
<td>India</td>
<td>Delhi (NCR)</td>
</tr>
<tr>
<td>5</td>
<td>India</td>
<td>Chennai</td>
</tr>
<tr>
<td>6</td>
<td>India</td>
<td>Hyderabad</td>
</tr>
<tr>
<td>7</td>
<td>India</td>
<td>Pune</td>
</tr>
<tr>
<td>8</td>
<td>Philippines</td>
<td>Cebu City</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td>69</td>
<td>Philippines</td>
<td>Davao</td>
</tr>
<tr>
<td>94</td>
<td>Philippines</td>
<td>Bacolod</td>
</tr>
<tr>
<td>99</td>
<td>Philippines</td>
<td>Baguio</td>
</tr>
</tbody>
</table>

(Tholons, 2013)

9 Mumbai was ranked second and Metro Manila third in 2013; in 2014 this was reversed, and Metro Manila moved ahead of Mumbai (Tholons, 2014).

10 Metropolitan Manila consists of 17 municipalities, which together form the national capital region (NCR); both terms are used synonymously throughout this study.
These difficulties can be particularly challenging for female researchers due to the problems women can encounter in Indian society. Research on Indian call centres presents additional problems and barriers to entry, even when conducted by male middle-class Indian researchers. Vira and James report from the challenges of their study: “the typical Indian call centre workplace was a relatively inaccessible fortress, surrounded by high fences and gated entry, security guards who carefully controlled movement” (2011: 12).

Western firms that are offshoring services, and thereby relocating well-paid jobs of middle-class professionals, have been increasingly subject to negative press (most importantly during US election campaigns) and prefer to operate in relative secrecy. In one case, a global bank in India tried to hide the fact from the general public and the (Western) media that it employed several thousand employees in their shared service centre by prohibiting their own employees from mentioning their employer’s name to anyone. Instead of telling their families and friends that they worked for ‘Bank of America’ they were asked to say they worked for the ‘back office of a global financial service provider’. In such a context, Western scholars face severe difficulties to organise official interviews, access resource persons, or gain information on a company’s operations.

Interestingly, in the Philippines, access to information was much easier to realise. The reasons for the difference in access to information depend on a multitude of factors, including culture, but also because the definition of what was ‘confidential information’ appeared to be
set much higher. The fact that India has been confronted with stronger negative publicity than
the 'latecomer' Philippines will have played a role in the respective attitudes towards sharing
information. Moreover, previous studies conducted on the Indian offshore service sector have
led to research fatigue by elite interviewees and stakeholders. The Indian business association
could not be enlisted for a joint survey initiative, which was achieved in the Philippines.

Case study expert Yin (2009) argues that generally, multiple-case studies are to be
preferred over single-case studies; however, the benefit of a single-case study design is the
ability to focus on the specific context rather than on the ways in which both cases can be
contrasted. The latter is especially difficult in cross-cultural case studies (Bryman, 2008).
Since I was able to secure rich empirical material from the hitherto largely unexplored case
of the Philippines, I decided to limit the Indian case study to a reference case, rather than a
fully comparative case. Only Chapters 2 and 6 use my empirical data on India to compare
the sector with the Philippines. In addition to primary interview data, I used secondary
data from research reports by international management consulting offices, publications by
the industry body, and existing academic research published on India.

The often-studied case of India seems to present a unique or extreme case. World Bank
economist Engman, in a chapter titled 'Following in India's Footsteps', argues that although
a number of countries deliver back-office services and engage in customer support, India
remains "the only developing country that has created a sizeable, export-oriented IT service
sector" (2010: 222). In this sense, India is a unique or extreme case, whereas the Philippines
may represent a more 'exemplifying' (Bryman, 2008) or 'typical' (Yin, 2009) case from
which other countries can draw lessons.

### 1.3.4 Fieldwork periods, methods and data sources

Instead of opting for one long consecutive fieldwork stay, I chose several shorter periods (see
Table 1.5). Visiting the Philippines more than once had the advantage that I could trace the
evolution of the sector over several years, given that, since the beginning of this research,
the sector has grown from 560,000 to 1,000,000 employees in the Philippines. Moreover, the
multiple visits enabled me to analyse and discuss data at my home university before entering
the next fieldwork period, allowing for more reflection during the data-collection process. I
also based this decision on pragmatic considerations to avoid the monsoon season in both
countries (July-August) and the typhoon season in the Philippines (August to November).

<table>
<thead>
<tr>
<th>Date</th>
<th>Location</th>
<th>Data Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>22 June-26 August 2011</td>
<td>Manila, Mumbai</td>
<td>Establish contacts, background interviews</td>
</tr>
<tr>
<td>15 January-25 March 2012</td>
<td>Mumbai, Pune</td>
<td>Interviews, secondary materials</td>
</tr>
<tr>
<td>15 April-25 June 2012</td>
<td>Manila, Baguio, Bacolod</td>
<td>Interviews</td>
</tr>
<tr>
<td>4 February-24 April 2013</td>
<td>Manila, Davao</td>
<td>Interviews and survey set-up</td>
</tr>
</tbody>
</table>
I used the first field trip to India and the Philippines, in 2011, to familiarise myself with the two foreign research areas, to make initial contacts with the business sector and business organisations, and to lay contacts at partner institutions. Geographer Olds argues that establishing relations with an academic institution “is an absolutely critical factor in conducting multi-locale field work” (2001: 253). Thanks to my position in a collaborative research project\(^{11}\), the University of the Philippines’ School of Labour and Industrial Relations at the Diliman Campus in Quezon City (Metro Manila) and Mumbai University’s Faculty of Economics welcomed me during my fieldwork periods. These relations were very helpful in negotiating access to interviewees and resolving the practical (and bureaucratic) issues of conducting fieldwork in foreign environments. In the Indian case, my colleagues accompanied me on several interviews and on a longer research trip to Pune\(^{12}\).

When researching investment attraction and the emergence of the BPO sector in second-tier cities, many interviewees in Metro Manila urged me to visit Davao City and to include it in my study. However, due to a negative travel advisory for the entire Mindanao region, I had to delay my visit to Davao. When the security situation had temporarily improved, I was able to conduct a brief fieldwork visit and interviews in Davao in 2013\(^{13}\), a year after my research in Baguio and Bacolod.

**Interviews**

The main data for this research are 127 open and semi-structured interviews, held between 2011 and 2013. Of these, I conducted 106 in the Philippines and 21 in India (see Table 1.6; for a detailed list of all interviews, see Appendix). Yeung identified interviews with business managers as the “one of the best and most suitable methods in international business research in an Asian urban context” (1995: 314). Interviews offer the opportunity to get in-depth information and can increase the validity of findings (Schoenberger, 1991).

In an environment of scant information on existing firms and limited access, sampling was primarily driven by pragmatic concerns. However, attention was paid to include different types of firms, based on ownership (i.e. captive and outsourced, foreign- and domestic-owned). Access was gained through gatekeepers, especially in the business associations and foreign business chambers, and snowballing. Gaining trust was important for eliciting information, which was only possible through personal interactions. Offshore service firms are often highly secured with metal detectors and large security apparatuses. Thousands of employees are registered and controlled every time they enter or leave the building, and due to the sensitivity of information and data, employees and visitors are not

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\(^{11}\) NWO-WOTRO project “Understanding Globalisation”, grant number: W01.65.329.00.

\(^{12}\) Fortunately, I was given the opportunity to return the hospitality, when my colleagues spent several months as researchers at the University of Amsterdam.

\(^{13}\) After repeated terrorist attacks and hostage takings by separatists in the region, the US government in 2014 once again advises against travel to the entire region; the Dutch government advises against all non-essential travel to Davao.
Introduction

allowed to bring in mobile phones, USB sticks or laptops. In many cases, employees are not allowed to even bring their own pen and paper to their work station. Voice recording of interviews under these circumstances was often impossible, but interestingly, the handling of this client-determined policy turned out to vary from firm to firm. Voice recording was possible in 62% of interviews in India, and in 74% of cases in the Philippines.

I mainly conducted interviews with high-level managers of offshore service firms (domestic-owned as well as foreign-owned), and representatives of government bodies, industry associations, and support sectors. I targeted the highest-ranking manager in each firm at the specific location to get an overview of the firm’s operations; their strategies relating to types of tasks and location choice; their relations with the firm’s headquarters; with other firms in the network and with clients; and the overall evolution of their firm and the sector in general. In several instances, more than one representative of the same firm was interviewed, usually one from the operations side and one dealing with human resources, helping to gain an overview of the firm from different perspectives. These interviews occurred either simultaneously or one after the other. Most interviewees had had at least one previous offshore service sector-related job (especially in the Indian context, where interviewees were slightly older). Respondents could therefore reflect from the position of more than one firm, and more than one function14. Interviews in the Philippines continued to a point where little new information was discovered and a saturation point was reached.

Data collection was a strenuous process of long commutes through metropolises with largely dysfunctional public transport systems. The metropolitan region of Manila spans 640 km², Mumbai 603 km², and the commute to interview locations often took up to several hours in a day. Most interviews were conducted during daytime, especially with governmental and non-governmental organisations. By contrast, the working hours of most call centres in

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14 I interviewed, for example, a managing director of a captive MNC in the financial sector, who had previously worked for the firm’s captive subsidiary in the Philippines, had then been transferred to manage the Indian office of the same firm, and was subsequently head-hunted by a competing firm for a similar position in India.
the Philippines are during the ‘graveyard shift’, meaning that several interviews were held in the late evening, early morning, or at night. While challenging to the body rhythm, the interviews provided the opportunity to observe the industry in its busiest setting.

Survey
In 2013, I organised an online survey in cooperation with BPAP among its 623 members. My survey questions focused on the evolution of the BPO sector in the Philippines, especially on industry-academe linkages (Chapter five) and upgrading into higher value-added services (Chapter six). Without the cooperation of the Philippine business association it would have been impossible to conduct the survey, since contact details and firm names are not openly available. The non-representative survey yielded 111 responses from BPO firms, an overall response rate of 18%. These survey findings were used to complement qualitative findings by adding information on a larger number of firms and to triangulate certain research findings.

Secondary sources
In addition to the survey, the quantitative data used in this project come from secondary sources. Basic productivity calculations, for instance, are made on the basis of data released by the business associations. An analysis of the spatial distribution of the offshore service sector throughout the Philippines is based upon a database of the Philippine Economic Zone Authority (PEZA) and correlated locational data of consumption outlets from a coffee store company’s website.

Moreover, as background information, I accessed reports from the business associations NASSCOM (India) and BPAP (Philippines). These publications, in several cases outsourced to management consultancies such as McKinsey, are sold for several hundred US dollars per copy. They contain a wealth of quantitative information and industry forecasts, often without a clear description of methods or data sources used. I was able to get hold of hard copies of materials on the Philippines, and managed to negotiate access to the archive of NASSCOM in Mumbai, where I was able to read through and take notes on these publications. Finally, locally published sources, such as books and English-language newspapers were used to provide further background information on the sector.

Personal observations
Finally, personal observations form the backdrop to this research. Apart from taking notes on my impressions of firms and their workers during interview visits, I attended several high-level industry events. These included Chief Executive Officer (CEO) briefings, general membership meetings of BPAP, Arangkada Philippines (a joint event organised by the foreign business chambers), and the fringes of the NASSCOM Indian Leadership Summit in Mumbai. These provided the opportunity for networking and accessing further resource persons, and simultaneously revealed the actors most engaged in the offshore service industry, their presentations, and internal discussions. The frequently organised job fairs, often in shopping malls, also provided a good overview of firms and their activities.
Moreover, I was able to observe the rapid growth of the offshore service sector and rapid urban transformation as a temporary inhabitant of Metro Manila. In the Philippines, over the last few years, the offshore service sector has become an important economic driver and employer of a very visible, young, educated, English-speaking workforce. I took field notes on my interactions with workers and my informal discussions with various people in the industry during my field stays. Upon hearing about my research topic, most people I met, ranging from academics to parents, taxi drivers, and of course workers, would offer their own opinions and observations.

1.3.5 Data analysis and limitations of the study

My interview notes and field notes were digitised or transcribed and grouped according to themes, with the help of a qualitative data software programme (Atlas.ti). For each chapter, I used a part of the data as described in each separate methodology section. Some interviews were relevant to more than one chapter. The data was combined per theme and place and subsequently interpreted. I triangulated my findings across different interview sources, industry expert interviews and secondary sources, including business and media reports.

The research is based on a single-case study with India as a reference case. It is therefore context-specific and does not allow for generalisation of findings beyond the Philippines. The study addresses the emergence and evolution of the offshore service sector from the perspective of business leaders, industry stakeholders, and the government to analyse the impact on local economic development. These actors are grounded in the Philippines, and as this research will show, are often located far away from places where decisions are taken on the offshoring of services. Most studies on offshoring have analysed decision-makers, often using surveys, in the Global North. In comparison, my Global South approach gave me a stronger understanding of the implications and outcomes of these decisions. However, this approach also has its limitations, as I did not interview buyers of offshore services and the key decision-makers in GPNs. Lastly, analysing an ongoing process, such as the emerging offshore service sector in the Philippines, makes for an exciting and contemporary topic; however, there are limitations to analysing ongoing processes and understanding not only their emergence but also their evolution, while it is still in the process of evolving.

1.4 Setting the scene: Globalisation and economic development in the Philippines

With a population of more than 100 million, the Philippines is the 12th most populated country in the world. The Philippines presents a curious case of maldevelopment in Asia. In earlier phases of global restructuring of production networks, the country only managed to achieve modest industrialisation on the basis of exporting textiles and the assembly of electronics. The lack of economic growth and employment opportunities in the country have led to a large overseas migration of workers, often at high emotional costs to individuals and
families. So are the Philippines now at a ‘turning point’ for economic development (Bird & Hill, 2009)? This section provides a concise introduction to previous economic development in the Philippines over the past decades to provide the context for the ensuing interpretation of changes due to the arrival of the offshore service sector on the country’s shores.

1.4.1 A development puzzle

The Philippines have long time been recognised as an outlier in the region when it comes to economic development. Scholars have puzzled over the failure of the Philippines to successfully industrialise and generate economic growth, especially when compared to the development trajectories of its neighbouring countries (Balisacan & Hill, 2003; King, 2007). The editors of the book ‘The Philippine Economy’ assert that “[the Philippines’] development outcomes have been disappointing by any yardstick” (Balisacan & Hill, 2003: 4). Real per-capita GDP in 2000 was on the same level as in 1980, and since the 1950s, the Philippines’ per capita income has been overtaken by Korea, Taiwan, Thailand, Indonesia and China (ibid.). At $3,270 per-capita gross national income in 2013, the Philippines remains a lower-middle income country in Southeast Asia (World Bank, 2015).

The Philippines seems to have particularly underperformed compared to the rapid industrialisation of other East Asian countries (Maca & Morris, 2013; Medella et al., 1995; Studwell, 2014). But also within the Association of Southeast Asian Nations (ASEAN), and the group of countries called the ASEAN-5 (Philippines, Indonesia, Malaysia, Thailand, and Singapore), average GDP growth of the Philippines has, for a long time, been lagging (see Table 1.7). In particular, the 1980s were a decade of dismal growth in the Philippines.

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<td>Thailand</td>
<td>8.4</td>
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(Source: Balisacan & Hill, 2003: 7, Table 1.1)

The Philippines “missed out almost completely on the Asian boom from the late 1970s to the mid-1990s” (Balisacan & Hill, 2003) when a large-scale relocation of labour-intensive activities to the region occurred (see Table 1.8). Foreign investments stemming from Japan skipped the Philippines (Bello, 2009: 19-20).

When the Philippines, in later decades, managed to attract FDI and develop an export-oriented manufacturing sector, its competitiveness was largely based on cheap labour. This led to footloose production in branch plants, which could easily relocate to cheaper productions,
following the ‘flying geese model’ (Kojima, 2000). As a result, only temporary employment in the garments sector (commonly referred to as a ‘sunset industry’ in the Philippines) and in low-end electronics manufacturing was created (Beerepoot & Hernández-Agramonte, 2009; Kelly, 2002; McKay, 2006). Other export-oriented industries, such as furniture manufacturing, equally struggled to compete globally and declined (Beerepoot, 2005).

During its decades of economic stagnation, the Philippines failed to upgrade into higher value-added production and develop a competitive export-oriented manufacturing sector driven by technology and innovation gains (King, 2007). Unable to compete with countries offering lower-cost workforces, especially with large labour forces, such as China, the Philippines had limited opportunities to attract export-oriented manufacturing as a springboard for economic development. This difficulty to develop a robust manufacturing sector led to two processes: large-scale overseas labour migration and a rising services sector (see Section 1.4.3).

1.4.2 Causes of maldevelopment

Why was the Philippines not able to achieve rapid economic development, at par with its neighbours? Scholars have brought forward various explanations for the country’s economic underperformance, ranging from colonial legacies, faulty economic policies, foreign debt accumulation via global financial institutions, and the role of elites in the political economy. Many of these explanations are interrelated and their popularity has changed over time, often depending on ideological convictions. Historians have focused on the implications of colonial relations, economists on the Philippine’s macroeconomic policies, and political scientists on the role of elites in the political economy.

Colonial legacies

Colonisation led to the uneven integration of many countries in the Global South into the global economy as resource exporters, plundered for economic gains by colonial leaders. The Philippines was a Spanish colony between 1565 and 1898. At the end of the Spanish-

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<td>16,663</td>
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<td>Thailand</td>
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<td>1,405</td>
<td>6,134</td>
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(Source: UNCTAD, 2014)

15 China’s rapid rise and its manufacturing prowess, in general, arguably block other countries’ economic development through export-oriented industrialisation (Jaques, 2012).
Chapter 1

American war, the Philippines was transferred to the US, which ruled from 1898 to 1946 (with increasing autonomy from 1935 onwards). Following the stated aim of colonial 'exceptionalism' and 'benevolent assimilation', the US created political institutions and an education system modelled on its own, in order to prepare the Philippines for self-governance and education (Diokno, 2011; Hedman & Sidel, 2000). These colonial relations impacted the political economy of the Philippines in several ways. Bello, a Filipino academic, politician and activist argues (2003) that the US model of government, forced upon the Philippines in the wake of independence, has harmed the formation of a 'developmental state' as seen in East Asia and instead lead to the rise of an 'anti-developmental state':

The American pattern of a weak central authority coexisting with a powerful upper-class social organization [...] was reproduced in the Philippines, creating a weak state that was constantly captured by upper-class interests and preventing the emergence of the activist 'developmental' state that disciplined the private sector in other societies in postwar Asia (Bello, 2009: 4).

The American influence has therefore had important repercussions for the political economy of the Philippines. The absence of a strong state in the Philippines coupled with strong elite interests has influenced the economic development in the Philippines.

Import-substitution policies, the Marcos dictatorship and debt accumulation

Domestic economic policies in the 1950s and 1960s followed import-substitution policies. As the protectionist policies were unable to kick-start economic growth, the Philippines embarked on economic liberalisation from the 1980s onwards, as demanded by international financial institutions. During the Marcos presidency (1965-1986), some economic growth occurred, based largely on foreign loans from the World Bank and the IMF. In return for these loans the government was forced to implement 'structural adjustment' policies demanding liberalisation, deregulation and privatisation. However, the borrowed money was not used for economic development purposes, but was instead redistributed among the personal networks of oligarchs and cronies of Ferdinand Marcos, who instituted martial law in 1972. His dictatorship, sometimes characterised as a 'kleptocracy', plundered the economy and left the country highly indebted (Aquino, 1987; Chaikin & Sharman, 2009).

Over the next decades, paying off loans initiated by the Marcos regime became a major burden on the economy (Bello, 2009; Bello, Kinley & Elinson, 1982). Abinales and Amoroso argue that a lack of state resources seriously impedes economic development programmes today: “The government faces a huge deficit caused largely by the servicing of massive domestic and foreign debt accumulated since the 1970s. The other major cause is the state’s inability to collect taxes from well-connected corporations and wealthy families” (2005: 16). The role of these elite families in preventing land reform and undermining efforts at economic development to protect personal gains are elaborated upon in the next section.

16 For a discussion of developmental states and GPNs in East Asia, see Yeung (2014).
17 Transparency International, a non-governmental organisation, lists Ferdinand Marcos as one of the most notorious cases of global political corruption (Transparency International, 2004: 13).
Crony capitalism and the rentier economy

Although the Marcos dictatorship exposed a virulent form of corruption and plunder, political scientist Hutchcroft (1991) argues that the Marcos era did not represent an exception in the country’s economic history, instead contending that patrimonial plunder has been continuous, embedded in long-standing neo-patrimonial state structures. For example, a long tradition of powerful land-owning elites has effectively blocked land reform (Krinks, 2002). Studwell, who sees land reform as a crucial first step towards economic development, notes that “the Philippines is probably the most extreme example of land-policy dysfunction in Southeast Asia” (2014: 39). Ferdinand Marcos broke traditional structures and upset the established political order by introducing a new set of cronies (McCoy, 1994). After his dictatorship, the People Power Revolution brought back the old oligarchy with Cory Acquino at its helm (born Cojuangco), stemming from one of the most powerful families in the Philippines, assuming the presidency (Anderson, 1988). Her son, Benigno ‘Noynoy’ Acquino III, became President of the Philippines in June 2010.

The immensely negative impact of elites and oligarchs on the Philippines is reflected in the number of publications devoted to them, and the multitude of concepts developed to describe their rule over the political-economy of the country, variously called ‘crony capitalism’, ‘cacique democracy’, ‘booty capitalism’, or ‘bossism’ (Anderson, 1988; McCoy, 1994; Hutchcroft, 1998; Sidel, 1999). The oligarchy derives its income from rent-seeking behaviour18. Studwell writes that in the Philippines “the political class has been the most selfish and culpable among all the major states in east Asia” (2014: 88).

However, corruption and crony capitalism is not unique to the Philippines, and was also prevalent in ‘Tiger’ economies like South Korea (Kang, 2002). Development outcomes, therefore, do not depend on the individual ambitions of elites but on the institutional settings in which they are embedded. The existence of extractive institutions instead of inclusive institutions in the Philippines, is essentially what Acemoglu and Robinson (2012) identify as the cause of ‘why nations fail’. Elite interests have persistently been able to dominate the political economy in the country (Raquiza, 2012; Van Helvoirt, 2009).

1.4.3 The rise of service sector employment in the Philippines

In 2012, the services sector contributed the largest share to Philippine GDP at 57%, agriculture at 11% and industry at only 32% of GDP (NSCB, 2015). Employment is also strongly based in the services sector, which employs 18.6 million people – more than agriculture (11.9 million) and industry (5.4 million) combined (NSCB data, in Mitra, 2013). The rise of the service sector in the Philippines is not a very recent phenomenon, as the share of services in GDP has exceeded manufacturing since the mid-1980s (Mitra, 2013). The share of agriculture has been steadily declining and failed land reform has led to

18 "Rent-seeking refers to the propensity of entrepreneurs to concentrate their efforts on obtaining protection and subsidies (rents) from the state without delivering the technological progress and competitiveness that economic development requires" (Studwell, 2014: 61).
Chapter 1

the creation of a highly uneven agricultural sector. On the one hand, a few large haciendas produce crops for export (rice, coconut, and exotic fruits); on the other hand, subsistence agriculture with low production for domestic consumption accounts for considerable employment (Studwell, 2014). When the share of agriculture to GDP started to decline, the share of manufacturing did not increase but marginally decreased; and the percentage of services as a share of GDP grew by a staggering 50% since 1980 (Balisacan & Hill, 2003: 13).

The services sector has not only supported the domestic economy but been important in attracting foreign exchange, for example through the tourism sector. The most important contribution to the Philippine economy for many decades has been the export of (service) workers19, whose remittances accounted for $22.4 billion (8.5% of GDP) in 2012, according to the Philippines’ Central Bank (BSP) (Magtulis, 2013). Such labour migration is managed by the state, which acts as a broker for overseas contract migration (Rodriguez, 2010). Finally, the real estate sector’s strong growth also contributes to high growth rates in the services sector.

The focus of this book is on the rapidly expanding BPO sector (see Figure 1.1), which is lauded as an ‘endless sunshine industry’ (Estopace, 2013) to differentiate it from earlier short-term boom phases which were followed by economic recessions. Will the BPO sector continue to grow, or relocate and turn into an early sunset, similar to earlier sunrise industries? Media and analysts are eager see a rising Philippines as the ‘next Asian miracle’ (Sharma, 2012) on a path to economic growth. Economic development, however, requires more than mere GDP growth, and depends on the spatial and social distribution of gains made from integration into the global economy.

1.5 Structure of the dissertation

The majority of empirical chapters of this book have been published, or are forthcoming, in international peer-reviewed academic journals (as indicated at the beginning of each chapter). For the reader, a collection of stand-alone articles, each providing a brief introduction to the subject, theory and methodology, can make for tedious reading. The best way to approach the structure of this book, therefore, is as an edited volume of a single scholar, devoted to the study of a specific subject, involving multiple angles of approach. This study follows a clear line in terms of the topic, research question, and the overarching theoretical framework. The GPN framework extends through all chapters, each focusing on a specific concept of the capacious framework, as elaborated in Section 1.3. The structure of the remainder of this book is as follows.

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19 Most migrants are employed in service professions abroad; the main professions are “household service workers; waiters, cleaners and related workers; charworkers, cleaners and related workers; nurses; professionals; caregivers and caretakers” (Rodriguez, 2010: xii).
Chapter two: Services-led economic development: Comparing the emergence of the offshore service sector in India and the Philippines [accepted for publication as a book chapter in the forthcoming the Routledge-edited volume “The Local Impact of Globalization in South and Southeast Asia: Offshore Business Process Outsourcing in Services Industries”]

India and the Philippines are the two largest offshore service providers globally. Chapter two examines the crucial similarities and differences in the rise of the offshore service sector in India and the Philippines. Findings, based on interviews and secondary literature, show that the sector, in both countries, was initially driven by foreign MNCs and an initially indifferent government response to the growth of the sector. Differences in scale and institutional set-up, especially in the education system, have led Indian entrepreneurs to focus on IT services and form large national companies, in contrast to the Philippines.

Chapter three: Strategic coupling in ‘next-wave cities’: Local institutional actors and the offshore service sector in the Philippines [published in Singapore Journal of Tropical Geography, 2014, awarded Best Graduate Student Publication 2014 by SJTG]

Chapter three looks at the scope for agency of local institutional actors in the investment attraction of BPO companies. Drawing on empirical work from the Philippines, I analyse the process of GPNs expanding towards lower-tier cities and the integration of new places into these networks. Specifically, the role of local institutional actors as facilitators of FDI attraction and their role in strategically coupling local assets with the needs of foreign investors in offshore services is discussed. Two contrasting cases, the second-tier cities of Baguio and Bacolod, show that considerable scope for intervention rests with local institutional actors.

Chapter four: Global production networks, offshore services and the branch-plant syndrome [accepted for publication in Regional Studies]

The offshoring of service activities has created opportunities for developing countries to become integrated into GPNs of service delivery. Assessing the resulting opportunities for economic development, the branch-plant economy literature is revisited, combined with ideas of the GPN approach and applied to the case of offshore services in the Philippines. Based on empirical research in Metro Manila and three second-tier cities in the Philippines, it is argued that the branch-plant literature continues to provide important insights for analysing the impact of FDI in services. In particular, second-tier cities are characterised by a dependent position in the international division of labour.


The global sourcing of services from developing countries has made human capital a key factor for attracting FDI. This chapter analyses how companies get access to ‘talent’, how individual companies engage in linkages and collaborations with universities, and how the education sector responds to the knowledge economy’s new demands. A case study of industry-academe linkages in the growing offshore service sector in the Philippines shows that companies have been able
to collaborate with institutions and introduce changes in the education system to supply mainly lower-end skills, potentially transforming the country into a dependent-market economy.

Chapter six: Upgrading in business process outsourcing in the Philippines and India: Emerging South-South divisions of labour

The chapter investigates upgrading trajectories in the Philippines, a rising provider of BPO services, and compares it to India's successful upgrading trajectory. It posits a distinction of upgrading into more knowledge-intensive and higher-revenue generating parts of global production networks of service delivery, with varying opportunities of value capture. Moreover, it assesses the different opportunities for upgrading for different types of BPO firms (domestic- or foreign-owned firms; outsourced or in-house operations). The findings reveal that limited upgrading is driven by MNCs' captive operations in the Philippines. An emerging specialisation and Indian-Philippine division of labour in offshore service delivery is unfolding.

Chapter seven: Islands of globalisation: Offshore services and the changing spatial division of labour [accepted for publication in Environment and Planning A, awarded Best Graduate Student Paper in Development Geography by the Association of American Geographers]

Where do offshore service firms invest in the Philippines? Which spatial transformations occur as a result, and why? This chapter maps the location of offshore service investments on a national and regional level and traces the genesis of service-based special economic zones (SEZs) in the central business districts of Metro Manila. These zones form 'islands of globalisation' within the metropolis and combine global production with consumption features. Existing powerful real estate developers are revealed not only as enablers, but also as primary local beneficiaries, of this feature of contemporary globalisation.

Chapter eight: Conclusions

The final chapter reflects on what the combination of these findings mean for the case at hand and for the study of the globalisation of services and economic development. Finally, remaining questions and suggestions for further research are presented.
Services-led economic development: Comparing the emergence of the offshore service sector in India and the Philippines

2.1 Introduction

The offshoring of services has created opportunities for developing countries to generate revenue and employment by exporting services to the Global North (Dossani & Kenney, 2007; Ghani, 2010). Changes in information and communications technology have led to a "tradability revolution" (UNCTAD, 2004), allowing international trade in so-called modern services. This has enabled the spatial reorganization and expansion of value chains and GPNs in services. So far, most interest on the potential and actual threats of offshoring for developed economies has arisen from a Western perspective. The impact on receiving countries, however, has been less explored. Bryson (2007) claims that research on offshore services has focused on the effects for employment-sending countries in the Global North, rather than assessing the impacts on service-delivering countries. Arguably, the growth of exports of IT-enabled services has created new opportunities for developing countries to leapfrog industrialisation and to achieve services-led economic development (Dossani & Kenney, 2007; Gereffi & Fernandez-Stark, 2010a).

This chapter addresses a gap in current research to look deeper into the experiences of developing countries and the newly emerging division of labour in offshore service delivery. The similarities and differences of the emergence of the sector in India and the Philippines are analysed and the causal factors for divergent trajectories are distilled. So far, little comparative research on this topic has been done and “much of the emerging conventional wisdom is based on an extrapolation of the Indian experience as a potential development alternative available to other developing countries” (Majluf, 2007: 148). Milberg and Winkler argue that India’s IT sector may have “suffered from a selection bias of successful cases” (2013: 13). In particular, the increasing sophistication of work conducted out of India has received much scholarly attention (Dossani & Kenney, 2007; 2009: 99-100).

India is by far the largest provider of offshore services globally, holding a global market share of 58% (NASSCOM, 2012: 7). The Philippines has emerged more recently as a participant in the offshore service sector, but has overtaken India in one sub-sector, namely call-centre operations (IBM, 2010; The Economist, 2012). India and the Philippines are among the world’s largest providers of global offshore services and the top eight offshoring cities are located in either of the two countries (Tholons, 2013: 2). This chapter investigates the interplay of factors that gave rise to offshore service delivery from India and the Philippines and the role of diverse actors in the “strategic coupling” of regions with offshore service networks, as discussed in the GPN framework (Coe et al. 2004; Coe et al., 2008; Henderson et al., 2002).

The analyses of similarities and differences between India and the Philippines, both of which have been successful in integrating into GPNs and delivering services to developed countries, forms the first step in a critical discussion of services-led development strategies. The rise of the offshore service sector is a relatively recent and very dynamic phenomenon, owing to various factors, as Massini and Miozzo write:
It is clear that the evolution of offshoring cannot be understood as an isolated event, but [...] result[s] from the interplay and interaction of multilevel agenda and endogenous and exogenous factors, demand and supply or push and pull factors which interplay and affect one another to result in emerging dynamics (2012: 1238).

The relevance of this study lies in understanding the underlying mechanisms of current processes of globalisation, and the offshoring of services, in a comparative perspective. Using several variables, this comparative case study argues that key differences have led to diverging processes of integration into GPNs in India and the Philippines. Moreover, it explains how and why both countries have followed different trajectories, and discusses potential future pathways. For this research, 40 interviews were conducted with key stakeholders, including representatives of business associations; managers of shared services firms and call centres; special economic zone authorities; and sector experts in India (Mumbai) and the Philippines (Metro Manila). In addition, I reviewed secondary sources, including academic articles, business reports, (online) newspaper articles, and popular biographies (and hagiographies) of IT-firm founders. The majority of secondary sources available focused on the Indian case, as apart from non-academic business reports, publications on the emergence of the offshore service sector in the Philippines are still a scarce commodity.

Several limitations and challenges need to be mentioned for this comparative study. First, the use of different, not clearly defined and overlapping terminologies exists in the field of offshore services. This limits the ability to compare data (Sass & Fifekova, 2011). Second, individual, country-specific data on the sector are estimates by business associations, which admit in interviews to not always having access to accurate data themselves. Recently, both the Indian business association NASSCOM and BPAP in the Philippines have changed the way they calculate data20, which makes even tracking the development of a single case over time difficult. Other data comes from private consulting firms (e.g. McKinsey & Company, Everest, Boston Consulting Group, Evaluseve, Gartner), which often generate income from advising firms on offshoring part of their tasks and arguably hold a bias in favour of portraying the industry in a more positive light for marketing purposes.

Third, cross-country international trade figures available for offshore services are inherently flawed. One problem is that non-outsourced activities usually occur between a head office and cost-centres as intra-firm trade, creating possibilities for transfer pricing. Another problem is that trade data does not consider the level of value added (Milberg & Winkler, 2013: 41). Therefore, this chapter concentrates on the more qualitative aspects of the integration of India and the Philippines into GPNs.

In order to achieve its aims, this chapter first develops a theoretical understanding of the prerequisites for the local emergence of a (viable) offshore service sector (Section 2.2).

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20 Domestic services have been included in the calculation (though offshoring is usually export-oriented) and more recently even hardware production (both for domestic consumption and exports) has been added (e.g. NASSCOM, 2012) to augment total numbers.
Next, similarities and differences are identified between the development trajectories of the offshore service sectors in India and the Philippines (Sections 2.3 and 2.4). The differences are then explained in Section 2.5, after which Section 2.6 ponders the implications for the debate on service-led economic development and formulates suggestions for further research.

### 2.2 Prerequisites for integration into the GPNs of services

Several of the forces of globalisation have combined to lead to the creation and expansion of GPNs, namely economic liberalisation policies, increased global competition, and the spread and pervasive use of ICT (Henderson et al., 2002: 443). The same three processes have played a role in the offshoring of services. The establishment of service-provision centres in developing countries has taken place due to the increased competition among service providers and in order to reduce costs, as well as take advantage of potential economies of scale (due to centralised service provision), access to skilled labour and new markets. Though service production and consumption was believed to be spatially inseparable, reliable and cheap high-speed communication technologies can now allow back-office and call centre activities to be provided across large distances. In fact, all services can be offshored that do not require face-to-face interaction, can be transmitted via modern telecommunications infrastructure, have a considerable wage difference across space, and do not require extensive networking (UNCTAD, 2004).

The offshore service sector is a heterogeneous category, including various services and activities, located at different points of the value chain (Gereffi & Fernandez-Stark, 2010a). The acronym BPO encompasses customer services (voice-based services conducted in call centres; or non-voice-based services delivered via email and chat programmes), back-office services (e.g. data processing), engineering services, transcription services, and creative services (e.g. animation). These vary vastly in terms of routine, codability, and skill-level required, on a scale from simple to complex work. High-end services, such as legal services, financial analytics and engineering design require domain expertise and specific skills, whereas the lower-end functions found in call centres are scripted, routine functions.

The financial services sector has been a driver of offshore services. The majority of global financial corporations have relocated part of their activities to India or the Philippines. Increasingly, firms are opting for service delivery from both of these countries simultaneously (also in an effort to hedge country-specific risks), creating increasingly complex GPNs in services. The network metaphor employed by the GPN framework, instead of a linear conceptualisation of a value ‘chain’, is useful to illustrate the complex forms of organisation of contemporary service production. In contrast to earlier approaches (e.g. the global commodity chain), the GPN framework is more inclusive in terms of the types of actors, who are understood to shape and influence the networks. These include firms, labour, and institutions, which hold asymmetric powers and operate at various scales (Coe et al., 2008).

A main contribution of the GPN approach is its conceptualisation of regional development as the outcome of attracting investments and becoming integrated into GPNs
through a process of ‘strategic coupling’. This notion refers to the actions of regional actors to link, or couple, the strategic assets of a given region with the demands of a GPN (Coe et al., 2004). Existing regional assets are therefore crucial for the ability for developing countries to couple their regions with the offshore service sector.

English-language skills are an important strategic asset and, in fact, a requirement for exporting services to the largest offshore service market, the US. Since labour arbitrage is the main rationale for sourcing tasks from developing countries, a key asset required for the participation in the offshore service sector is a low-cost, but sufficiently skilled, workforce. The skill level (and especially language abilities) of workers contrasts with the earlier relocation of manufacturing activities from the Global North to lower-cost destinations around the globe. By focusing on their skilled workers, countries, which have been unable to gain from this earlier offshoring of manufacturing due to uncompetitive business environments, are now able to participate in GPNs. The World Bank economists Goswami, Mattoo and Saez state that:

countries such as India and the Philippines are doing well in cross-border exports of skill-intensive services but are lagging in labor-intensive manufacturing exports, not because of their absolute advantage in services—they remain relatively abundant in unskilled labor—but because of their comparative disadvantage in manufacturing (2012: 8).

In contrast to manufacturing, offshore services generally require relatively little infrastructure investment, except for communications infrastructure. Reliable and cost-efficient internet connectivity to transfer large volumes of data is a key requirement for offshore service delivery. The liberalisation of the telecommunications sector has been pivotal to increase competition, reduce costs, and raise investment in the sector (Goswami et al., 2012). It is important to note, though, that only business hubs need to be equipped with telecommunications infrastructure; the overall share of households with internet connection is not decisive.

Both India and the Philippines are characterised by globally uncompetitive business environments and deficient physical infrastructure. In a ranking of ‘ease of doing business’, India and the Philippines occupy positions 132 and 138 respectively, out of a total of 183 countries (World Bank & International Finance Corporation, 2013: 3). In order to attract investments in an uncompetitive business environment, government policies and special incentives are required by national governments to facilitate the emergence of an offshore service sector. The three crucial factors for the attraction of offshore service investments can be summarised as (1) a relatively low-cost labour force with widespread English-language skills, (2) a liberalised telecommunications sector, and (3) government incentives for services exports.
2.3 Comparing the offshore service sector in India and the Philippines: similarities

All three requirements for offshore service sector development are fulfilled by India and the Philippines, which constitute the main similarities of both countries’ integration into GPNs. First, and most importantly, both India and the Philippines have been under the rule of English-speaking colonisers and both are developing countries with skilled, but underutilised, workers.

Second, the telecommunications sector in both countries has been liberalised. Panagariya (2008) defines the Indian telecommunications sector reform as one of few successful policies introduced by the technocratic government in the mid-1990s. Despite generating the opportunity for companies operating in business hubs to link up to the internet, it is noteworthy that India’s national internet penetration, as of 2008, was only 2% (Nilekani, 2008: 371). In the Philippines, the privatisation and liberalisation of the telecommunications sector under the Ramos presidency drastically reduced end-user rates. Introducing competition for long-distance communications in 1995 provided a further increase in competitiveness (Fink, Mattoo & Rathindran, 2001).

Third, the governments of both countries have facilitated the rise of the offshore service sector through a range of policies. In India, private sector representatives argued frequently during interviews that the offshore service sector grew ‘despite the government’ and did not receive any special attention or facilitation by the government. The sector in India, however, benefitted from an exception to government-enforced general restrictions to foreign investment, which initially led to more advantageous conditions for offshore service firms relative to other sectors (Karnik, 2012).

A closer look also reveals that in both India and the Philippines the offshore service sector has benefitted from a range of incentives and received substantial state support in forms of the creation of SEZs for offshore services. In India, the Software Technology Parks of India (STPI) were founded in 1991. The establishment of these parks has been a critical national state policy, offering tax incentives and subsidised infrastructure (Upadhya, 2011: 179). The STPI regime was terminated in 2011, and since then a new SEZ scheme has taken its place, which offers fairly similar incentives.

In the Philippines the offshore service sector was recognised as an investment priority sector, thereby qualifying for tax incentives and exemption from foreign ownership restrictions by the Board of Investments and the Philippines Economic Zone Authority (PEZA). The privatisation of PEZA in 1995 and the reduction of minimum space requirements for SEZs helped the offshore service sector, since individual floors of prime office buildings in central business districts became eligible for tax incentives. IT-Parks and Centres mushroomed from zero in 1999 to 168 in 2012, according to PEZA data (see Chapter seven).

Aside from tax incentives, the SEZs fulfil two important roles: first, they provide enclaves of good business environments, in terms of infrastructure and internet connectivity, in countries which generally lack these (Engman, 2010: 234). Second, the formation of one-stop-shop professional organisations for foreign investors cuts red tape and decreases
opportunities for corruption and bureaucratic delay (Yi, 2012: 141). The national and state governments have played a role in supporting the growth of the offshore service sector through these policies. In addition, the Philippine government has also provided more direct financial support to the sector through funding of its business association and educational programs, which are directed at increasing the supply of a suitable workforce for the sector.

2.4 Comparing the offshore service sector in India and the Philippines: differences

2.4.1 Sector composition

The offshore service sectors in India and in the Philippines differ in many ways, as Table 2.1 shows. India’s total offshore service sector is much larger than that of the Philippines, employing almost three times the number of employees and receiving close to five times more revenue for its exports. However, in relative terms, offshore services employ a larger share of the population in the Philippines than in India, since India’s population is larger by a factor of 12. Labour productivity for offshore services (measured as revenue per employee), is almost double in India compared to the Philippines, demonstrating that higher value-added service provision is taking place in India. This also relates to the different revenue generating opportunities in different sub-sectors. Moreover, different types of foreign investors have invested in India and the Philippines, and the business associations have performed different roles, as explained in more detail below.

The composition of the offshore service sectors in India and the Philippines based on export revenue is depicted in Figure 2.1. In the Philippines, call centres (voice-based BPO) make up 66% of the total export revenue earned; voice- and non-voice-based BPO

<table>
<thead>
<tr>
<th>Year 2012</th>
<th>India</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inhabitants (approx.)</td>
<td>1,200 mio</td>
<td>100 mio</td>
</tr>
<tr>
<td>Full-time employees (FTE)</td>
<td>2,175,000</td>
<td>772,000</td>
</tr>
<tr>
<td>Annual export revenue ($)</td>
<td>69 billion</td>
<td>13 billion</td>
</tr>
<tr>
<td>Annual revenue per FTE ($)</td>
<td>31,700</td>
<td>16,800</td>
</tr>
<tr>
<td>Rationale of companies</td>
<td>Cost and availability of IT-skills, benefits of scale</td>
<td>Cost and availability of English language, customer-service ability</td>
</tr>
<tr>
<td>Type of services</td>
<td>Predominantly IT-related, back-office, (decreasing) voice-based services</td>
<td>Mainly voice-based services, transcription, back office, animation and creative services</td>
</tr>
<tr>
<td>Foreign investors</td>
<td>Third-party providers and in-house shared service IT centres; changing interrelationships with domestic companies</td>
<td>Large third-party providers (primarily US-owned call centres), shared service back-offices on the rise for MNCs</td>
</tr>
<tr>
<td>Business associations</td>
<td>NASSCOM: strong body, independent funding, focus on the selling of services</td>
<td>BPAP: government-funded, focus on investment-attraction</td>
</tr>
</tbody>
</table>

(Source: NASSCOM; BPAP; author’s analysis)
sectors combined account for 85%. By contrast, less than 23% of revenue stems from BPO services in India; instead, IT services dominate with 58%. (The corresponding figure of the Philippines is only 9%). High value-added engineering and research and development (R&D) work contributes 19% in India. In the Philippines, health services (including medical transcription), engineering services, animation, and game development in total represent 6% of offshore service sector export revenues.

### 2.4.2 Foreign investors

Foreign investors have been a central driver of the offshore service sector. In India, domestic-industry protectionism under the License Raj led IBM in 1978 (then still largely a producer of computer hardware) to leave the country. IBM re-entered India only gradual liberalisation of the economy since 1991, this time through a joint-venture (Das, 2002). The softening of foreign ownership restrictions led to increased flows of FDI into India. Many foreign investors started offshoring services on a small scale through existing subsidiaries of MNCs, which were initially set up to cater to the local market. When firms discovered the opportunity for labour arbitrage in service provision, they started setting up separate shared service operations to deliver services to the Global North.

Many of these businesses operated ‘under the radar’ at first, as their cost-savings were considered an advantage over competitors, and therefore kept secret. Several early movers set up their dedicated in-house offices in India in the early 1990s. These included firms like General Electric, financial service providers, and outsourcing companies, such as IBM and Accenture. Some of these subsidiaries of foreign-owned companies for service delivery from India were later taken over by Indian-owned companies: General Electric’s in-house centre started servicing other clients and became an independent third-party supplier (Genpact); British Airways’ shared services centre, in a similar fashion, became WNS.
Chapter 2

One of the earliest foreign investors to provide offshore services from the Philippines was the US communications company AOL, which started in 1997 to cater to US clients from Subic Freeport Zone. In the following years, mainly foreign-owned BPO companies such as Convergys and Sykes, mostly with previous offshoring experience in India, invested in additional offices in the Philippines. Later, MNCs started to relocate their back-office operations to Metro Manila. These originated primarily from the financial sector, but also included other industries such as manufacturing, logistics and publishing. Compared to India, an inverse process of changing ownership can be witnessed: foreign-owned companies bought out Filipino-owned companies, which could not compete with the larger, international, third-party suppliers. As a result, the Philippine offshore service sector is now primarily foreign-owned and foreign-equity participation in the sector stands at above 90% (Yi, 2012).

2.4.3 Business associations for offshore service delivery

Business associations can be important drivers to advance a sector. The Indian National Association of Software and Services Companies (NASSCOM) was founded in 1988, first operating out of a small apartment in Delhi. Since then, it has grown to a membership of about 1,350 companies. The professional organisation has become the lodestar for countries aiming at replicating India’s IT sector success, which can also be seen in the names given to these associations (e.g. BRASSCOM in Brazil, GASSCOM in Ghana). NASSCOM is privately funded through membership fees and the majority of its members are Indian-owned companies.

In the Philippines, BPAP was founded in 2004 and is much smaller than its Indian counterpart. The majority of its members are foreign-owned companies but its board of directors consists exclusively of Filipinos. Of the five sub-organizations, the contact centre association (CCAP) is by far the most powerful one, representing the largest share of activities. Apart from membership fees, a considerable amount of funding is obtained from the government and from Filipino-owned support organizations profiting from the offshore service sector, such as telecommunication providers and commercial real-estate developers. Their role in supporting the sector is also apparent in the fact that they fill three board positions (of the non-industry board) in addition to the five-person industry board.

In terms of their core work, both agencies proactively follow relatively similar policies. The Philippines acknowledge replicating some of NASSCOM’s strategies, especially in terms of organising the training and testing of the potential workforce for employment in the sector, engaging in government lobbying for incentives, and in terms of marketing and branding efforts. Due to the dominance of foreign-owned companies in the Philippines’ BPO sector, the umbrella organisation has mainly engaged in foreign investment promotion through road shows and campaigns. A difference in power, size, and its forerunner position, means that NASSCOM has been forced to deal with a US backlash against the offshoring of services, lobbying the US government abroad, and representing the interests of Indian IT companies globally (Karnik, 2012). BPAP has had less reason to engage in this, since most companies delivering offshore work from the Philippines are US-owned MNCs, who are better positioned to lobby their own government rather than working through BPAP.
2.5. Causal factors for different trajectories of offshore service sector development in India and the Philippines

The main reasons why India and the Philippines differ in the positions they occupy within global offshore service networks are summarised in Table 2.2. They are discussed in detail below.

2.5.1 Timing of integration into the GPNs of services

Comparing India’s service-led development with China’s manufacturing success, Ghani argues that both were shaped by “their relative strength in education and infrastructure, and the timing of the globalisation of services” (2010: 95). The point in time at which a country integrates into GPNs matters, as historic windows of opportunity can open or close. As a forerunner in the sector, India started providing services to the US under very different conditions from the Philippines, which entered the offshore sector almost 15 years later. Already during the 1980s, India engaged in the practice of short-term labour migration (or ‘body shopping’) of software programmers to clients’ offices in the Global North (Parthasarathy, 2013: 380-381).

During that time, service delivery focused on IT services, since the telecommunication infrastructure was still too rudimentary for voice-based services. The dotcom bubble had a preferential impact on the development of offshore service delivery from India in two ways: during the boom, over-investment in optical fibre cables reduced connectivity costs globally, while the bust led to cost pressures for companies, and therefore, offshoring to India. The Y2K bug, in the run-up to the year 2000, was another decisive moment for Indian IT companies to prove their capabilities (Dossani, 2013; Dossani & Kenny, 2009: 81). Gaining a foothold early in the sector has been an important advantage for India, as Milberg and Winkler note that “GPNs have a cumulative and herd-like character […] as one firm in an industry has success, others have tended to follow” (2013: 33).

The Philippines entered the offshore service sector on a large scale only after the year 2000. The Asian financial crisis led to lower commercial property prices in Metro Manila.

Table 2.2: Variables explaining differences in offshore service sector

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing</td>
<td>Forerunner (1980s onwards), short-term</td>
<td>Later entrant (starting 2000s) after</td>
</tr>
<tr>
<td></td>
<td>labour migration ('body shopping'), dotcom</td>
<td>Asian financial crisis, liberalisation of</td>
</tr>
<tr>
<td></td>
<td>bubble, Y2K</td>
<td>telecommunication</td>
</tr>
<tr>
<td>Labour pool</td>
<td>Former British colony, education system</td>
<td>Former American colony, ‘cultural affinity’ and</td>
</tr>
<tr>
<td></td>
<td>with high technical and management training</td>
<td>English-language skills, high literacy levels but</td>
</tr>
<tr>
<td></td>
<td>for small percentage of the population</td>
<td>lower quality education in critical skillsets</td>
</tr>
<tr>
<td>Domestic-owned firms</td>
<td>Domestic-owned firms drove growth of sector; now large actors in the global industry</td>
<td>No active role by domestically owned firms in the development of the offshore sector; now mainly small, uncompetitive actors</td>
</tr>
<tr>
<td>Returnee migrants</td>
<td>Important ‘brain circulation’, established</td>
<td>Less important role, large labour migration is</td>
</tr>
<tr>
<td></td>
<td>business contacts and networks</td>
<td>mainly unskilled/non-BPO related</td>
</tr>
</tbody>
</table>
which reduced the cost of office space for foreign investors in prime locations. By then, advances in communications technology allowed low-cost voice-based services, and exports in this field mushroomed. More recently, the rise of social media use and advanced mobile-phone technology has created opportunities for marketing and customer service via social-network sites, which is being delivered out of customer-service centres in the Philippines. Differences in timing can therefore partially explain a difference in orientation towards particular sub-sectors; however, the main explanatory variables are regional assets in the form of a large, skilled labour force.

2.5.2 Size and skillsets of the labour force

While both countries have a large number of English speakers, their respective educated labour pools differ. The difference of population size of the two countries should be kept in mind, since economies of scale are important in the offshore service sector. Early on, India developed high-standard technical education through the renowned Indian Institutes of Technology (IITs), elitist public schools, which were the result of Nehru’s education policy in the 1950s. At 16%, India has a relatively low percentage of tertiary education enrolment (World Bank, 2013), but with 220,000 students at IITs and Indian Institutes of Management combined, the total number of highly-skilled individuals is still considerable (Brown et al., 2011: 33).

Due to the opening up of the education sector to private providers, who received subsidies from various states in India, a drastic increase in the supply of engineers in these states resulted, leading to a concentration of offshore service activities in the states of Andhra Pradesh, Karnataka, Maharashtra and Tamil Nadu (Dossani, 2013: 162-163; Nilekani, 2008: 346). With a focus on top tertiary education for the few, primary education has been neglected in India. This has led to low literacy rates, especially among women, almost half of whom remain illiterate (United Nations Educational, Scientific and Cultural Organisation [UNESCO], 2006).

This contrasts with a literacy rate above 95% for both genders in the Philippines (UNESCO, 2008). Moreover, tertiary education enrolment is relatively high at 28% in 2009 (World Bank, 2013) as a result of an implementation of a US-style college system. The quality of tertiary education however, suffers from the fact that 90% of all higher education institutes are privately-owned (and largely non-accredited), and less than 10% of academic staff hold PhDs (Welch, 2011). Overall, research capabilities are limited, and some universities and colleges offer low-quality degrees (Tullao, 2003).

Only ten school years are required for students entering university, two years less than in most countries. As a result, an often-mentioned problem by offshore service companies located in the Philippines are the limited generalist skills of graduates (including English-language skills), leading to hiring rates of less than 10% in voice-based services. This problem has been recognised by the government and current reform efforts in the Philippines include the introduction of a 12-year curriculum (K+12) to increase the competitiveness of Filipino graduates.
Although English is widely spoken in India and the Philippines as a result of colonisation, there are differences between both countries as a result of their colonial histories. US colonisation of the Philippines (1898-1946) introduced institutions according to the American model and the interaction led to what is often labelled a “cultural affinity” of the Philippines with the US (Rodolfo, 2005: 35). Work that involves direct customer interaction with American clients over the phone values the ‘neutral’ accent of Filipinos.

In both countries, the offshoring of services has been driven by companies wanting to reduce costs, leading to “efficiency-seeking vertical investments” (Hardy, Sass & Fifekova, 2011b), but the difference in existing labour pools in both countries means that the sourcing strategies of foreign investors have differed. In the case of India, technical, and to a lesser extent, managerial skills have been sought. The Philippines’ strongest asset has been its English-language skills. This, in combination with a cultural affinity with its main offshore market – the US – has led global firms to source voice-based services from the Philippines.

2.5.3 Domestic-owned companies and the role of domestic entrepreneurs

The most striking difference between the sector in India and the Philippines is the role of domestic-owned companies. While in India, a considerable amount of home-grown companies have acquired the status of MNCs today (notably Tata Consultancy Services [TCS], Infosys, and Wipro), there are few sizable Filipino-owned offshore service firms. Also in absolute numbers, the offshore service sector in the Philippines is dominated by foreign-owned firms, whereas in India, the majority of firms are domestic-owned. The reasons for this divergence have yet to be better understood.

Interviewees in both countries use cultural arguments to attribute an ‘entrepreneurial mind-set’ to Indians and an ‘employee mind-set’ to Filipinos. However, a strong entrepreneurial spirit among Filipinos can be seen when it comes to small companies and self-employment; for instance, organised through international job websites such as oDesk, where a significant percentage of all completed tasks and assignments is conducted from the Philippines (Beerepoot & Lambregts, forthcoming). It is also noteworthy that some successful Filipino-grown companies were acquired by foreign companies when they entered the market, leading to a decreasing number of Filipino-owned companies.

In India, the offshore service sector has grown due to domestic entrepreneurs and the availability of engineering and managerial talent. Oftentimes, companies emanated from old conglomerates, such as Tata Steel in the case of TCS. The six largest Indian IT firms were founded between 1968 and 1986 (Dossani, 2013: 157). The early founders of offshore service companies and today’s IT tycoons are admired individuals and their stories have been well documented (e.g. Ramadorai, 2011). Several of them underwent engineering training at universities in the US before returning to India and setting up their firms (Dossani, 2013). Indian entrepreneurs have also played a central role in upgrading into higher-end services due to their accumulation of technical expertise (Parthasarathy & Aoyama, 2006).

In the Philippines, existing conglomerates with enough financial wherewithal and manpower to set up offshore service firms have been reluctant to do so. Diversification from
real estate and retailing business has mainly been directed at the telecommunications and utilities sectors (Gutierrez & Rodriguez, 2013). These can be considered more traditional rent-seeking activities. The only conglomerate to experiment with voice-based service delivery to foreign clients has been Ayala Corporation, which created the BPO-investment arm LiveIT Investments and acquired the US-based contact centre, Stream.

2.5.4 Diaspora networks, returnee migrants, and brain-circulation

Development studies’ scholars and practitioners have long discussed the negative implications of a ‘brain drain’ from developing countries towards the Global North. More recently, the idea of a “brain circulation” has taken hold, in which highly-educated professionals return to their home countries bringing crucial experience and networks with them (Saxenian, 2002; Majluf, 2007). Both India and the Philippines exhibit a large pattern of outward labour migration. Close to ten million overseas Filipino workers (OFWs) are employed as contract workers abroad, contributing more than $21 billion (in 2012) in remittances to the Philippine economy (National Statistics Office, 2013). The majority of their work is in unskilled or low-skilled service jobs, or unrelated to (potential) offshore services. Only 1% of OFWs occupy administrative/managerial or technical professions in the US (Yi, 2012: 130). So far, the impact of returnee migrants on the Filipino offshore service sector has therefore been low.

Although India has seen much low-skilled labour migration as well, a considerable number of highly skilled professionals and researchers have migrated to the US. These diaspora networks have been crucial to the rise of India’s IT sector (Engman, 2010: 225). The US is the most attractive destination for Indian PhD students and Indians encompass the largest group of foreign students in engineering and sciences in the US – about 68,000 students in 2009 (Van Riemsdijk, 2013).

Recently, many US-educated and trained professionals have returned to India as a result of increased economic opportunities in their home country, as well as due to personal, cultural and lifestyle reasons (Wadhwa, Jain, Saxenian, Gereffi & Wang, 2011). Several of these Returned Non-Resident Indians set up their own successful offshore service businesses in India with the help of their experience and networks from abroad (Chacko, 2007). Brain circulation has been an important component of India’s integration into the global economy and it remains to be seen if the Philippines is able to benefit from returning outward migration in the future.

2.6 Conclusions: different trajectories in offshore services

This chapter has shown how varied the integration into GPNs in India and the Philippines has been. Although foreign investors and clients started to source services from both countries based on the idea of labour arbitrage, strategic coupling took place on the basis of different regional assets. In the Indian case, this was based on the technical and management capabilities of the Indian elite, whereas in the Philippines, the English-language advantages of the Filipino labour force were the main regional asset. This constitutes the single most important difference
in regional assets and has important implications for the types of services produced. The differences in human capital, not limited to the local workforce, but also in the existence of successful entrepreneurs and technically skilled returnee migrants with crucial networks in the service-receiving home markets, distinguishes the Indian case markedly from the Philippines.

These findings provide a first starting point for further discussions of a services-led model of economic development, since they show how diverse the trajectories of both countries’ integration into GPNs has been, and how the strategic coupling of regions with the offshore sector has taken place in very different ways. Though the different entry points into the offshore service sector play a role, they do not fully explain the differences in the type and quality of services provided, which depends on the availability of regional assets. With the maturing of the offshore service sector, these differences have become more pronounced over time; for example, due to the relocation of voice-based activities from India to the Philippines. Both countries have not been acting independent of each other, but their offshore delivery networks have become increasingly connected. MNCs hedge their investment by opting for advanced models of offshore service delivery, including offshore service centres operating out of several countries simultaneously.

More recently, Indian companies have started to invest in the Philippines, mainly establishing subsidiaries offering voice-based services to clients in the Global North. This increasing specialisation in call-centre work is considered to be at the lower-end of the value chain. At the same time, both countries are pursuing strategies to move up the services value-chain, and opportunities may exist for the Philippines to upgrade into higher-value-added, non-voice-based services. If upgrading strategies in the Philippines prove successful, more-direct competition for similar types of services between both countries might arise. Additional research is required on the emerging specialisations of India and the Philippines in different sub-sectors of offshore service delivery.

To what extent the relatively low-end service provision from the Philippines will be beneficial for the country’s economic development in the long run remains to be seen. This chapter has focused on the emergence of the sector, discussing strategic coupling on the state level in the two countries. Future research could continue the enquiry on a different scale: How does the process of strategic coupling occur in specific cities and regions, and which (local) actors are involved in enabling and facilitating investment attraction and offshore service delivery? Also, more research is needed on the evolution of GPNs in offshore services. To what extent is upgrading into higher-value-added services occurring and how can this be facilitated in both India and the Philippines? Finally, more research on local outcomes of services-led economic development is required for understanding the opportunities and implications arising from this form of contemporary globalisation for local economic development.
CHAPTER 3

Strategic coupling in ‘next-wave cities’: Local institutional actors and the offshore service sector in the Philippines

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3.1 Offshoring of services to developing countries: an introduction

The outsourcing and offshoring of services to developing countries has created new opportunities for economic development for countries in the Global South. The fragmentation and unbundling of service production chains and the ensuing commodification of services, in combination with innovations in ICT, have led to a “tradability revolution in services” (UNCTAD, 2004) and, arguably, to a “next wave of globalization” (Dossani & Kenney, 2007; World Bank, 2007). By portraying globalisation as an overwhelming natural force that sweeps over countries and is driven by powerful multinational corporations, the role of local actors in influencing and shaping these processes at regional and local levels tends to become obscured (Kelly, 2000). The rather simplistic understanding of processes of economic change and the implications of an ever-changing international division of labour needs to be challenged by a closer reading of these processes on a sub-national scale.

Through receiving FDI, countries are becoming integrated into GPNs (Coe et al., 2004; Coe et al., 2008; Henderson et al., 2002; Yeung, 2009a). In the GPN framework, regional actors are understood to play a significant role in investment attraction through the process of 'strategic coupling': the idea that regional actors will attempt to link the strategic assets of their region with the GPN, thereby leading to regional development (Coe et al., 2004). Using this “middle-ground interpretation that is both structural and actor-centric” (Coe et al., 2004: 482), this chapter examines the role of local and regional actors (such as local government units, investment attraction organisations, and so forth) in second-tier cities in the Philippines, to advance the understanding of structural factors vis-à-vis the actions of regional actors in attracting FDI.

This empirical study analyses how the insertion of second-tier cities into GPNs is taking place and identifies to what extent local institutional actors have engaged in efforts of strategic coupling and what their scope for agency has been in negotiations with investors. To what extent is strategic coupling taking place in the case of service offshoring, and in the context of a power relationship between local governments and transnational companies that is arguably highly uneven? This chapter aims to contribute to a better understanding of contemporary processes of the global sourcing of services and strategic coupling, and the role of local institutional actors in developing countries.

The offshore service sector is dominated by foreign MNCs and is highly concentrated in Metro Manila and to a lesser degree in the second-largest urban agglomeration, Cebu City. This spatial concentration has led to cost pressure for investing companies, and recently investments have increased in second-tier cities. This chapter focuses on the integration of so-called 'next wave cities' (NWCs), a term coined for promotional purposes by the Business Processing Association of the Philippines (BPAP, 2009; 2011), into global production networks of BPO companies in the Philippines. BPO is the common abbreviation given to a diverse group of business services, such as customer-service-related tasks (either voice- or non-voice based), human resource management (e.g. payroll administration) and enterprise resource management (e.g. finance and accounting). The Philippines are largest provider of voice-
based services (IBM Global Business Services, 2010), which are conducted in call centres and encompass the lower-end of the continuum of BPO tasks (Gereffi & Fernandez-Stark, 2010a).

Based on 40 interviews conducted in the Philippines in 2012, this study examines the role of local institutional actors in attracting inward FDI and strategically coupling their regional assets to the needs of multinational service corporations. It discusses the scope for agency of actors on the lower spatial scales in shaping and creating (pre)conditions for territorial development, by contrasting the case of Baguio City (weak local institutional involvement) with the case of Bacolod City (high level of local institutional support).

The following sections elaborate on location-choice factors for companies that are offshoring, as well as the role of local institutional actors in attracting FDI. Subsequently, the research methodology and case study selection is presented. A concise introduction to the context of the case precedes the presentation and discussion of empirical results of the study. The conclusion addresses the implications of the findings for theory and for policy-makers.

3.2 Location-choice factors for offshoring service companies

The terms outsourcing and offshoring are often used synonymously; however, they describe two different processes. Outsourcing relates to the transfer of ownership of a task that was previously conducted in-house to a third-party provider. Offshoring relates to the place in which a task is carried out: the spatial relocation of a task across national borders. If both processes happen simultaneously (the relocation of a task across borders to another firm) offshore outsourcing is occurring (see also Section 1.2). As this chapter deals with the issue of FDI attraction, offshoring – which can also be termed the “global sourcing of services” (World Bank, 2007: 148) – is of primary importance here. Specifically, location-choice factors following the initial decision to relocate service production are discussed below.

The location-decision patterns of voice-based BPO services in the form of call centres have received a substantial amount of scholarly interest (see e.g. Bristow, Munday & Gripaios, 2000; Richardson & Marshall, 1996). Call centres first moved within developed countries, for example to lower-tier cities of the American Midwest; subsequently, they were transferred across borders to other developed countries, such as Ireland, before relocating to developing countries like South Africa (Benner, 2006) and India (Dossani & Kenny, 2007). These relocation patterns suggest that voice-based BPO services appear to be rather footloose with relatively low fixed investments (Bristow et al., 2000).

The most important input required for call centre operations is human capital. Research reveals that location-choice factors for BPO companies tend to be primarily shaped by the availability of a skilled labour force, or ‘talent’, as it is referred to within the industry (Couto et al., 2007; Lewin et al., 2009). The availability of college graduates with good English language abilities (at relatively low cost) is mentioned as one of the most important factors for location choice (Sass & Fifekova, 2011). This is especially the case for the higher end, knowledge-intensive services, on which much of the recent publications on offshore services have focused (Couto et al., 2007; Currie, Michell & Abanishe, 2008; Manning, Sydow & Windeler, 2012; Massini & Miozzo, 2010).
Important intermediaries informing the location choice of companies are business consultancies (see e.g. AT Kearney, 2011) which rank places according to various factors. These rankings influence the perceived attractiveness of a place, but few rankings go beyond using states as their unit of analysis to include second-tier cities (an exception is Tholons, 2013). The forces that impact upon the decision for a specific location can be seen as the result of a combination of push- and pull-factors. Location-specific advantages, as suggested as part of Dunning’s eclectic framework (2001), make it possible for a given region to pull in FDI. Call centres looking for lower-cost production of services are therefore part of what Hardy et al. (2011b) identify as vertical-efficiency-seeking FDI in services.

Several features of the business model of call centres affect location choice. First, call centres require the availability of large volumes of call centre agents for their operations in order to obtain economies of scale. Second, business continuity is crucial for the operation of offshore service companies, which makes a spreading of risk (e.g. of natural hazards) over multiple locations an appealing option. Third, the location decisions of offshore outsourcing firms are not only taken by the companies’ management abroad, but are often determined by the end-client of the service. Often clients decide on ‘proven’ destinations, leading to a clustering of companies. Fourth, it can be argued that call centres are part of the most standardised, lower-end spectrum of BPO services and fall into the last stage of the product life-cycle theory (Vernon, 1966); therefore, they are likely to be shifted more easily to low-cost destinations. The apparently footloose nature of the sector might have implications for strategic coupling; it would make it relatively easy for second-tier cities to attract investment, while simultaneously making it harder to retain them.

Looking at the factors affecting companies’ decisions on the location-decision for service exports, Goswami et al. (2012) confirm that human capital is the most important factor. In addition, the quality of telecommunications infrastructure, local institutions and government policies seem to play a role, though the actual weight of the latter component as a factor in companies’ decisions is hard to estimate (ibid.: 33).

### 3.3 Conceptualising the role of local institutional actors in attracting investment in services

While many national governments are aware of the strong potential for economic development that FDI offers, academic literature on FDI is rather sceptical of the ability of states to bargain with MNCs, due to the power differential between both actors (Dawley, 2011; Dicken, 2011; Phelps, 2008). Arguably, competition between countries leads to locational tournaments (Mytelka, 1999), which play out to the benefit of the MNCs, which are less less-territorially bound than states. Existing research has often focused on the role of national governments and institutions in this bargaining process. Lower territorial scales in the process, especially in developing countries, have been less subject to empirical research21.

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21 In the context of FDI attraction in manufacturing, attention has been paid to the role of local states engaging in territorial competition (e.g. Rodriguez-Pose & Arbix, 2001).
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FDI occurs in specific localities and requires intense interactions between investors and a variety of actors on the receiving end. As a result of tendencies towards decentralisation in many countries, these interactions increasingly include local and regional actors (as opposed to national actors), which heightens the need to investigate their actions in global processes. The GPN framework explicitly tries to capture these dynamics. A major contribution has been the focus on multi-scalar and trans-regional processes, through which regions become integrated into international networks (Henderson et al., 2002). These processes shape local and regional development in a globalised world.

Of particularly explanatory value of the GPN framework is the notion of strategic coupling, in which regional institutions act as “glue”, tying regional assets with foreign investors (Coe et al., 2004: 474). Yeung defines strategic coupling as a “dynamic processes through which actors in cities and/or regions coordinate, mediate and arbitrage strategic interests between local actors and their counterparts in the global economy” (2009b: 213).

As the central actors for achieving strategic coupling, local institutional actors can also be conceptualised as coalitions or “inward investment regimes” (Phelps & Wood, 2006). These include local actors, who translate foreign investors’ interests to the local level by acting “as intermediaries or coordinating agents on behalf of inward investors in their dealings with local interests” (ibid.: 503). While these local institutional actors have been discussed in the context of private and public sector actors in the US and UK, their existence, form, and function in a developing country context is not clear yet. Similarly, while several studies on strategic coupling exist (e.g. Yang, 2009), strategic coupling has, up to now, not been empirically studied under the specific conditions of service offshoring in developing countries. Nonetheless, the concept has been criticised for being overly optimistic of the power of local actors to reach positive territorial development outcomes through bargaining with MNCs, noting the high differential in power that both agents possess (Dawley, 2011; MacKinnon, 2012). To what extent strategic coupling is taking place in second-tier cities in the context of even more asymmetric power relations between governments in developing countries and MNCs, and the arguably more footloose nature of investments in services (compared to manufacturing), requires a better understanding.

It is important to note that strategic coupling ultimately aims at understanding regional economic development, which is conceptualised as value creation, enhancement and capture. While investment attraction and strategic coupling might be necessary conditions for this form of value creation, they are by no means sufficient in determining the impact on a region’s development (Coe et al., 2004: 481). Hardy et al. (2011b) found that strategic coupling occurs between efficiency-seeking foreign companies and local and national formal and informal institutions in Eastern Europe; however, the result was mainly “institutional harnessing” by foreign investors. Other scholars argue that the attraction of MNCs and inward investment can lead to the creation of branch-plant economies with few linkages with the rest of the host economy (Phelps, MacKinnon, Stone & Braidford, 2003) and a ‘lock-in’ in low-value-added activities.
3.4 Research methodology and case selection

To address the research questions, this chapter uses a qualitative case study design, investigating two Philippine cities comparatively. First, I discuss the city of Baguio, the capital of the Cordillera Administrative Region in Northern Luzon and second, the city of Bacolod, in Negros Occidental in the Western Visayas (see Figure 1.4). Both are identified as potential locations for BPO companies in the NWC ranking by BPAP. The cities are roughly evenly matched in terms of their skilled labour pools; however, they diverge in the category of business environment and risk management (which is linked most closely to policy-making by local actors). Baguio receives 62% and Bacolod 97%; the lowest and highest scores respectively in the overall ranking (BPAP, 2011: 5). This leads to the assumption that there is a strong difference in local/regional government support for the industry and the involvement of local actors in investment attraction. Comparing and contrasting the emergence of the BPO industry in both cities is therefore useful in analysing the role of regional assets and ‘regional’ actors in terms of successful coupling processes with foreign MNCs.

For this research, primary data was collected through 40 semi-structured interviews in the Philippines between April and June 2012. The majority of interviews were conducted in the two case study locations with BPO companies (covering about three-quarters of the total sector in both cities), and local institutional actors, such as local government units, members of the ICT council, investment-attraction agencies and local chapters of Department of Trade and Industry (DTI). Respondents were identified through the attendance lists of BPO working group meetings organised by the local ICT councils as well as recommendations by interviewees. Since not all high-level decision-makers are permanently located in the second-tier cities, a further 12 interviews were conducted in Metro Manila. These respondents were identified as key informants or relevant actors in the process of investment attraction in both cities during the first round of interviews in Baguio and Bacolod.

Quantitative data on the industry is derived from secondary sources: business and news reports, data published by the Philippine Board of Investment (BOI), the Philippines Economic Zone Authority (PEZA), and publications of the business associations of the sector. All interviews were conducted in English and lasted on average one hour. The interviews were transcribed, thematically grouped and subsequently analysed. A triangulation of data was achieved through a careful cross-comparison of the collected primary data in itself and with the responses of key industry informants and available secondary data.

3.5 The Philippine BPO industry

Since the 1990s, the Philippines has embarked on a policy of deregulation and liberalisation, attuning the country to the needs of foreign investors by creating SEZs for export-oriented

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22 Factors measured for this category are “number of PEZA-approved sites, existence of a local ICT council, vulnerability to natural disturbances; as well as security issues [...]” (BPAP, 2011: 4).
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manufacturing (Kelly, 2000). Increased international competition in textiles and electronics manufacturing, however, led to a declining share of manufacturing and an increased share of services as measured through national GDP. FDI attraction to the Philippines has been hampered due to its poor business environment; as of 2013 it is ranked 138 out of 183 countries on ease of doing business (World Bank & International Finance Corporation, 2013). Despite improvements over the past years, the Global Competitiveness Report shows that the top two problematic factors for doing business in the Philippines continue to be corruption and inefficient government bureaucracy (World Economic Forum, 2012: 292), leading to low transparency and increased costs for companies investing in the country.

Despite such disadvantages, widespread English-language skills and cultural affinity with the US (the Philippines were a US colony from 1898-1946) have created opportunities to attract FDI from BPO companies. The sector directly employed 640,000 people and earned $11 billion in revenue in 2011, translating to about 5% of GDP (DoST-ICT Office & BPAP, 2012). The dominant share of the BPO sector is in voice-based services, provided from call centres. Since 2009, the Philippines are the leading provider of voice-based services globally, placing India second (IBM Global Business Services, 2010: 7). The Philippine BPO industry has benefited from support from national institutions and a proactive private sector, in which business association BPAP played a vital role (Yi, 2012).

In 2007, 80% of the Philippines’ BPO employment was located in the National Capital Region of Metro Manila, where the sector remains heavily concentrated (BPAP, 2009). The highly uneven spatial distribution of economic development in the Philippines, due to the uneven impact of globalisation, has been discussed by Kelly (2000) and, more recently, by Clausen (2010). In addition to the problems of attaining regional balance and inclusive growth for the archipelago, BPO companies now face an increasingly tight labour market in Metro Manila. The high growth scenario for the industry, forecasting 1.3 million employees in the sector by 2016 (DoST-ICT Office & BPAP, 2012: 19), can only be achieved if more investments occur outside of the capital region to meet the labour demand of call centres.

In order to stimulate investment in second-tier cities, a coalition of national actors (BPAP together with the ICT Office, DTI and BOI of the Philippines) convened in 2007 to identify NWCs, which are promoted as investment opportunities for expanding offshore service companies. The National ICT confederation of the Philippines provides a platform for 30 ICT councils located in provincial cities, who share best practices for attracting investment outside of the country’s established hubs.

FDI attraction to the Philippines is managed by PEZA, which initially created public SEZs providing benefits and incentives for manufacturing companies. In September 2012, 174 IT business parks and centres (including individual buildings) were in operation throughout the country, hosting exporting BPO companies (PEZA, 2012). Since the devolution of

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23 This strategy of a ranking has been successful; for companies the ranking resembles investment consultancies’ reports, which usually influence their investment decisions and the cities themselves are stimulated to compete for higher rankings (e.g. by reforming bureaucratic procedures).
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decision-making powers in 1991, the institutional framework of the Philippines grants increased competencies to local government units (LGUs). The decision to declare land or buildings available for PEZA incentives rests on the LGUs, making them influential actors: “Local government support […] will be a critical factor that will determine whether an ecozone will achieve long term viability” (PEZA, 2012, unpublished presentation). Part of the incentives package granted by PEZA is the suspension of all local government taxes and fees for a period of four years, seen as a powerful tool for a national agency in influencing the local government’s ability to collect taxes.

3.5.1 Baguio – the educational hub in the northern mountains

The city of Baguio in the mountainous region of Northern Luzon is the educational centre of the north. It is a former US colonial hill station and used to be the centre of the American government during the hot summer months. Today, Baguio is an important tourism destination due to its relatively mild climate. It has about 300,000 inhabitants and hosts the Baguio City Economic Zone (BCEZ) in the southeast of the city, where electronics and textiles are produced for export. The BPO industry has grown here despite a supposedly low local government intervention, as seen by the lowest ranking on the NWC’s report on this indicator (BPAP, 2011).

The call-centre industry in Baguio started with the opening of one site by Client Logic (now Sitel) in 2004 in the BCEZ. Sitel is by far the largest BPO firm in Baguio, employing close to 3,000 staff at three sites – making it the largest employer in the city (and indeed the entire Cordillera Autonomous Region). It employs three-quarters of Baguio’s voice-based BPO industry, which consists of 4,243 full-time employees, in 2011, according to the Baguio City Planning Office. Moreover, there are three BPO firms with 100–999 employees and two smaller call centres with less than 100 employees. Except for one company, an international hotel chain’s in-house reservation centre, all call centres are outsourced to third-party providers.

3.5.2 Bacolod – from sugar production to offshore services

Bacolod is located in the Western Visayas and is the capital of the administrative region of Negros Occidental. Bacolod’s economy traditionally depends on sugar plantations: 70% of the entire country’s sugar production is harvested in the province. Lacking significant industrial development, the city today is much poorer than Baguio. It has about 500,000 inhabitants and signed in 2010 a twin-city agreement with the larger, neighbouring city of Iloilo, which has also attracted a sizeable BPO sector.

In the NWCs ranking, Bacolod has received the highest score for business environment and risk management, in contrast to low-ranking Baguio, and has been very aggressive in attracting the BPO industry. The call-centre industry in Bacolod started in 2006 with the investment of three large companies; since then it has grown to employ 8,204 full-time employees, in 2011, according to the City Planning Office. Six large call centres with more than 1000 employees and two smaller ones with less than 100 employees are operating in Bacolod, all of which are run by third-party providers.
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3.5.3 Comparing and contrasting the BPO landscapes

The BPO sector in Baguio started earlier but is much smaller and largely dependent on one single, large-scale investor. Bacolod is considered to have been more successful recently in attracting FDI from offshoring companies; its BPO employment is almost twice as large as Baguio’s. It is important to note that almost all BPO companies already have operations in Manila, which suggests that few companies have chosen a second-tier city directly, but first set up in the capital region. Moreover, operations in Manila are not relocated to these lower-tier cities but instead are the result of expansions and extensions of GPNs beyond metropolitan areas. This has important implications for how FDI attraction is conceptualised. While being greenfield investments in Baguio or Bacolod, these are based on previous experiences of the investor in the country and possibly the result of a combination of push factors out of Metro Manila and pull factors of the second-tier cities.

3.6 Regional assets as pull factors in NWCs

Several push factors are driving companies out of Manila and making them look for alternative locations for their expansions. Most frequently mentioned by interviewees are cost pressures due to rising salaries (Baguio’s and Bacolod’s non-agricultural minimum wage is 40% less than Manila’s), high staff turnover rates, rising rental rates, and traffic jams in Metro Manila. Another important issue for offshore service companies is the spreading of risk. By not ‘putting all eggs into one basket’ but instead operating from multiple locations within one country, business continuity can be ensured in case of localised natural calamities, such as floods and typhoons.

The regional assets of second-tier cities can be considered additional pull factors for attracting investment; therefore, the differences in assets between both cases are considered in the following. If Baguio were less equipped with favourable structural conditions for attracting investment, this might explain the difference in inward FDI, rather than the role of local institutional actors. According to BPAP (2009; 2011) the major pull factors for companies to relocate to second-tier cities can be summarised as talent, infrastructure, business environment/risk, and cost.

The skilled labour pool, measured in the number of annual tertiary graduates, is almost equal, with a slight advantage for Baguio (11,500 graduates in 2008) compared to Bacolod (10,000 in 2008), (BPAP, 2009). However, Baguio also has other advantages. First, contrary to Bacolod, which does not have a large manufacturing sector, Baguio has an industrial zone hosting several American companies. Therefore, a history of US investment exists, with Texas Instruments having been the largest employer of the city, prior to the arrival of the BPO investors. This can promote further investments through a demonstration effect, explains the mayor of Baguio: “These companies are some of our advertisers that tell people outside of the Philippines that there is Baguio city in the Philippines for you” (Interview 120528b).

Second, Baguio’s location in the Cordilleras, the mountainous region in North Luzon, endows it with cooler climates than those found elsewhere in the Philippine archipelago, leading to lower electricity costs (estimated to be 10% of total operational costs due to savings...
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on air conditioning (Beerepoot & Hendriks, 2013). Only the absence of a commercial airport, which is available in Bacolod, is a negative factor for Baguio. On the basis of its regional asset base alone, Baguio should, in theory, not receive less investment than Bacolod.

3.7 Actions undertaken by local institutional actors: from hesitant to aggressive

The push by national actors for turning Baguio into a centre for BPO investment has been very strong. Former President Gloria Macapagal-Arroyo declared Baguio in a state-of-the-nation address as one of the identified ICT hubs of the Philippines, and Baguio received BPO investors as early as 2004. However, its overall investment has remained low compared to Bacolod. No concerted effort was undertaken by local institutional actors to form an ICT council and little promotion by the investment-attraction bodies was undertaken. Local actors have been hesitant in supporting the industry and engaging in the attraction of BPO investment.

The local government envisions its main role as securing peace and order, which does not suggest an active promotion of the sector. The local branch of the national DTI is indifferent about promoting the sector and creating investment, arguing that it has been a top-down decision to attract the BPO industry to Baguio:

It’s a new sector, we do not know the impact yet, but it creates employment. This is important so we have to promote it. The government dictates us that we shall promote it, by all means we need to promote it (Interview 120508a).

Despite efforts to create an ICT council with local stakeholders for the investment attraction of BPO companies in 2011, it was not yet operational at the time of writing. The most pressing problem for potential new investors in the city is the lack of office space for setting up a call centre. The local government has to agree to the location and currently two proposals for new IT business parks in the central business district of Baguio are being evaluated. The fact that, to date, only one inner-city location has been granted the status as a PEZA building, a choice that rests ultimately with the city mayor, shows that investment attraction in offshore services has not been a high priority for the local government.

In general, the attitude towards attracting inward investment seems rather negative. Rapid urbanisation and inward labour migration into the city, due to employment opportunities in the BPO sector, appear to cause multiple concerns. Local actors interviewed for this research mentioned heightened traffic congestion, shortages of water, increased levels of garbage, and social concerns (such as changing lifestyles and declining family values) as negative effects on the liveability in the city. Creating more employment opportunities in Baguio is only desired for existing residents of the city and is not intended to encourage inward migration. In negotiations, the city of Baguio was able to include a clause determining that 80% of the call-centre labour force must be hired locally (Interview 120507a).

Bacolod, on the other hand, has been very much engaged in attracting investments from the BPO industry. Being an agricultural-based economy, the urgency for economic
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diversification was realised and the need “to do something for the city” (Interview 120515b) led local actors early on to commission a study on the potential for inward BPO investment and on the potential economic benefits for the city, showing a potential positive economic impact of the offshore service sector on local employment. In addition to promoting the city via information brochures, the city had a presence at the annual E-Services Global Sourcing Conference and Exhibition in Metro Manila as early as 2004.

To negotiate directly with investors, rather than wait for them to come to Bacolod, local actors from Bacolod’s DTI office flew to investors’ offices in Manila:

It was not so easy attracting investors. In fact, during that time, prior to [the investor’s] decision to put a call centre here, we met some of their top officials in Manila. We really went to Manila just to meet their top officials. We started the meeting at 10 o’clock in the evening and we were done with the meeting at 3 o’clock in the morning. So, of course, we’re not used to that, because, well, Bacolod City is just small compared to Manila … (Interview 120515a).

A task force called IT-Focus Team was founded in 2005. Additionally, the IT Schools Network of Negros Occidental, Inc. was created in order to strengthen the talent pool – the key asset of the city. Moreover, collecting and presenting an overview of relevant information on the labour pool and infrastructure for potential investors, a value proposition, was another crucial factor. Lastly, the creation of the ICT council, the Bacolod-Negros Occidental Federation for ICT (BNEFIT), was formalised. This proactive alliance with strong leadership by local and regional actors produced a critical juncture for attracting BPO investment to Bacolod. The ICT council functions as a one-stop-shop contact for potential investors, with representatives from government, academia, real estate, telecommunications, and existing BPO investors, thereby providing an arena for local institutional actors and MNCs to meet.

While providing a conducive investment climate, the local institutional actors did not agree blindly to all requests from BPO companies but successfully engaged in bargaining with them. In one situation, an MNC approached the city government early on, asking for an exclusivity clause for its operations. Although the city of Dumaguete had granted the company this extra incentive, Bacolod refused:

So, of course, there were some negotiations, because they were asking for some favours […] for example they will be investing here in Bacolod City but for a specific period, we will not accept other investors to invest here… Some sort of exclusivity for them. But at that time we were actually weighing the pros and cons of that proposal. The members of the ICT task force were not agreeable to that proposal, so we lay down our card on that proposal and despite of our negative response to that proposal, yet they invested here in the city” (Interview 120515a).

This example shows that the bargaining power of an informed government, aware of its key assets and economic potential due an informed ICT council, held considerable bargaining power against the MNC.
Recently, the local government of Bacolod has taken a step further and has become an active developer of an IT business park, Negros First Cyber Park. The park is currently under construction at the site of a former sports complex, aimed at receiving more BPO investment in the future and to increase income for the local government, rather than for private developers, through the collection of office rents.

3.8 Investors’ evaluation of the role of local institutional actors

Foreign BPO investors need local institutional actors for several reasons. First, they can address the information gap on local investment conditions, such as the available labour pool, and costs and availability of office space, electricity, and internet connectivity. Second, the building of trust is especially important in the context of the Philippines, a business environment where investors frequently voice concerns over high corruption and a lack of transparency, which is worrying for investors. Through an early engagement with local institutional actors, the long-term viability of a company can be ensured. Third, the transaction cost for recruiting labour can be slightly lowered by establishing connections between the educational institutions supplying the skilled labour force and investing companies. Fourth, the city needs to be supportive of the new type of economy that the investments in offshore services require, as they do not operate in a sociocultural vacuum. Institutional actors can, in this regard, facilitate and organise the supporting infrastructure desired by investors.

In the case of Baguio, investors voiced a concern about a lack of government support, arguing that they had had “not the best experience with [the] government” and that “some politicians are clearly not in favour of the BPO industry” (Interview 210528d). The city is perceived as “laid back and provincial”, juxtaposed with the “global” mind-set of the BPO industry. All interviewees representing BPO companies stressed the need to “educate” local stakeholders and the city about their “new” industry (Interview 120517a). This demonstrates that companies are driving the process of integrating Baguio into GPNs with minimal action undertaken by local actors. The level of agency by the local government is low and its efforts at investment attraction are limited.

BPO investors in Bacolod also mentioned the necessity to introduce a change in the city in order to fulfil the demands of global firms operating 24/7, such as installing improved street lighting and increasing public transportation at night. Most of all, the investors appealed to create a better understanding among stakeholders and citizens of the workings of the BPO industry, to educate the city about their needs. One respondent of a BPO company explains that “[y]ou come into a city where probably only in hospitals people work at night time and they’re quite unfamiliar with our territory” (Interview 120516a). However, companies argue that they received help in this process of changing local settings by local actors:

BNEFIT, for one, in Bacolod has been very helpful to us, especially with our linkages with universities and colleges and with other business sectors too, because you’d have to tap investors for not only real estate, so you’re also
looking at restaurants being put up to help support the business, maintenance companies, security agencies, and whatnot. So basically BNEFIT has helped us link to all those different investors that can help us support our business, even transportation [...] In early 2006 we only had a few taxis, right now there's several hundreds of them (Interview 120516a).

Clearly, local institutional support was seen as an important factor for location choice for the BPO firm, recognising that the building of trust between local government and the investing firm is vital for future operations: "And so we've looked at different cities and eventually decided on Bacolod, mainly because of the support of the government and the ICT group on ICT industry" (Interview 120516a).

3.9 Strategic coupling in Baguio and Bacolod

No 'strategic' coupling took place in the case of the multinational call centres in the city of Baguio. Instead of a planned and concerted action by regional actors to tie the existing regional assets to potential investors, the investment process has been primarily driven by MNCs themselves. In this case, coalitions translating the interests of foreign investors have been absent. This seems to confirm the idea of a top-down process of globalisation, in which local actors are regarded as passive investment recipients. However, a closer analysis shows that the reasons for Baguio's hesitation to attract the sector were problems caused due to a feared influx of workers from surrounding provinces. Indeed, a clause to employ local labour was negotiated, which illustrates the leverage local actors can have on foreign investors. Despite of the local actors not engaging in concerted efforts to attract inward investment, the call-centre industry has seen some growth, albeit limited, due to Baguio's key asset of a large and educated labour pool.

By contrast, the efforts of crucial individuals and locally formed organisations to support the BPO industry in Bacolod have led to a strategic coupling of the city's main assets, its English-speaking graduates, to the needs of globally operating service providers. Most notably, they were able to present relevant information for investors that was key, due to the prevailing information asymmetry about local investment conditions. This convinced investors of the viability of their investments. Second, the local actors signalled government support and built trust in a political setting in which investors regularly face the burdens of corruption and bureaucratic red tape. Moreover, the linking of educational institutions with investors reduced the transaction costs of hiring skilled labour.

Bacolod has received a significant amount of BPO investments and has become integrated into the GPNs of these MNCs. Conducting research into the needs of potential investors, creating awareness of their key assets and successful bargaining with MNCs made it possible to attract investment. In the case of Bacolod, the ICT council can be interpreted as a coalition for investment attraction. However, it is important to realise that Bacolod's local institutional actors were not simply captured by investors' interests. Local institutional
actors did not fall into the trap of promising an exclusivity arrangement to any one investor, which ultimately would limit the economic development opportunities of the city and create dependency on a single investor. This discussion has shown that the scope for agency of local actors in shaping processes of globalisation should not be underestimated.

It is important to notice that the concept of strategic coupling is dynamic (Coe et al., 2004; MacKinnon, 2012). Local governments can change and also the power balance can shift after an MNC investment to the benefit of local institutional actors, as their leverage increases over the MNC once investments have been made. Even in the situation of more flexible investment in offshore service facilities, the MNC’s decision to disinvest will be costly for the firm, so its bargaining power vis-à-vis local institutional actors is reduced. To evaluate these processes in detail would require more research, but in the case of Bacolod, some controversies have arisen on the issue of taxation between investors and the national government, on the one hand, and local government, on the other hand.

### 3.10 Conclusions

This contrasting case study of BPO investment has evaluated the role of local institutional support for attracting investment. Despite Baguio’s marginally more favourable initial conditions and assets, Bacolod managed to attract twice as much BPO employment as Baguio, which can be attributed to the role of local institutional actors. Though structural factors are essential, they are not the only reason for companies to invest in a given location. Local institutional actors have had an impact in attracting the sector and linking it to regional assets. This shows that there is a strong role for local agency in co-shaping processes of foreign-investment attraction, creating opportunities for policy-makers willing to integrate their cities into GPNs.

For policy-makers in other lower-tier cities, opportunities exist to employ similar strategies. Whereas existing regional assets can only be modified in the long run, the strategies used by local institutional actors can be implemented relatively quickly. The successful case of Bacolod shows that it is vital to first understand the needs of the industry and identify the regional assets, in order to link the two. Furthermore, the establishment of an ICT council, a one-stop-shop contact for potential investors with representatives from all relevant stakeholders, has been crucial in informing, building trust and ultimately convincing companies to establish offshore service operations.

In the case of Bacolod, we can see strategic coupling as a concerted and planned effort undertaken by institutional actors to create a linkage. It is important, however, to realise that all coupling processes are dynamic. The roles of actors do not remain fixed over time. Local government units are subject to the electoral cycle and previously fervent supporters of an industry can be replaced by more critical ones, leading to drastic changes in local policy-making over time. It is too early to assess the durability and depth of the coalitions formed among local institutional actors for strategic coupling in the cases discussed above. More research will be needed to assess how the relationships between local actors and foreign investors play out over time.
On a theoretical level, this study shows that discussions on FDI attraction need to focus not only on actors at the national level but also take into consideration the actions of actors at lower geographical scales. The concept of strategic coupling has been applied to services in a developing-country context. Despite the fact that investments can be considered more footloose, and asymmetric power relations exist between local territorially-bound actors and transnational corporations, it has been shown that local institutional actors, in at least one case, played a vital role in coupling their region’s assets to the needs of MNCs and attracting BPO investment.

The choice of where to carry out their operations rests with decision-makers within MNCs. In the case of BPO companies, access to a skilled labour pool remains the main driver in terms of which location is chosen. Nevertheless, multi-level institutions are involved in the strategic coupling processes and the role of local institutions is seen to constitute an important factor for inward investment attraction. The power configurations and resources given to local actors within the institutional framework of the Philippines allow actors from the lower geographical scales to have the scope for agency to co-shape these processes, despite uneven power relations between actors. This corroborates Coe et al’s (2004) middle-ground view of structural and agency factors, with the proviso that local actors can indeed play a role.

It is crucial, however, to see what this attraction of investment means in qualitative terms for the recipient cities. The integration into a GPN is not in itself a guarantee for successful territorial development, but contingent; the so-called ‘dark side’ of GPNs (Coe & Hess, 2011; MacKinnon, 2012). A branch-plant economy (Phelps et al., 2003) with low embeddedness of firms, locked into low-value-added production, is one of the potential pitfalls identified by scholars.

More research is needed to evaluate the role these second-tier cities perform within wider GPNs, in order to analyse their options for value enhancement and capture. Future studies could focus on the interrelationship between second-tier cities and tier-one cities, and the way functions are geographically divided within the countries in receipt of investment. Moreover, it seems important to analyse the longer-term implications of offshore service investment and to see to what extent increased territorial embeddedness and upgrading into higher-value activities is taking place in second-tier cities.
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CHAPTER 4

Global production networks, offshore services and the branch-plant syndrome

This chapter is forthcoming as a single-authored article in Regional Studies, [accepted for publication in February 2015].
4.1 Introduction: The globalisation of service sourcing and local economic development

A key feature of contemporary globalisation is a change in the international division of labour through the expansion of offshore service delivery from developing countries. This has been termed a “second global shift” (Bryson, 2007), or a “newer international division of labour” (Hutchinson, 2004). The offshoring of BPO services has made administrative and professional office jobs available for developing countries with a large, English-speaking, well-educated labour pool. In general, optimism reigns about the potential benefits for countries that deliver offshore services (Dossani & Kenney, 2007; World Bank, 2007). A more cautious analyst stresses that “rapid income gain for developing countries is possible, however, the impact of offshore production is uncertain and contingent” (Levy, 2005: 691). The opportunities the BPO sector creates for regional development in developing countries are, to date, still poorly understood.

A burgeoning body of literature has focused on the global sourcing of services (Bunyaratavej et al., 2011; Dossani & Kenney, 2007; Massini & Miozzo, 2012) but the discussion of the implications for economic development and potential drawbacks due to a dependency on foreign investors and lead firms in production networks has been limited to a few European capitals (Breathnach, 2000; White, 2004; Hardy et al., 2011b). Of the developing countries studied, India has received the largest share of attention, to the neglect of other destinations (Paus, 2007).

The Philippines has experienced strong growth in the BPO industry over the last decade, from 100,000 employees in 2004 to 780,000 employees in 2012, contributing $13 billion to the economy (Mitra, 2013). The country has overtaken India as the largest provider of voice-based services globally, and Metro Manila has become “a new capital of call centers” (Bajaj, 2011). In recent years, several second-tier cities in the Philippines have also successfully attracted FDI in offshore services (see Chapter three).

This chapter explores the impact on recipient localities by analysing their position in GPNs. An advancement of global value chain analysis, the GPN framework (Coe et al., 2004; Henderson et al., 2002) offers insights into the positions of firms, their global and local linkages, and the distribution of power. Developed to assess the changing economic geographies and local outcomes of economic globalisation, the GPN framework stresses the positive features of increased integration into the global economy. Integration into GPNs is seen as a necessary, though not sufficient, condition for regional economic development (Coe et al., 2004).

Critics have countered the optimism, arguing that the GPN framework fails to fully recognise the tensions created by the asymmetric powers held by actors in the network (Dawley, 2011; MacKinnon, 2012). Questions of external control and dependency of regions as a result of FDI attraction have long been debated in the branch-plant literature (Breathnach, 1993; Firn, 1975; Hayter, 1982; Hood & Young, 1976; Massey, 1984; Phelps, 1993; Phelps, Lovering & Morgan, 1998; Townroe, 1975; Watts, 1981). Reviewing literature on the branch-plant syndrome, Sonn and Lee (2012) find that outcomes are context-specific and depend on the sector and the location examined. The question of whether FDI results in
Chapter 4

dependent or developmental outcomes for cities and regions is therefore an empirical one, differing according to the position subsidiaries occupy in the wider production network and how power and governance is distributed among the units of the network. A framework for assessing different empirical cases is required for this task.

The aim of this chapter is threefold. First, it adapts the GPN framework with indicators stemming from the branch-plant literature to the case of services. The focus on services is new, since most GPN research has revolved around manufacturing industries. The branch-plant literature clearly holds a manufacturing bias; instead of factories, this study focuses on the role of offshored branch offices delivering services. A new framework is created for analysing economic development opportunities in the case of the offshoring of services, based on insights from economic geography and regional-studies discussions on FDI and regional development. By synthesising indicators developed by branch-plant scholars and contemporary GPN research, I address some of the recent criticism levelled against the GPN framework.

Second, I empirically map the position and power relations of offshore service branches in the Philippines. Which positions do the individual multinational corporations subsidiaries in the Philippines occupy in their respective GPNs? What opportunities for local economic development result from FDI in offshore services? These are important empirical questions, since the offshoring of services to a developing country is a rather recent phenomenon, whose local outcomes are opaque.

Third, this chapter looks beyond capital cities and includes the experience of second-tier cities, which have attracted considerable offshore service investment. It distinguishes between the more advanced capital region and lower-tier cities in terms of their respective integration into GPNs. The role that various regions perform in the broader national setting has so far not been covered extensively. Research on economic development has often focused on capital cities as gateway cities linking to the hinterland, but this hinterland has often been omitted from further studies (Rossi et al., 2007). This chapter aims to fill the gap by analysing the integration of Metro Manila (NCR) and selected second-tier cities from the Philippines into GPNs.

Combining the insights from the GPN approach with the branch-plant literature, two cognate but previously disconnected bodies of literature, allows a more fine-grained analysis of various indicators determining the position of branch offices in FDI recipient regions that receive FDI. This framework leads to a more nuanced understanding of the dynamics of how places integrate into GPNs through the establishment of foreign subsidiaries.

The next section introduces ideas from the GPN framework and revisits the branch-plant economy debate to stipulate a framework to analyse how offshore services impact regional economic development. This is based on the dimensions of ownership, nature of activities, network position, local decision-making and control, quality of jobs, local linkages and (fixed) investments to assess the footlooseness and risk of relocation of firms. After describing the methodology and research context in Section 4.3, Section 4.4 presents empirical findings from a comparative and relational case study. Section 4.5 evaluates the findings and the conclusion (Section 4.6) addresses the theoretical implications.
4.2 Towards a framework assessing economic development and dependency in GPNs

The GPN framework was developed to explain regional economic development, also in the Global South, through the “strategic coupling” of regions with global lead firms (Coe et al., 2004; Coe et al., 2008; Henderson et al., 2002; Yeung, 2009b). Power is one of the key concepts of the GPN approach, and three types of power are distinguished: corporate, institutional and collective power (Henderson et al., 2002). Corporate power determines the distribution of power within in the network and is defined as “the extent to which the lead firm in the GPN has the capacity to influence decisions and resource allocations – vis-à-vis other firms in the network – decisively and consistently in its own interests” (Henderson et al., 2002: 450). Institutional power is the power held by (local) states and regions; this structures the bargaining between firms and host territories. Collective power refers to labour unions, business associations and non-governmental organisations. In more recent formulations, the “dark side” of GPNs (Coe & Hess, 2011), has been acknowledged; the fact that regional economic outcomes depend on the bargaining of actors with uneven powers. A more nuanced understanding of corporate power and its location in GPNs is required to examine developmental outcomes in specific cities and places as a result of their integration into GPNs.

Considerable attention has been devoted to the role of multinational companies and their impact on regional development in the places where they invest (Dicken, 2011; Dunning & Lundan, 2008). Starting from the 1970s, literature on regional development has been occupied with investment flows between industrialised countries, with a predominance of studies focusing on peripheral regions in the United Kingdom and Ireland, which found evidence of branch-plant economy symptoms (Breathnach, 1993; Firn, 1975; Hood & Young, 1976; Phelps, 1993; Pike, 1998; Townroe, 1975). The so-called “branch-plant syndrome” is the result of a concentration of fully-owned subsidiaries (branch-plants) of larger companies in specific regions, which are characterised by external ownership and control, and truncated development opportunities.

Its insights can be usefully combined with the recent GPN approach, as Dawley suggests:

[While the GPN notions […] are useful heuristic devices, the traditional literature continues to offer a detailed series of insights into how such ‘coupling’ processes are constrained, enabled and expressed in the host regions. In particular, the analytical frameworks developed in the traditional literature around ‘studying regions by studying firms’ still offer considerable utility in grounding the impacts and interrelations between TNCs and regional development (Markusen, 1995) (Dawley, 2011: 396).]

This research follows the above suggestion and expands the economic geography-derived GPN approach with insights from traditional literature on FDI and regional development.

The branch-plant literature continues to be geographically biased towards developed economies, neglecting the experience of developing countries. Moreover, the offshoring
of services has been excluded, even in very recent publications (Sonn & Lee, 2012). While previously believed to be not offshoreable, the “tradability revolution in services” (UNCTAD, 2004) has led to the unbundling and offshoring of tasks. FDI in services differs from manufacturing in several important aspects: work is conducted in offices rather than production plants, and intangible commodities are not affected by transportation costs, require less (locally sourced) inputs, and usually require close interaction with the consumer.

Since the beginning of “branch-plant syndrome” debates, the international division of labour has progressed further. Flexible specialisation and outsourcing have led to a reorganisation of work and more complex inter- and intra-firm divisions of labour have emerged (Dicken, 2011). The GPN approach uses a wider perspective of company networks and goes beyond intra-firm MNC structures to assess the position local branches occupy in global networks. Table 4.1 lists eight dimensions for the analysis of dependent and developmental outcomes from offshore service branches, based on a combination of GPN literature and branch-plant debates.

The schematic distinction should be seen as a scale continuum rather than a binary division and is loosely based on earlier differentiations (Dawley, 2011; Pike, 1998). The interrelated indicators are elaborated upon in more detail below. Together they provide the framework for empirical analysis in this chapter.

**Ownership**
Foreign ownership is a crucial factor in the branch-plant literature. Dicken (2007 [1976]) argued that despite being an important concept, as an indicator alone, ownership does not suffice to explain the regional development outcomes of investments. In addition, Dicken writes that it is necessary to examine the “organisational structure of the enterprise and the relative position of the subsidiary or branch unit within that structure” (S44). Lead companies in GPNs have the power to also exercise control over companies that are not fully owned by them and many MNCs increasingly rely on outsourcing rather than establishing branch-plants through FDI, due to benefits of lower costs and increased flexibility (Gereffi et al., 2005).

**Table 4.1:** Continuum of dependent and developmental outcomes in offshore services

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Dependent</th>
<th>Developmental</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Foreign-owned, outsourced or captive</td>
<td>Domestic-owned, outsourced</td>
</tr>
<tr>
<td>Nature of activities</td>
<td>Low-end</td>
<td>High-end</td>
</tr>
<tr>
<td>Network position</td>
<td>Peripheral position</td>
<td>Nodal position</td>
</tr>
<tr>
<td>Decision-making and control</td>
<td>Foreign, external</td>
<td>Local, internal</td>
</tr>
<tr>
<td>Job quality</td>
<td>Unskilled work</td>
<td>Skilled work</td>
</tr>
<tr>
<td>Local linkages</td>
<td>Limited</td>
<td>Extensive</td>
</tr>
<tr>
<td>(Fixed) investments</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Ease of relocation</td>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>
Still, the distinction of whether operations are subcontracted to third-party suppliers or conducted within fully-owned subsidiaries remains a key feature for understanding power relations. Offshore service providers in the Philippines can take three forms, depending on whether a task is outsourced or not: fully-owned MNC subsidiaries (MNC captive), subsidiaries of a foreign-owned third-party supplier (foreign-owned BPO), or Philippine-owned firms (see Chapter one, Table 1.1). The first two involve the setting-up of foreign-owned branch offices. We can therefore distinguish between two kinds of branch offices: outsourced (BPO branch) or fully-owned (MNC branch).

**Nature of activities**

Offshore services, transmitted through ICT infrastructure, typically require higher-skilled labour than manufacturing activities. BPO encompasses, among others, customer services (voice-based services conducted through call centres or via email and chat support) and back-office services, including finance and accounting, human resource services and data processing. These services occupy different positions in the value chain: customer services deal with the end customers of firms and can form an add-on to the value-chain, often after a product or service has been sold, whereas back-office services are part of the support services and business services of a wide range of firms.

The lower-end functions found in call centres can be seen as “the lowest level of the firm's vertical division of labour which, when divided geographically, leads to and reinforces territorially uneven development” (Perrons, 2001: 11). While the sourcing of higher-value services is rising in an “emerging global race for talent” (Lewin et al., 2009), Massini and Miozzo conclude that “an important set of activities, including the most creative and knowledge-intensive activities and technological integration and coordination of lead firms, still remains rooted in dynamic regions in advanced economies” (2012: 19).

**Network position**

The GPN framework allows us to visualise the position each branch office takes: “Each GPN can be mapped by 'placing' its agents and sketching their mutual connections” (Henderson et al., 2002: 447). A firm’s GPN position and control exercised in the network are closely interlinked. Hymer (1972) foresaw the creation of a hierarchical international division of labour and an intra-firm system of production in which control is centralised in global headquarters and a dispersed set of subordinated branch-plants carries out lower-level activities. Massey wrote that in a rising “part-process spatial structure”, in which branch-plants control only one of many production processes, “there is both a managerial hierarchy and geographical separation of stages of production, regions ‘lower down’ the hierarchy will be subject to both external ownership and production dependence” (1985: 101). ICT developments and global competitiveness pressures have intensified the geographic specialisation in niche activities (Dicken, 2011) and enabled firms to “fine-slice value chains [and] optimize the location of specific narrow activity sets” (Rugman, Verbeke & Yuan, 2011: 255).
Decision-making and control

The impact of external control on hosting regions is one of the most important topics of the early branch-plant literature (Firn, 1975; Hayter, 1982; Hood & Young, 1976; Townroe, 1975; Watts, 1981). Townroe (1975) identified several potential concerns on the creation of branch plants due to the fact that decision-making on broader issues is taken at a corporate headquarters outside of the region: no managerial decision-making staff is brought to the area, a highly feminised labour force is employed, branch plants relocate or close down relatively easily in times of recession, and less local linkages are sought.

Relating to the discussion of the locus of power in networks is the distribution of strategic decision-making abilities. Strategic decision-making includes decisions of where and under what condition production takes place. The ability to make strategic decisions can be concentrated in one single firm in the network, in so-called ‘networks of direction’, or can be shared among several firms in ‘networks of mutual dependence’, which feature more dispersed forms of control (Sacchetti & Sugden, 2003). Concentrated strategic-decision making, often by large MNCs, is more likely to occur in vertical offshore service investments but presents fewer opportunities for regional development.

Gereffi et al. (2005) argue that the position of a firm in a particular value chain depends on the form of governance within the chain, which ranges from market-driven to hierarchical. Offshore services are often characterised by hierarchical or quasi-hierarchical governance structures, in which decisions are taken at a distance (Hardy et al., 2011b). Hierarchical relations, according to Gereffi et al., are characterised by “managerial control, flowing from managers to subordinates, or from headquarters to subsidiaries and affiliates”; quasi-hierarchical relations with outsourced firms often show a “high degree of monitoring and control by lead firms” (2005: 84).

Job quality

Manufacturing branch-plants have often been dedicated to lower-end functions, whereas several higher-end functions remained centralised at headquarter level. Sonn & Lee (2012) assess not only the quality of jobs, but also the quantity and stability, as important indicators for branch plants. Developed economies might be in a better situation to selectively attract investments, whereas developing countries, and especially their second-tier cities, might find short-term employment generation to be a beneficial outcome nonetheless.

Offshore services vary from simple to complex, and differ in terms of routine and the skill level required (UNCTAD, 2004). High-end services, such as legal services, financial forecasting and engineering design, require domain expertise and specific skills. Generally, offshore services require a higher skilled workforce than manufacturing, and often employ university graduates with specific skills, such as English-language and computer skills, particular domain knowledge, and a customer-focused attitude (Goswami et al., 2012).

Local linkages

Branch plants are often criticised for lacking local linkages, because inputs are procured from outside the region (Phelps, 1993). Local linkages are often seen as a form of territorial
embeddedness. The GPN approach deploys embeddedness as core concept for understanding the outcomes for local economic development. The territorial embeddedness of firms ‘deals with the various GPN firms’ ‘anchoring’ in different places (…) which affects the prospects for the development of these locations’ (Henderson et al., 2002: 452). The concept overlaps with the ideas of the locally embedded plant in regional studies literature (Pike, 1998; Phelps et al., 2003). Andersson and Forsgren (1996) have shown that the increased embeddedness of subsidiaries with regard to actors external to the firm can decrease headquarters’ powers over their subsidiaries.

Offshore services are efficiency-seeking vertical investments, directed at the export market (Hardy et al., 2011b). In offshore services, the absence of demand for locally sourced components combined with the absence of local customers leads to relatively low territorial linkages and an arguably high footlooseness in the sector (White, 2004; Hardy & Hollinshead, 2011). The existence of locally networked offices is therefore even less likely in offshore services.

**Fixed investments**

Fixed investments, such as the construction of expensive firm-specific production facilities, increase the attachment of the firm to the region they invest in. Clark and Wrigley (1995) argue that sunk costs, which cannot be recovered in exit, play an important role in determining spatial flexibility and fixity. They state that “sunk costs (even in their absence), are an essential lens through which to understand the patterns and processes of restructuring” (ibid.: 213). Outsourcing to third-party suppliers, especially with shorter-term contracts, decreases the sunk-costs of firms.

In contrast to manufacturing industries, offshore services do not require complex production facilities and use largely mobile equipment. This decreases the firm's dependence on the investment-recipient region and increases its ability to relocate relatively easily in case more profitable alternative sites for investment are identified (Hardy et al., 2011b). Investment incentives offered by regional authorities in their competition for inward investment, furthermore reduces the (re)location costs of firms, potentially increasing their footlooseness (Phelps & Fuller, 2000; Phelps & Raines, 2003).

**Ease of relocation**

All factors above have an impact on the relative ease of relocation of foreign-owned subsidiaries, which has been a key concern for branch-plant literature scholars. Branch plants are thought to be more vulnerable to closure in times of recessions, though evidence of this is sketchy (Townroe, 1975). Markusen's typology of “sticky places” identifies different industrial districts and their ability to attract and keep investment in a specific place. Among these, the “satellite platform – a congregation of branch facilities of externally based multiplant firms” (Markusen, 1996: 304) is potentially the least sticky, especially if it occurs in less skilled, low-cost districts and fixed capital investments are low. Markusen (1999) specifically applied the typology to the study of manufacturing activities in second-tier cities.

The distribution of power between firms and regions is essentially asymmetric, due to the place-based nature of regions in contrast to increasingly mobile, transnational
firms (Dawley, 2011). In this sense, regions have lost power to MNCs, which can use the threat of disinvestment and relocation to their advantage (Christopherson & Clark, 2007). Dicken (2011) argues that although firms have the ability to exploit geographic differences and change and re-change production locations, states are able to restrict access to local resources, such as highly skilled labour pools.

If service-delivery companies are foreign-owned, cater exclusively to the export market, have low fixed capital investments and operate largely independent of local suppliers, the footlooseness of the sector may be high. If operations require specialised skills, the specific subsidiary occupies an important node in the GPN, and increasing decision-making powers rest with the local branch office, then the region can be considered less vulnerable to a sudden disinvestment. Ultimately, it is useful to conceptualise investment not as a one-off “coupling” process, but to include recoupling and decoupling processes in the analysis (MacKinnon, 2012). Cities and regions compete not only for inward investment but also for repeat investments (Phelps & Fuller, 2006).

4.3 Methodology, research sites, and data collection

This research is based on a multi-site case study of offshore service firms in the Philippines. The case study approach is most effective research design for contextualised, multi-factored research (Yin, 2009). In order to understand the position of offshore service branches in the Philippines in wider production networks, this research takes a bottom-up approach to trace the power relations ‘from below’. Instead of focusing on decision-makers at headquarter locations, findings are based upon the experience of branch-office managers located in the offshore locations.

Studying global networks and development in specific places simultaneously is a difficult endeavour. In order to analyse both, the case study has comparative and relational elements. On the one hand, the different research sites are compared and contrasted with the functions they fulfil. On the other hand, the network relations between firms in these places are addressed, including firms’ connections and relations with each other and the distribution of corporate power in the GPN.

Metro Manila, the capital and primary business location in the Philippines, is an obvious choice for investigating the Philippines’ position in offshore service GPNs. Regional economic differences in the Philippines are considerable; therefore, the second-tier cities were selected from the three island groups: Baguio, in the mountainous northern part of Luzon, Bacolod in the sugar-based island of Negros (Visayas) and Davao, in the southern island of Mindanao (see Figure 4.1). All three are mentioned in a Top 100 ranking of global offshore destinations; on positions 76, 93 and 99 respectively (Tholons, 2013).

Semi-structured, face-to-face interviews were chosen as a method, since offshore service firms are often reluctant to share information on their operations, also due to political backlashes in developed economies against the offshoring of professional jobs. Only in a situation of trust, best established through direct interaction with the researcher, will executives and managers therefore discuss their firm’s activities and share data. A total of
43 interviews were conducted during two fieldwork visits in April-June 2012 and February-April 2013, of which 7-8 took place in each second-tier city, and 21 in Metro Manila.

The first interviews were conducted with business-association representatives, investment-attraction authorities, and sector experts to gain an insight into the types of firms active in the sector. Based on these interviews, companies were targeted for participation in the study. This was facilitated by the attendance of industry events, introductions by business-association representatives to their members, and snowballing for further recommendations of business leaders by their peers. In this sense, sampling was primarily driven by pragmatic concerns. BPO operations tend to be large, since economies of scale drive operations; companies with
less than 100 employees were excluded from the sample. In total, 23 representatives from 18 companies in all four cities were interviewed. These firms constitute about half to three-quarters of all offshore service employment in second-tier cities. Metro Manila is estimated to host several hundred offshore service firms; 8 of the sampled firms are among the 36 largest offshore service firms in the Philippines (ABS-CBN News, 2014). Firms differ with regard to ownership (seven with offshore ownership, one mixed, and 10 outsourced) and in terms of their activities (13 call centres and five back-office operations).

Interviewees were drawn from top-level management, which differed per location. In Metro Manila, country managers (overseeing all operations in the Philippines), managing directors or operations managers were interviewed, and in some instances, human resource (HR) managers. In five cases, interviews were conducted both with a senior manager and an HR manager, either simultaneously or consecutively. In second-tier cities, the highest-ranking manager is usually the site director (whose role may involve frequent traveling to offices in Metro Manila) and the HR manager. The absence of (permanent) high-level management staff at second-tier cities is a finding in itself and confirms arguments about the branch-plant syndrome (Townroe, 1975).

Several of the companies interviewed operate in more than one of the four cities, providing the opportunity to examine relational structures, such as the distribution of tasks, decision-making and relations between offices. Interviews lasted between 40 minutes and two hours. The core themes emerged out of the theoretical framework (see Table 4.1) and centred around the position of branch offices in their larger firm networks, power relations (in terms of decision-making and control) inherent in these relations, activities conducted out of each office and types of jobs created, linkages with local firms and institutions, investments, and the evaluation of challenges and threats of closure and relocation. For each of them, a set of indicators was used. Although the interviews covered themes and questions from an interview guide, open and discursive dialogue is proven to be the best form to collect information from business elites on complex ongoing processes and network relations (Schoenberger, 1991; Yeung, 1995).

After data collection, the interview data were organised and thematically grouped (according to the dimensions identified in the theoretical framework of the study) with the help of a qualitative data analysis programme. The findings were compared for each theme and each city to observe and identify patterns. Finally, the findings were interpreted, individual stories placed into perspective and specific claims triangulated with industry-stakeholder and expert interviews, thereby enhancing the validity of the findings.

4.4 GPNs and offshore services in the Philippines

The global sourcing of services from the Philippines consists primarily of customer-service work, conducted out of foreign-owned call centres. Other activities include back-office operations, transcription, IT, engineering services, animation and game development. The dominant share of foreign investors stems from the US, which is also the main market
for offshore service exports. The history of US colonisation has led to close relations and ‘cultural affinity’ of the Philippines with North America, which constitute a key precondition for attracting (voice-based) offshore service investments.

Metro Manila is the nerve centre of the Philippine economy and is a BPO investment hub, responsible for the predominant share of the sector’s revenue and employment. Therefore, it is expected to fulfil a different function in GPNs compared to lower-ranking cities. Of the three second-tier cities covered in this research, Bacolod is the most advanced. Its BPO sector consists of six foreign-owned call centres, each with more than 1,000 employees and a total of about 8,000 employees. Baguio’s BPO sector has approximately 4,000 employees, with four foreign-owned call centres, one of which is responsible for 70% of all BPO employees; it is moreover the largest employer in the entire city. Davao City is located on the island of Mindanao, which is politically unstable due to an insurgency. The instability has led to difficulties in attracting foreign-owned call centres despite its large human-capital base. So far, only two foreign-owned call centres are operating from Davao City. Economies of scale are an important factor for offshore service production, limiting the ability of small cities to attract FDI.

4.4.1 Ownership: predominantly foreign, sub-contracted

Offshore services in the Philippines are predominantly foreign-owned and foreign equity participation in the Philippines’ offshore service sector is 93.3% (Yi, 2012: 137). Few Filipino-owned BPO companies exist, which starkly contrasts with the large number of domestic-owned firms in the Indian offshore service sector (Dossani & Kenney, 2007). Most large BPO firms have a network of offices spanning the globe, using the ‘follow-the-sun-model’ and transferring work processes through different time zones. The majority of all work from the Philippines is delivered to end-customers in the US. Recently, several Indian-owned BPO companies have been expanding in the Philippines. Their clients are still located in the US and for the Philippines branch offices little has changed in terms of their position in the GPN. One office holding control functions in the US has simply been substituted for another one in India, where decision-making powers remain.

Distinguishing ownership between outsourced BPO branches and fully-owned MNC branches, a clear difference exists between Metro Manila (6 MNC branches and 1 mixed ownership) and the second-tier cities (all outsourced, except 1 MNC branch). Usually, outsourced operations are believed to hold relatively more power in contrast to vertically integrated production networks (Gereffi et al., 2005), but in the specific case of offshore services, the additional (foreign-located) actor simply adds another intermediary and lengthens the chain of command. Also, setting up a fully-owned MNC branch office is usually a more stable investment, in contrast to the flexibility provided by using BPO providers. Employees value the fact that they work for known brand names, rather than for their suppliers, which gives them more sense of ownership.

24 By being direct employees of the company, they can receive special benefits, e.g. reduced staff-rate for hotel stays similar to other employees of the hotel group (Interview 120508d).
4.4.2 Nature of activities: low to medium-end

MNC branches in offshore services in the Philippines are mostly operating as cost centres and not as revenue generating offices, though customer service companies frequently use upselling strategies to generate a limited amount of revenue. Most work conducted in the contact centres can be classified as routine and is standardised and scripted. Clearly, cost reduction, in the form of labour arbitrage, continues to be the primary driver for opening branch offices in the Philippines.

The tasks conducted in Metro Manila and in the three provincial cities differ in several ways. Five large companies in the sample carry out back-office operations for fully-owned subsidiaries of financial service, publishing, media and petroleum MNCs. In the second-tier cities, only front-office contact centres exist, suggesting that relatively higher-end services are so far only conducted out of Metro Manila. Internal labour migration to the NCR is facilitated by investors; for example, 200 accounting graduates were recruited by Deutsche Bank at Universities in Bacolod and subsequently employed in its captive shared-service centre in Manila, according to an investment specialist (Interview 120529a).

Comparing contact centres in the NCR and second-tier cities, two differences are noteworthy. First, second-tier cities’ offshore service branch offices have fewer accounts or clients. One subsidiary of a large call centre in Baguio only services one single client, for which all its employees work, whereas their Metro Manila office has more than a dozen clients. Since clients often work with several service providers and can shift or end contracts relatively easily, dependence on a single client can have profound negative impacts. Second, the sampled second-tier offices more often take over seasonal accounts, such as taking orders for cut-flower delivery. In a call centre in Bacolod, seasonal accounts were filled with 400-500 temporal workers, about a quarter of the total workforce (Interview 120517a). This makes lower-tier offices more dependent on a small number of clients and more vulnerable to sudden contract termination.

4.4.3 Network position: dependent, low-ranking offices

The fragmentation of service production and the functional and spatial separation of lower back-office and customer-service functions from the rest of the lead company leads to an increasing specialisation and ‘fine-slicing’ of value chains (Rugman et al., 2011), which makes a lock-in into low-value-added services and a dependent position in the GPN more likely. Figure 4.2 visualises the position of Philippine branch offices in the offshore service GPN, with end-customers and the client company located in the US (the most common arrangement). Metro Manila hosts both directly-owned shared-service centres (MNC branches) and foreign-owned BPO offices (BPO branches), both controlled by the lead firm in the network, the MNC headquarters.

In second-tier cities, outsourced operations dominate and almost exclusively foreign-owned BPO branches exist. These offices can clearly be seen as the weakest link in the network, with ownership, power and control-relations extending from both MNC and BPO headquarters in the developed country and from the higher-ranking BPO branch office in the
NCR. This confirms their low-ranking position within the international division of labour and the existence of hierarchical and quasi-hierarchical governance relations (Gereffi et al., 2005; Hardy et al., 2011b). Another important point is the relative competition between the different branches. Whereas MNCs generally have few captive offices (usually up to five shared-service offices), BPO firms have many more branches (often up to 100). Smaller branches in second-tier cities at the periphery of the network are particularly affected by competition stemming from other branches.

All offshore service investments in second-tier cities in the sample have offices in Metro Manila as well. Strikingly, investments in the provincial cities were without exception made as expansionary investments, after a first round of investment in Metro Manila. Therefore, no independent investments flowed into the second-tier cities and all companies continue to simultaneously operate offices in Metro Manila. The NCR-based offices are usually larger and operate as higher-ranking offices in the network, coordinating the work and forming a vital node for the offices in second-tier cities. A call centre's site director in Baguio confirms their low-ranking position: “We are just satellites” (Interview 120528d).

The same clients are often shared between second-tier cities and the NCR for reasons of business continuity, though several clients are serviced exclusively from Manila, due to smaller office sizes in the second-tier cities (Interview 120517a). Clients retain considerable power through the flexibility of changing providers relatively easily, facilitated by creating competition between providers based on performance indicators. “Especially in third-party outsourcing, the contracts are written in such a manner that it is very easy to actually pull out from one provider and [move] it to the other” (Interview 130315b). Companies can shift the volume between service providers easily, since the individual providers are largely non-specialised, offering the same service. A country manager of a US-owned BPO firm explains that “most of [the buyers], I would say have the same line of work, or same type of call, going to us and a couple of our competitors” (Interview 130320b). Thin profit margins result for many BPO firms.
4.4.4 External decision-making and control

The control and decision-making powers of the individual subsidiary in relation to other units in the network (headquarters and/or clients) are crucial for assessing the subsidiary’s level of dependency. Decision-making on where an office is set up, what type of tasks are carried out, and who is recruited for positions is usually divided between a client’s headquarters and the BPO’s headquarters, with limited autonomy remaining in the Philippines. Head offices in North America or in Europe coordinate and control the activities conducted out of each office:

‘If you are a local company here ... before you can actually say anything, you need to have clearance with global marketing and it passes through India, it passes through your Malaysia office, it goes back through the US before it actually comes here. In fact, any bit of small movement here in the Philippines, it has to be cleared somewhere else. There is very little liberty as far as the companies here are concerned, because they are an attachment to a larger company (Interview 130315b).’

Only limited management personnel is based in the Philippines; of the top-level global management positions, the Philippines has vice presidents or ‘global heads’ only for human resources or training positions (since the majority of the global BPO workforce may be based in the Philippines); all other global management positions are kept abroad. The country manager of a BPO branch explained that all ‘operations teams’ report to himself in Metro Manila, because this is the regional operating centre, but all ‘global heads’ are in the US (Interview 130320b). In a similar fashion, a senior HR analyst based in Davao explained the process of their firm: “We only have one general manager, one HR director, so decision-making would come from the top-notch in Manila and then would be cascaded to each site” (Interview 130327e).

The buyers of services retain considerable control over processes as “they are heavily involved in running the business” (Interview 120517a). In several cases, clients fly to second-tier cities to personally decide on recruitment issues: “We took the clients to Bacolod, we even had them interview the applicants that we had” (Interview 120516a). This high retention of control and involvement also relates to the function these subsidiaries carry out: call centres directly interact with the MNC’s end-clients. Mistakes and problems in customer-facing activities are costly to correct and have an immediate impact on brand perception, a crucial difference from manufacturing branches. Another factor is the lack of local management capabilities, especially in smaller cities. Lower-level decisions are usually decided in Metro Manila, where all main decision-makers are located. Videoconferencing facilities enable communication with second-tier branch offices, which require only one site director for management.

The export-market orientation of the sector means that few domestic companies are customers of the services. Despite the fact that many companies have spare capacity (empty seats) during the day (they are only used to service North American customers during the night shift), branch offices are not able to effectively compete for local contracts. The senior manager of external affairs of a foreign-owned BPO firm in Metro Manila explains that:
Actually, it is because we have to conform to a specific pricing model and that is dictated by our headquarters […], so everything is dollar-based, so we cannot offer them anything lower. Everything in [our company] is centralised, we have like a proposal laboratory in New York and everything is coming from there, I cannot just send a quotation for our services based on what I think is right (Interview 120529d).

Captive operations of a publishing company have experienced devolution of decision-making power for certain tasks over time; for example, for the selection of pictures for web content. Previously the workers needed to get permission from the London office; now a supervisor is sitting right next to them in Metro Manila (Interview 130306d). This exemplifies how over time, and through the build-up of trust, more control over the process may shift to Metro Manila for in-house services. Moreover, being a captive operation means that certain higher-end tasks can be conducted from the Philippines because confidential information remains within the same organisation (Interview 120522). The potential for upgrading and the devolution of decision-making power in captive operations over time is discussed in more detail in Chapter six.

4.4.5 Job quality: medium- to high-skilled

Employment in the offshore service sector requires above all a skilled labour force (Goswami et al., 2012). The BPO sector draws mainly on young, urban, highly-educated individuals. The top educational institutes in the Philippines are located in Metro Manila. Therefore, the number and quality of graduates in the NCR are higher compared to second-tier cities. English-language skills are the most important qualification for work in the call centres. In many cities, provincial dialects are spoken as a first language, followed by English, which is sometimes better spoken than the national language Tagalog, making certain regions attractive for foreign investors.

Interestingly, the sampled firms were not characterised by a skewed gender ratio of their workforce. This fits earlier findings of a government survey, which found an almost even distribution of employment, with women accounting for 55% of the offshore service labour force (National Statistics Office, 2012). This stands in contrast to earlier findings that branch plants significantly prefer to hire female labour (Breathnach, 1993; Breathnach, 2000; Townroe, 1975).

The outer appearance of all offices belonging to the same firm is identical as companies strive for a “one-look consistency throughout all sites” and security procedures are standardised. However, employees’ salaries are significantly lower in second-tier cities, since they are adapted to regional costs of living (Interview 130327e). Government-set minimum-wage levels differ considerably between regions, and similar differences are reflected in BPO wages, though the sector pays above average in all locations. Also the type of jobs available per location differ. Often more diverse and higher-end positions are available in Metro Manila, compared to second-tier locations.

The BPO sector is characterised by a high labour turnover. The voluntary attrition rate is higher in the NCR, facilitated by more intense competition between companies for suitable
workers. Many BPO offices are located in high-rise buildings with several floors dedicated to each company. “In Manila, you go one floor up, there is the next [BPO] company”; fewer alternative opportunities exist in second-tier cities, reducing competition for qualified labour (Interview 120517a).

### 4.4.6 Local linkages: limited

In general few local linkages exist between offshore service operators and local businesses. BPO companies can have either backward linkages with local suppliers or forward linkages with local business clients. Few locally-sourced inputs are required for services production and local suppliers are mainly limited to security, janitorial services, and food concessions. The need for local or domestic clients is limited by the export-driven nature of the offshore service companies.

Magtibay-Ramos, Estrada & Felipe (2008) found only very limited forward and backward linkages in the Philippine BPO sector. Few companies use domestic service-providers, but if they do, the contracts (such as payroll administration for a 17,000-strong workforce) are centrally given to large companies located in Metro Manila. Since most work is already sub-contracted, opportunities to pass work on to local companies is limited by contractual regulations and lack of capacity in local businesses, leading to few spin-offs and domestic-owned companies in the sector. Indirectly, the demand for round-the-clock transportation, housing, and increased consumption spending by the young workforce impact the local economy. With skilled labour as the most important input in the production process, increased linkages with higher education institutions have also been developed (see Chapter five).

Contrary to what Markusen (1996) expects in manufacturing satellite platforms, the offshore service branch offices in the Philippines have sufficient commonalities to enable the creation of a business association. The Business Process Association of the Philippines and its activities can increase territorial embeddedness in the home market, showing that the sectoral orientation of branch plants matters in evaluating their stickiness in a given place.

### 4.4.7 Fixed investments: low

Sunk costs in the offshore service sector are relatively low, since contrary to manufacturing factories, only office space is needed. This is usually leased for relatively short periods of time and fully equipped with the necessary IT infrastructure. Computers and other technical equipment, though often costly, are mobile and can be easily transported and set up at other office locations. The vice chairman of BPAP argues that the offshore service sector is characterised by low fixed investments and is quite unique in terms of that it is very mobile, very easy to implement, within a matter of three to four months you are off and running, you don’t need huge capital investment, you know; you don’t have the NGOs [non-governmental organisations] that are pushing back because it is going to affect the environment and so on… (Interview 120611a).
BPO investment over the past decade has been supported by incentives from the Philippine government, including tax incentives (reduced income tax, value-added tax and tax-free import of equipment) in special economic zones (DoST-ICT Office and BPAP, 2012), further reducing the costs of investment by firms. The main local investment by offshore service companies is dedicated to workforce training. Generally, four to eight weeks of English-language training, accent neutralisation, information on the customer market’s geography and account-specific knowledge are provided for new employees. Some call centres offer free classes for prospective applicants at training centres (Interview 120528d).

4.4.8 Ease of relocation: danger of disinvestment in a footloose industry reassessed

The offshore service sector is often seen as footloose with low territorial embeddedness and low fixed investments (Hardy & Hollinshead, 2011). Re-shoring, or the relocation back to the home country, is usually the result of a failure of offshoring benefits to materialise. Several highly publicised cases of re-shoring call centres from India to the UK have been portrayed in the media (e.g. Jenkins & Kavanagh, 2011; Vaidyanathan, 2011). While the footlooseness of companies at first glance seems to be high, so far no disinvestment or re-shoring occurred by branch offices in the sample, in contrast to the Indian experience. During the global financial crisis, several companies actually increased offshoring to save costs. This ‘substitution effect’ was larger than demand contraction during the crisis, showing the anti-cyclical nature of offshore service activities (Gereffi & Fernandez-Stark, 2010b).

BPO branches, apart from full-scale closure or relocation of the business, face volatility in terms of their clients (especially temporary accounts). Lay-offs of large numbers of staff can result, in case the fluctuations cannot be balanced out. A BPO company in Baguio had excess facilities for 2000 staff remaining empty for an extended period (Interview 120507d). Another company, with 1500 employees, was servicing only one client, indicating that second-tier cities’ offices are more prone to disinvestment. This surplus capacity of second-tier cities might be related to their creation as expansionary investments, their function as back-up operations for NCR-based offices, and intra-corporate competition for repeat investment (Phelps & Fuller, 2000).

4.5 Differential regional outcomes of integrating into GPNs

The integration into GPNs produces varied impacts on the different regions of the archipelago. Table 4.2 summarises the different positions branch offices occupy in Metro Manila and in second-tier cities. Metro Manila performs the function of a gateway at national level, despite being a less advanced hub on a global scale. Offshore service branch offices in Metro Manila hold increased decision-making power, produce higher-value-added services and serve more diversified markets. In order sustain and expand Metro Manila’s role as a BPO hub, it is important to move further towards the developmental dimension, which will involve creating more local linkages, and move into higher-end services.
Chapter 4

Table 4.2: Classification of findings in dependency-development taxonomy

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Foreign-owned, all outsourced</th>
<th>Foreign-owned, both outsourced and captive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of activities</td>
<td>Low value-added, routine operations</td>
<td>Low to medium value-added, mostly routine operations</td>
</tr>
<tr>
<td>Network position</td>
<td>Weakest unit in the network</td>
<td>National/regional operational headquarters</td>
</tr>
<tr>
<td>Decision-making and control</td>
<td>Externally by clients and/or headquarters abroad or higher management in Manila, limiting local decision-making</td>
<td>Externally by clients and/or headquarters abroad, operational issues decided locally</td>
</tr>
<tr>
<td>Job quality</td>
<td>Medium-skilled</td>
<td>Medium to high-skilled</td>
</tr>
<tr>
<td>Local linkages</td>
<td>Limited</td>
<td>Limited, few domestic clients and outsourcing relationships</td>
</tr>
<tr>
<td>Fixed investments</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Ease of relocation</td>
<td>Potential contract discontinuation by individual clients high</td>
<td>More protected due to captive operations and more clients</td>
</tr>
</tbody>
</table>

Second-tier cities function mainly as back-up operations for other locations and occupy subordinate and peripheral positions in the international division of labour, conducting predominantly lower value-added, voice-based services with limited local linkages. The overreliance on offshore service FDI, especially from foreign-owned call centres and the weak position of the local branches in the international chain of command and control (exerted both from Metro Manila and abroad) presents unfavourable developmental conditions for second-tier cities.

This analysis presents a snapshot of the position of branch offices in different localities. It is important to realise that the offshore service sector investments in second-tier cities are a more recent phenomenon and may diversify their tasks or transfer higher-value-added functions in the future. The findings do not negate this possibility but highlight the currently existing limitations for such a trajectory.

4.6 Conclusions

This research has empirically evaluated the position of branch offices and power relations in GPNs from the perspective of the recipient region. Due to the prevalence of outsourcing, complex structures of decision-making and control exist, with clients and headquarters located abroad influencing and determining local service-production processes. Offshore outsourcing, if not occurring to domestic companies, leads to an even more dependent economic position of recipient locations than the branch-plant syndrome would suggest, since the increased flexibility of lead firms can heighten control functions over supplier firms and their subsidiaries.

A combination of insights from GPN analysis and branch-plant debates shows that the Philippines’ offshore service sector is characterised by vertical investment, with the locus
of power remaining abroad. Foreign ownership, control, and dependency characterise the majority of branch-office positions in GPNs, which are controlled by headquarters located abroad. A functional and spatial separation of lower-end tasks has become visible. The findings show that some of the traditional literature’s concerns about the branch-plant economy still remain relevant in an increasingly complex international division of service labour.

On the other hand, findings from the offshore service sector show that despite being routine, the number and quality of jobs is relatively high, paying premium wages for college graduates. In the face of high unemployment among young graduates, this creates new opportunities for this particular segment of the labour force. Moreover, a lower feminisation of the workforce was found compared to earlier research on branch plants. Though inherently flexible and footloose, little disinvestment (or threat thereof) has occurred to date in the sector. These findings validate the need to look at the specific type of branch plants and their context to assess developmental impacts (Sonn & Lee, 2012), corroborating the necessity for empirical, comparative and relational studies also in the future, for which the framework developed here may be useful.

On a theoretical level, this study has adapted, combined, and applied the GPN approach and the branch-plant literature to the case of services and to a developing-country context. The criticism of not paying sufficient attention to uneven power relations, levelled against the GPN approach (Dawley, 2011, MacKinnon, 2012), has been ameliorated by developing a more detailed list of indicators to empirically discuss the position of branch offices in GPNs. This creates a theoretically grounded basis for critically evaluating local developmental outcomes as a result of FDI. Ultimately, bringing these two strands of literature together engenders a more nuanced debate of regional development opportunities resulting from a region’s integration into GPNs.

It is important to keep in mind that GPNs are dynamic in nature and do change over time. The discussion of branch plants has brought attention to the processes of disinvestment, or de-coupling, which should be included in a dynamic GPN framework (MacKinnon, 2012). More positive possible dynamics include increased territorial embeddedness through the gradual development of local linkages and the rise of locally owned companies over time. Upgrading into higher-value-added services could occur with a maturing of the industry. This study has indicated that captive operations in Metro Manila have slowly gained more decision-making powers, a claim that will need more research to be substantiated. Further studies could evaluate the dynamic relationship between regions and GPNs and evaluate how nodes in service GPNs evolve over time, while simultaneously paying attention to the broader political-economy implications of dependent economic development. A better understanding of how local companies can be grown and entrepreneurship in offshore services supported is pertinent to decrease FDI dependency.
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Chapter 5

Industry-academe linkages in the Philippines: Embedding foreign investors, capturing institutions?

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5.1 Introduction: offshore services and the global knowledge economy

The global sourcing of services has changed the requirements for developing countries to attract FDI. Some scholars argue that as a "new stage in the evolution of the world economy, the shift of service jobs from developed countries provides an important opportunity for developing nations to drive growth and improve both social and economic conditions" (Gereffi & Fernandez-Stark, 2010a: 6). In order to attract investment in BPO services, the availability of educated, lower-cost human resources is a prime factor, creating new demands for tertiary education in developing countries (Goswami et al., 2010; World Bank, 2002).

Offshore services are often argued to be footloose, since they require few locally sourced inputs and have only limited local linkages other than skilled labour (White, 2004; Hardy & Hollinshead, 2011). Multinational corporations have long been recognised as political actors, able to shape and influence policy in the countries they invest in through bargaining with governments. In the case of highly mobile MNCs and territorially bound state actors, power asymmetries are high, potentially resulting in the ability of MNCs to capture institutions to fulfil their own goals (Dicken, 2011). In higher-end offshore services, foreign investors engage in a strategy of “active embedding” to access skilled labour, a process defined by Manning et al. as “the ongoing alignment of local institutional conditions with global MNC strategies and operational needs” (2012: 3). This strategy can have both enabling and restricting influences on the type of relationships that can develop between universities and industry.

The debate on the role of universities in stimulating regional development has primarily focused on their ability to generate synergies, spin-offs, and innovation in the Global North (Abel & Deitz, 2012; D’Este et al., 2013; Goddard & Vallance, 2011; Ponds et al., 2012). For developing countries, industry-academe engagement is often driven by a concern for better aligning higher education with labour-market requirements to reduce an employment-education mismatch. Closer collaboration can help update curricula, introduce more relevant skills, and lead to improved employment opportunities for graduates. Moreover, upgrading the skills of the labour force is recognised to be crucial for the ability of a region to increase its competitiveness, to attract further investment, and move into higher-value-added services (Fernandez-Stark, Bamber & Gereffi, 2011; Barrientos, Gereffi & Rossi, 2011). Whereas earlier literature on offshore service workers addressed the skill development of workers during BPO employment and the progression of workers’ individual careers (Beerepoot & Hendriks, 2013; Vira & James, 2012), this chapter analyses the intervention of BPO firms in the education sector, changing how skills are developed also prior to employment. It takes as a point of departure the GPN approach, traditionally focused on the level of the firm and the sector and less on workers’ experiences (Coe & Hess, 2013).

This chapter develops an empirically grounded understanding of a developing country’s integration into GPNs of service delivery, beyond the better-known case of India. I discuss the role of multiple actors involved in the emergence of an offshore service hub, the opportunities for upgrading (skills) in offshore services, and the resulting potential for economic development from this “second global shift of offshoring” (Bryson, 2007;
Chapter 5

Manning, 2013; Manning, Ricard, Rosatti Rique & Lewin, 2010). The empirical discussion focuses on industry-academe linkages as a form of territorial embeddedness by foreign investors in the offshore service sector in the Philippines.

Since the early 2000s, the Philippines has been exporting BPO services, such as customer- and back-office services, to the US and other countries in the Global North. Metro Manila is an advanced offshore service hub, occupying the third rank in global offshore service-delivery (Tholons, 2013). The offshore service sector employs more than 780,000 full-time employees in the Philippines as of the year 2012, and it is central to development strategies to transform the Philippines into a knowledge economy (Dumlao-Valisno, 2008).

Industry-academe linkages and changes in higher education curricula in the Philippines are used as examples to interrogate processes of territorial embedding and the institutional capture of MNCs. The theoretical contribution goes beyond the impact of different forms of industry-academe linkages and concerns wider debates on MNCs and their ability to intervene in regional institutions and ‘capture’ them. This relates to a gap identified by Christopherson and Clark in regional studies literature: “Missing from contemporary theory about regions is an account of how more powerful firms exercise political and economic power at various spatial scales in order to shape the labor markets and production environments in which they operate” (2007: 7). Moreover, the discussion is linked to debates on the varieties of capitalism about the emergence of dependent-market economies (Nölke & Vliegenthart, 2009).

Based on 40 interviews with foreign investors, education providers and industry experts in 2012 and 2013, this chapter addresses the following questions: What kind of industry-academe linkages exist between the offshore service sector and higher education institutions (HEIs) in the Philippines, why are they formed, and what are their implications? The findings show that firms have established linkages with universities and colleges to facilitate access to qualified workers. Lower-end standardised service providers have been the most active in developing relationships and changing curricula in the realm of English-language communication skills, whereas higher-end service providers have been reluctant to engage in collaborations that advance technical and management skills. I argue that educational institutions have been captured by foreign investors to satisfy their lower-end labour demand for routine activities. This provides serious challenges for strategies to upgrade workers’ skills, which are essential for the transformation into a knowledge economy.

The next section clarifies the theoretical concepts of the study, followed by the research methodology. A short introduction to the offshore service sector in the Philippines and its educational system preludes a discussion of empirical findings. The empirical section maps industry-academe linkages, discusses coordinated industry-academe-government initiatives pertaining to the education sector, and presents the rationale for actors to engage in industry-academe collaboration. Finally, the restricting and enabling impacts of foreign-investor-driven industry-academe linkages and education-policy reform are evaluated.
5.2 Territorial embeddedness and the knowledge economy: industry-academe linkages

Embeddedness can be seen as a social and spatial process: initially discussed in broader social terms (Granovetter, 1985), it has later often been reduced to a spatial concept (Hess, 2004). It is a widely used concept to assess regional economic development opportunities in the GPN framework (Henderson et al., 2002; Coe et al., 2004; Yeung, 2000). Territorial embeddedness, the main focus of this chapter, denotes the anchoring of firms in places, the (local) linkages established with suppliers and other actors. The concept “can be defined in terms of the depth and quality of the relationships between inward investors and local firms and organizations, and the extent to which spillovers provide opportunities for local economic development” (Phelps et al., 2003: 28). Increased local linkages and territorial embeddedness are believed to alleviate the threat of relocation, tying foreign companies to the regions they invest in (Henderson et al., 2002; Phelps et al., 2003).

The absence of territorial embeddedness, or ‘nonplace embeddedness’, may constrain development opportunities and lead to a higher chance of disinvestment (Markusen, 1996). Governments can try to embed firms in their regions, in the strongest form through “obligated embeddedness” (Liu & Dicken, 2006), in which the government imposes conditions of local linkages or locally sourced inputs for FDI. So far, territorial embeddedness has been mainly discussed in industrial settings, with the exception of a recent study by Coe and Lee (2013) on retailers who engage in local service-provision.

Foreign investments into offshore services are less likely to be territorially embedded (White, 2004; Hardy & Hollinshead, 2011). Low input-output linkages characterise the BPO sector in the Philippines (Magtibay-Ramos et al., 2008), and outsourced activities often remain limited to security, janitorial services, and food concessions. Due to the export orientation of the sector, few domestic companies are clients. Limited locally sourced inputs are required, and since most companies are conducting sub-contracted work, contract regulations and lack of capacity of local businesses prevent local sub-sub-contracting. This leaves industry-academe linkages as one avenue for increasing territorial embeddedness in offshore services.

5.2.1 Benefits of territorial embeddedness: increased competitiveness and development of skills

MNCs engaging in offshoring can play a positive role in upgrading human capital through their investment in training. Majluf writes that “offshoring can also have a wider systemic impact on the development of human capital in the host economy, if it serves as a driver for improvements of the national education system” (2007: 157). Arguably, these improvements can occur through industry-driven initiatives to adapt the education sector to its needs. In a similar vein, scholars have argued that universities in developing countries should engage in a more entrepreneurial role. In addition to research and teaching, they ought to fulfil a “third mission” of economic development (Etzkowitz, Gebhardt & Terra, 2000). However,
a critical examination of the type of industry-academe collaborations and the resulting developmental opportunities for the investment-recipient region is required.

The offshore service sector can be distinguished according to different sub-sectors and their positions in the value chain (Gereffi & Fernandez-Stark, 2010a). Although often classified as a knowledge-intensive sector, the BPO sector uses sophisticated technology but rarely produces it, making technical innovations, research and development, and spin-offs unlikely. A major distinction within BPO work relates to work that is voice-based (call centre) or non-voice-based (mainly back-office work). Call-centre work entails primarily soft skills necessary to perform ‘distanciated emotional labour’ (Bryson, 2007). Non-voice-based services can require specific expertise in fields such as finance and accounting, or HR. The higher-end back-office services are often referred to as knowledge process outsourcing. Beerepoot and Hendriks (2013), focusing on individual BPO workers’ employability and skills upgrading, described two distinct routes for skill development: a lower-end route of generic and transferable skill development through routine service work, and a higher-end specialisation of occupation-specific skills in professional knowledge-work.

Going beyond individual worker’s skills, this study investigates human capital development on a sector- and institutional level. In order to assess the potential spillovers of collaborations between foreign BPO investors and local universities and colleges, I introduce a differentiation of the types of industry-academe collaborations on three levels, based on their rationales: (1) facilitating recruitment (2) lower-end, entry-level skills development, and (3) advanced professional skills development. In a ‘hotspot’ environment like Metro Manila, with almost half a million employees in the offshore service sector, it can be expected that some form of coordination of industry-academe collaboration exists on a higher level, by the industry body or the government. Scholars have advanced a “triple-helix model” involving government, industry and universities to create innovation systems also in developing countries (Saad & Zawdie, 2011; Saad, Zawdie & Malairaja, 2008). Many higher-education institutions in developing countries still lack the capacity for such collaborations (Datta & Saad, 2008; D’Costa, 2006). Moreover, support for industry-academe linkages may be taken up by large firms in mature industries, not helping the emergence of new industries or supporting smaller firms in developing countries (Bodas Freitas, Marques & de Paula e Silva, 2013).

5.2.2 Risks of territorial embeddedness: institutional capture and dependency

The cost of initiatives to increase foreign investors’ embeddedness is generally borne by public resources, thereby allowing MNCs to find “social and cultural settings that shift the cost of reproducing labour power onto local societies and states” (Hudson, 1997: 473). Christopherson and Clark have warned that, while MNCs are dependent on local assets, such as skilled labour, they “can exercise power […] over regional labor markets, even those composed of highly skilled workers” (2007: 7). Instead of making location decisions based on existing conditions, they are able to intervene and change local conditions. Foreign electronic manufacturing companies in the Philippines have similarly embedded themselves using “strategic localization” to shape institutions and labour markets to their advantage (McKay, 2006).
From the perspective of firms, active embedding and localisation strategies through industry-academe collaboration are driven by the aim to acquire high-end knowledge and innovation through close linkages with the research and development facilities of universities. In the case of relatively standardised service delivery, it is access to qualified labour that drives the development of university linkages through “the institution-harnessing tendency of vertical investments, which forged links with universities to ensure a supply of suitable labour and to elicit specific technical knowledge” (Hardy et al., 2011b: 439). The ability of foreign-owned firms to create linkages and influence education reform depends on two factors: 1) on the recognition of existing weaknesses in the current education system (such as an education-labour market mismatch), and 2) on the relative bargaining power of investors in relation to the public sector.

If foreign companies are able to pivot national education policies to their needs, the reforms can also lead to an increased dependency of the region on the investors. The ‘dark side’ of integration into GPNs is that regions may lose some control to global actors (Coe & Hess, 2011; Phelps et al., 1998) or become locked-in into rigid specialisations (Grabher, 1993). The opportunity for manufacturing firms to capture institutional resources has been recognised by scholars (Phelps, 2000; 2008). This often involves the securing of tax incentives, subsidies and other benefits, permissions, and access to infrastructure.

FDI attraction policies often necessitate low taxation, which can lead to underinvestment in education by the state and to a low-skill, low-productivity equilibrium and a dependent-market economy, as observed in Eastern Europe (Cimpoca, 2011). The dependent-market economy (DME) paradigm is characterised by three factors: (1) it relies on moderately to highly skilled but relatively cheap labour; (2) technology transfers occur within MNCs; and (3) capital provision occurs via FDI (Nölke & Vliegenthart, 2009). It is a hybrid form between coordinated and liberal models of market-led economies, as defined in the varieties of capitalism approach (Hall & Soskice, 2001). Though the political economy and the institutional background of post-communist countries in Eastern Europe and the Philippines differ in many respects, they have both been the recipients of FDI in offshore services and have developed into strong service hubs within production networks of MNCs (Hardy, Grzegorz & Capik, 2011a; Hardy et al., 2011b). This makes a discussion of the DME approach apt for the case of the Philippines, with the proviso that the varieties of capitalism approach does not relate to one sector but the institutional set-up of a country25. Moreover, previous studies have pointed at the possibility of occupying a dependent position in the international division of labour based on the delivery of call-centre services (Breathnach, 2000).

25 The categorisation of countries relates to innovation systems: in coordinated market economies incremental innovation occurs, in liberal market economies, radical innovation (see Hall & Soskice, 2001 for a more detailed discussion). In the DME no real innovation occurs but is only passed on from the foreign investor’s headquarters.
5.3 Research methodology

This research is based on a qualitative case study of foreign offshore service companies in the Philippines. In total, 40 qualitative in-depth interviews were conducted between April 2012 and April 2013. Of these, 20 were conducted with BPO companies, focusing on the concept of territorial embeddedness, and more specifically, industry-academe linkages. All interviewed firms were foreign-owned BPO companies, mainly stemming from the US, which dominate the sector in the Philippines. The companies in the interview sample can be differentiated according to three features: (a) the nature of their activities: 12 contact centres, eight back-office service providers; (b) their ownership structure: 11 third-party (outsourced) BPOs and nine captive (in-house) service providers (all foreign-owned); and (c) their size: two small (< 100 FTE), six medium (< 1000 FTE) and 12 large (≥1000 FTE).

In addition, 14 interviews were conducted with representatives of the education sector, consisting of three top-ranked universities, five medium-ranked universities, two colleges and four training institutions. Six further interviews were held with representatives of business associations and relevant government agencies, including: BPAP; the Commission on Higher Education (CHED); the Technical Education and Skills Development Authority (TESDA); the ICT-Office at the Department of Science and Technology; and the National Competitiveness Council (NCC). Interviews were, in most instances, recorded. A few interviewees did not permit audio recording of interviews due to data security concerns, in which case notes were taken by hand. Subsequently, interviews were transcribed and analysed with the help of a qualitative software program (Atlas.ti).

In order to substantiate the interview findings, a question on industry-academe linkages was included in an online survey (conducted in collaboration with BPAP) of BPO companies in the Philippines. The survey ran from May to July 2013 among all BPAP members, which represents the majority of offshore service firms operating in the Philippines. Only the answers of foreign investors were used for the study to triangulate the interview responses with a larger sample (n=41).

5.4 Offshore services and the employment-education mismatch in the Philippines

The Philippines has been integrated in manufacturing GPNs through FDI since the 1980s, transforming in particular the provinces surrounding Metropolitan Manila (Kelly, 2013). More recently, cost-saving considerations have led MNCs to offshore the ‘production’ of services to developing countries, such as India, and more recently the Philippines (see Chapter three). English-language skills and “cultural affinity” with the US, from where the dominant share of BPO investors hails, have provided a main incentive for relocating voice-based customer services to the Philippines (DoST-ICT Office & BPAP; 2012). Most large offshore service firms are foreign-owned and foreign equity participation in the sector is high. The majority of firms still provide lower-end call-centre services, though
the number of back-office service providers is rising. Figure 5.1 shows that voice-based BPO services alone constitute two-thirds of total offshore service sector employment in the Philippines (see also Chapter two).

Figure 5.1: Offshore service sector employment in the Philippines, per sub-sector

![Pie chart showing employment distribution by sector](image)

(Source: data by BPAP, 2012)

5.4.1 The paradox of simultaneously overqualified and underqualified workers

Some authors have argued that the relatively high remuneration offered by BPO firms entices young graduates to take up employment in the sector, but drains their skills from the local labour market. "The contact-centre industry attracts college graduates whose training has been directed toward other highly skilled professions, and thus may have created an employment-education mismatch" (Magtibay-Ramos et al., 2008: 42). This is referred to as a paradox (Beerepoot & Hendriks, 2013), similar to overqualified call centre workers in developed countries.

A more surprising paradox emerges when looking at the hiring rates of candidates for BPO jobs, which interviewees confirm to be as low as 3%, due to applicants lacking the entry-level skills required. Firms need large HR departments to administer the process of résumé- and background checks, several exams, and different rounds of job interviews, before offering a contract. The managing director of a large call centre calculates that to hire sufficient staff for his operations across the Philippines, his company had to screen 30,000 applicants in one month (Interview 130320a). On top of this, high attrition rates of up to 60% annually lead to constant hiring and training needs for companies to secure a large enough workforce. Some workers see their employment as a temporary activity and leave

26 Many candidates do not fulfill the entry requirements, especially with regard to English-language skills, and few applicants are able to master the intake exams and fulfill the entry requirements for the job.
the sector; the majority however transfers for higher incentives, ‘sign-on bonuses’ or career advancement to a different company within the same sector (Bird & Ernst, 2009). Given the high cross-firm job-to-job mobility of employees, firms express reluctance to invest in their human resources and shoulder pre-employment training.

The low hiring rate is remarkable considering that the main reason for companies to offshore work to developing countries has been the presence of a (lower-cost) skilled labour force. One explanation for the low passing-rate is that the skill level involved changes when the task is offshored to a different country. English-language skills, combined with neutral accents and cultural understanding of the customers’ host environment, exist only among the highest-educated strata of Filipino society. Another explanation for this skills-labour market mismatch of graduates can be found in the education system in the Philippines.

5.4.2 Higher education in the Philippines: quantity over quality

The Philippines’ education system has been influenced by colonialism, first by Spanish-introduced Catholic institutions, and second through the introduction of English-language tertiary education by the US in the first half of the twentieth century. The result has been an overdeveloped college education and an underdeveloped vocational training, modelled according to the American system. This has led to relatively high enrolment rates and high gender balance but simultaneously low quality among the majority of education providers (Welch, 2011). Several studies have argued that processes of globalisation necessitate changes in the education system to transform the Philippines into a knowledge economy (Di Gropello, Tan & Tandon, 2010; Paprock, Yumol & Atienza, 2006; Symanco, 2013). Unemployment among tertiary education graduates is high, and even surpasses the rate of less-educated workers (Bitonio, 2007). Several reasons can explain the low quality of education and the resulting education-labour market mismatch.

First, private sector HEIs make up 90% of the total, many of which operate for profit, leading to a proliferation of popular studies based on demand alone (Welch, 2011). Second, a lack of binding accreditation limits the oversight by the state over education providers. Only a minority of HEIs pursued voluntary accreditation with the Philippine Commission on Higher Education (CHED), limiting scrutiny of the quality of education and leading to a situation where “a large majority of institutions have low or even zero passing rates in all programs” (Tullao, 2003: 245). Third, the insufficient qualifications of teaching staff limit the quality of tertiary education27. Fourth, due to the short schooling period of only ten years, colleges and universities fulfil to some extent the function of European high schools, teaching general subjects, including literature and mathematics. A newly introduced so-called K+12 (Kindergarten plus 12 years of school) initiative will add two additional high-school years and align the Philippines closer with global education standards. Fifth, the education sector is severely underfunded (Quismundo, 2012).

27 Those who possess higher-ranked degrees are hard to retain since they prefer to work abroad, according to interviewed deans at various universities, though this problem of brain drain is not unique to the Philippines (World Bank, 2002).
Education scholars have argued that the failure of the state to exercise control and authority over the education system is due to its capture by special interest groups of local elites, thereby inhibiting the economic development of the Philippines (Maca & Morris, 2012).

Given these problems of low-quality education, underfunding and the apparent mismatch between skills and labour-market requirements, companies have to invest heavily in training their workforces. The in-house company training of the sampled companies takes between six to eight weeks, with the exception of higher-end back-office services, which can take up to 16 weeks. Training consists of two parts: competence training and account- (or client-) specific training. The first involves general English communication skills (including accent neutralisation), and knowledge on the culture and geography of the US. The second depends on the sector-specific task profile and the complexity of the task, ranging from relatively easy order-taking for shopping catalogues, to technical knowledge for troubleshooting of consumer electronics. The rationale for high spending on training by one of the largest call centres operating in the Philippines is the realisation by BPO managers that “we don’t have a product, our product are [sic] our people” (Interview 120606b).

### 5.5 Increasing embeddedness: Offshore service sector-academe linkages in the Philippines

Most foreign BPO investors engage in university collaborations, confirming the importance of human-resource linkages. Table 5.1, based on qualitative interviews and a survey question, depicts the types of industry-academe linkages at three levels. Level one, recruitment-related activities, make up the largest share of activities with up to 68%. Level two, teaching or curriculum-development activities, are used by 15% of surveyed firms. Level three, advanced skills-development activities, which focus on entry-level skill development, are used by 15% of surveyed firms. Level three, advanced skills-development activities, are used by 15% of surveyed firms.

<table>
<thead>
<tr>
<th>Level</th>
<th>Type of collaboration</th>
<th>Interviews (n=20) in %</th>
<th>Survey (n=41) in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 No collaboration</td>
<td>No linkages</td>
<td>25</td>
<td>22</td>
</tr>
<tr>
<td>1 Recruitment-related activities</td>
<td>Campus recruitment</td>
<td>75</td>
<td>68</td>
</tr>
<tr>
<td></td>
<td>Special recruitment activities</td>
<td>60</td>
<td>56</td>
</tr>
<tr>
<td></td>
<td>Internship positions</td>
<td>45</td>
<td>56</td>
</tr>
<tr>
<td>2 Entry-level skills development (teaching and curriculum development)</td>
<td>Curriculum development</td>
<td>30</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Teaching course</td>
<td>25</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Training teachers</td>
<td>25</td>
<td>12</td>
</tr>
<tr>
<td>3 Advanced skills development (continuing education)</td>
<td>Facilitating continuing higher education (scholarships/university fee-subsidy, offering university courses at company)</td>
<td>15</td>
<td>2</td>
</tr>
</tbody>
</table>

(Source: Interviews and survey)
initiatives through continuing education, occur in only 2% of surveyed firms but in 15% of interviewed firms. In general, the survey findings confirm interview findings, though interviews consistently identify more collaboration at all levels. This may be the result of interview sampling aimed at including active firms in university-academe linkages, which are not necessarily representative of the total firm population.

**Level 1: Recruitment-related activities**
Recruitment activities usually aim at increasing the number of graduates applying for work in the BPO industry through disseminating information on job opportunities, work and remuneration, and marketing and employer branding efforts. Examples are the establishment of dedicated teams of employees for university-linkage engagement or ambassador programmes, in which current employees go back to their alma mater to give presentations about employment opportunities at their company. This is especially relevant to increase the number of potential applicants by improving the negative perception of BPO work held by many middle-class graduates.

**Level 2: Entry-level skills development – teaching and curriculum development**
Curricula change is largely based on pre-employment trainings conducted by companies and revolves around the skills needed for call-centre agents. In many cases this takes the form of an externalisation of company training programmes to universities. Most linkages occur with language departments, but are not limited to these. Also, several IT departments engage in close collaboration with offshore service firms; even in these cases, curriculum adaptation might not involve strengthening IT skills, as the Dean of an IT department explains: "Normally, the content of the training modules would be improving communication skills, including things like simulating actual call activity" (Interview 120517c). At the Polytechnic University of the Philippines, an entire building of the school is dedicated to customer-services and training, to facilitate the labour market entry of graduates, 80% of whom find employment in the BPO industry. At De La Salle University in Bacolod, close collaboration exists through call-centre training, integrated into a regular university course. On the campus, 'English only' signs are displayed to discipline students to converse only in English and not in their native tongues during class breaks. The campus thereby resembles call-centre office environments, where the same signs are used.

**Level 3: Advanced skills development – continuing education**
Several companies offer their employees opportunities for continued learning next to their jobs, for staff-retention purposes. A number of call centres allow flexible schedules to enable employees to combine full-time work with studies, especially to those who have not finished their degrees prior to starting work in the BPO sector. Several larger firms have opened their own ‘corporate universities’, which offer work- and non-work-related classes.

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28 Encouraging the development of non-work-related skills is based on the recognition that for many workers call-centre employment is a transitory job. Similar to the Indian case, many BPO employees aim at taking up non-BPO-related work in the future (Vira & James, 2012).
Though some offer professional-occupational skills development, others focus on generic skills development through personal development courses (time-planning, money-saving), to creative photography and cooking classes.

Most advanced in this regard is a Canadian-owned call-centre company, which brings in university professors to give classes on the company’s premises. Subsidising liberal arts education at a top university is seen as an “engagement program”, a strategic investment in education based on ideas of staff loyalty and retention, rather than teaching purely work-related skills. The firm’s director of learning and development argues that by offering prestigious university education, usually costing ₱250,000 (more than $5,500) per annum, at low rates for their employees, attrition rates are reduced. “The normal life expectancy of a call centre agent is 1.5 to two years, on average. Being able to make them stay for three or even four years is a real achievement!” (Interview 120511a). The focus on the continuous education of existing employees, rather than creating entry-level skills for narrow job-profiles, is a relatively new strategy. Several interviewed firms expressed an interest in starting a pilot project to offer advanced courses to their employees. Facilitating continuing education for workers who are already in employment, increases opportunities for employees to upgrade their skills through accredited, high-quality university degrees, parallel to their employment in BPO. It remains to be seen to what extent workers are able to endure the double burden of full-time employment during the night with daytime study.

5.5.1 Active embedding by companies: the rationale behind private-sector initiatives

Companies are the initiators and main drivers of local linkage creation with HEIs. Which types of companies engage in industry-academe linkages and why? Table 5.2 shows that mainly large, third-party-owned call centres engage in industry-academe linkages. Interviewees reveal that size is the most important explanatory factor determining companies’ collaboration with universities, since the investments required may be beyond

<table>
<thead>
<tr>
<th>Type of firm</th>
<th>Firms (n= 20)</th>
<th>Cooperation by level (in percentages)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>No linkages</td>
</tr>
<tr>
<td>Small (less than 100 FTE)</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>Medium (100 – 999 FTE)</td>
<td>6</td>
<td>50</td>
</tr>
<tr>
<td>Large (1000 FTE or larger)</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>Voice-based (call centre)</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>Non-voice-based (back office)</td>
<td>8</td>
<td>50</td>
</tr>
<tr>
<td>In-house captive provider</td>
<td>9</td>
<td>44</td>
</tr>
<tr>
<td>Outsourced to third-party provider</td>
<td>11</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>20</td>
<td>25</td>
</tr>
</tbody>
</table>

(Source: Interviews)
Chapter 5

small companies’ budgets and hiring requirements. Call centres are more active in creating university linkages than back-office providers, because they require specific communications skills (compared to the diverse skill-sets required by back-office operators), and generally have higher attrition rates and larger workforces than most back-office providers.

Third-party providers engage more often in linkages with HEIs, because captive service-providers usually offer higher-level services and employ more experienced staff. Lateral hiring of experienced employees (instead of recent graduates) allows these firms to benefit from investments and training programs carried out by previous employers. As captive providers relocate tasks from their head-office positions abroad, they compare training costs with their home-country prices, and are under less pressure to save costs. Moreover, operating under their global brand name, they are more concerned about their branding and image. Therefore, these firms are more inclined to conduct their own training. Another reason for lower linkages is the fact that several in-house providers have established offices in the Philippines quite recently and might still decide to create linkages at a later stage.

5.5.2 Engaging in industry initiatives: the rationale of educational institutions

The main reasons for universities and colleges to collaborate with industry partners can be summarised as, on the one hand, a desire to increase the employment rates of their graduates and, on the other hand, a recognised lack of knowledge of labour-market demands. The first point is especially crucial for private institutions, which are dependent upon high graduate-hiring rates in their competition for students. In the absence of reliable quality controls, the number of graduates finding employment is an important metric. Creating graduates with relevant skill-sets for employment in the offshore service sector is seen as “win-win situation” by some education institutions (Interview 120516d). A lack of experience makes it difficult for HEIs to develop the necessary skills and curricula independent of industry input (Interview 130219a). Both public and private HEIs engage in industry collaborations.

However, arguments against engaging in industry collaborations are also expressed. First, the BPO industry in the Philippines, especially the voice-based sub-sector, has a negative perception by school officials and faculty members, who do not want their graduates to become call-centre agents (Interview 130405). A more general reluctance to have industry take over educational policies is expressed by one professor at a top-ranked university in Manila:

There are vested interests on the part of the industry. They want an easy return on their money, and will train instructors that will suit their immediate needs, not that of the country […] I have a reservation against the education being dictated, though this is a strong word, and shaped by the business sector. There is nothing wrong with getting input on how we craft our curriculum, but there is too much emphasis being put on employment that we forget the real meaning of education, which is to equip people for life-long learning (Interview 130304b).

These more fundamental reasons against excessively close collaboration between business and schools can be found in the top-tier schools in Metro Manila. Tier-one universities in
Territorial embeddedness and BPO-university linkages

Metro Manila are less likely to engage in formal relationships for teaching and education of a future workforce. However, they have a larger share in knowledge exchange and scholarship collaborations, providing higher education for BPO employees. More-extensive linkages in recruitment, teaching and curriculum development can be found in lower-tier institutions as a result of a perceived need to do so, either due to lower quality education and low hiring rates of their graduates, or as a result of their peripheral locations.

5.5.3 Hotspot-coordination and government support

The fact that the industry is maturing in Metro Manila and the city has advanced to a global hotspot location in offshore service delivery requires a coordination of efforts, in which the business association BPAP takes a leading role. The rationale for concerted action lies in the danger of a ‘talent war’ in which new investors resort to poaching competitors’ employees, leading to wage escalation and thereby rising labour costs for existing companies. This can be prevented by keeping the talent pool large. The threat of relocation by companies in case of rising labour costs means that the government is responsive to providing subsidies for education and training. This goes beyond individual academe-linkages but takes the form of triple-helix collaboration between industry, education institutions and government to make the workforce 'BPO ready', as shown in Table 5.3.

Three initiatives have been organised bilaterally between industry and academe: (1) marketing efforts to increase the number of people who consider BPO employment, (2)

<table>
<thead>
<tr>
<th>Type of relationship</th>
<th>Type of activity</th>
<th>Description</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher education-industry linkage</td>
<td>Marketing</td>
<td>Lobbying, disseminating information, branding activities</td>
<td>Enlarge pool of labour through marketing</td>
</tr>
<tr>
<td></td>
<td>Testing</td>
<td>General Competence Assessment Test (GCAT), to test BPO-required skills of 20,000 students at 75 schools</td>
<td>Filtering of existing skills of workforce, prove education-skills gap to create rationale for education change</td>
</tr>
<tr>
<td></td>
<td>Teacher training</td>
<td>Advanced English-proficiency training, Summer classes for English teachers in American pronunciation and business English</td>
<td>Prevent the pronunciation mistakes of English teachers to be taught to students</td>
</tr>
<tr>
<td>Triple-helix structure</td>
<td>Vocational education</td>
<td>&quot;Near-Hire Training&quot; (post-graduate vocational training of 100 hours at TESDA institutes), Government funding ca. $10 million in 2006 and 2011, Ca. 65.000 – 70.000 students trained</td>
<td>Practice and reviewing of existing skills, to get ‘near hires’ (20-30% of applicants) to pass the entrance exams of companies</td>
</tr>
<tr>
<td>(higher education-industry-government linkage)</td>
<td>University curriculum development</td>
<td>Service-management course, 21 elective units (BPO 101 and 102, communication skills, service culture)</td>
<td>Shift focus to practical, work-related skills, mainly for call centres, Extension of internship programmes</td>
</tr>
</tbody>
</table>

(Source: Interviews)
general competence-assessment tests of the student population, revealing that skills in all but three top schools are below industry requirements, exposing a skills-labour market mismatch and creating a rationale for intervention in the existing education system, and (3) advanced English-proficiency training aimed at correcting teachers’ English pronunciation and increase teachers’ awareness and understanding of the sector.

Two initiatives have also involved government and are therefore considered triple-helix strategies. First, a large-scale, government-funded training programme for TESDA courses relevant to BPO employment was set up and administered by BPAP. Originally a vocational mid-level training facility, offering courses in fields like welding and construction through a network of training institutions, TESDA has become a post-graduate training provider. Though courses exist for transcription and game-development, the lessons focus “mostly [on] Americanisation of English and culture” (Interview 120601a). Candidates for the trainings are pre-screened by BPO companies and, if classified as ‘near hires’, receive P5,000 (approx. $110) vouchers with which they can receive free training, and subsequently return to the company for another job interview.

Second, an initiative for tertiary education has been implemented, which includes 21 units of elective courses in regular Bachelor’s degree programmes (CHED, 2012). Technically open to be filled in by the universities themselves, the units can also be adapted to fields such as health transcription or technical skills for IT, but again mostly focus on call-centre training. According to a CHED commissioner, the lowest-end spectrum of the value chain is targeted for government intervention because it requires the least amount of training (Interview 120525a). The subjects taught largely overlap with the in-house training conducted within the companies, such as geography of the US, accent neutralisation and service orientation. Moreover, subjects include “some behavioural competences like adaptation, tolerance to pressure, because the employees in the industry are facing that pressure as they transact with customers. The extreme would be verbal abuse. So they are trained how to cope, coping mechanisms” (Interview 120525a).

The courses can be offered by any university or college but 17 public HEIs signed a special Memorandum of Agreement for implementing the curriculum in 2013. An important part of the curriculum is a prolonged internship period (up to 600 hours from the regular 150 hours), which allows firms to recover their investment in training, as students work in the company for an allowance. This can be seen as a reorientation to skills-based education, determined by current market demand for graduates.

Programmes to encourage employees to undergo further studies, as propagated by individual companies, have not become institutionalised on a larger scale. Though industry respondents stress the need for higher-qualified mid-level managers, little progress has been achieved in offering higher-level training or post-graduate management courses. No concerted effort has been undertaken yet to ameliorate the shortage of scholars and scientists needed for the country to move up the value chain in offshore services. Moreover, little encouragement and training for entrepreneurship seems to exist, and the universities that offer specific entrepreneurship courses see most of their graduates choose to open
small-scale, traditional food businesses, instead of becoming entrepreneurs in offshore services. A teacher at a college offering a degree in game development opines that their graduates are more likely to become employees in foreign-owned BPO companies than to open their own game development studios (Interview 130402).

### 5.6 Impact of industry-academe linkages and triple-helix collaboration

The impact of industry-academe linkages and triple-helix collaboration of industry, government and universities has led to an increased territorial embeddedness of firms, increasing the competitiveness of Metro Manila as an offshoring hub. Through a narrow focus on the skills required for entry-level (call centre) positions in vocational courses and university electives, a workforce to reach the first rungs of the employment ladder has been created. Faster curriculum change has been introduced and subsidised training opportunities have been created for applicants who would like to find employment in Manila’s expanding call-centre sector. In particular, the short ‘finishers’ courses, have been successful in increasing the talent pool and BPAP estimates that 70% of the students taking these courses, or 49,000 people, will find employment afterwards. Companies evaluate this intervention positively, arguing that the initiative helped them continue their operations and grow.

The labour-market-education mismatch, however, has not been fully solved. Many BPO companies complain that employees are not able to “think out of the box” and only carry out prescribed tasks. A second mismatch concerns the lack of management staff for BPO operations, which has been noted for some time (Beshouri & Farrell, 2005). Only a few higher-management institutes exist and general business courses have limited places only²⁹. The lack of trained managers leads to a policy of internal recruitment for management positions from agent level, leaving management responsibilities frequently tasked to inexperienced, young staff. The implemented education reforms and triple-helix strategies can be seen as part of the FDI attraction ‘package’ of footloose offshore service investment. Several problems arise out of the leading and coordinating role of the ‘triple-helix’ structure by the private sector, because conflicting goals are held by the private and public sectors. While foreign investors want to achieve cost savings through lower-cost labour, the aim of the public sector should be to develop the national economy. The operations director of the National Competitiveness Council recognises that it is the role of government, and specifically CHED, to coordinate and interact “with the schools to provide us with the necessary skills for moving up the value chain. But it has to be part of a deliberate government policy and plan” (Interview 130228).

A discourse on the importance of “moving up the value chain” exists in the Philippines since the lowest end of the offshore service value chain is facing much cost competition and threats of automation (Phadnis, 2013). An upgrading of skills is required to move

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²⁹ Out of 10,000 applicants for business and accounting courses at the University of the Philippines, only 200 students are admitted every year due to limited institutional resources (Interview 130213b).
up the value chain (Fernandez-Stark et al., 2011). More knowledge-intensive activities require more highly educated individuals, but most initiatives so far focus on low-end talent supply. Literature on BPO work suggests positive spillovers from workers’ increased employability beyond the offshore service sector, based on transferable skills gained during BPO employment (Beerepoot & Hendriks, 2013; Vira & James, 2012). From the perspective of individual BPO workers in the Philippines, a focus on English-communication skills can facilitate overseas labour migration or employment in the tourism industry. The move into knowledge-process services, requiring specific skills, however, remains often restricted by the need for formal training.

From the perspective of the industry, the ability to attract higher-value-added offshore service functions and sectoral upgrading, remain limited if high-end professional skills, including technical and management skills, continue to be lacking. A faculty member of Asia Pacific College, which has close industry-academe linkages, explains: “What we are producing right now, in essence, would be the people who are problem-solvers and immediately can do solutioning [sic] to certain problems. We’re not looking at producing people who will become scientists or the scholarly type” (Interview 130219a). While this keeps foreign investors’ operations running, it will do little in helping to achieve upgrading.

Another conflict of interest between foreign investors and the public sector results from their different time horizons. Whereas companies want to achieve a return on investment within short periods, the educational sector is slower to change, and the effects of changes take considerable time to bear fruit. The pressures of foreign investors, however, prioritise short-term goals over long-term ones. BPAP’s executive director for talent development argues: “If [they] can’t hire today, our investors will go away. We can’t tell them: Wait! We’re doing something with the K +12 program. That will give us a more qualified pool in six years. They can’t wait for six years!” (Interview 130405).

The result of closer academe-industry linkages and coordinated education policy-change driven by foreign investors’ interests reflects institutional capture. The capturing occurring in the education sector is even stronger than identified by Phelps (2000; 2008) in a developed-economy context. The Philippines’ government has actively subsidised call-centre training institutions and reformed university curricula, shifting internal training costs partially from firms to the state, especially when this occurs through public universities. This confirms earlier findings on the “institution harnessing strategies” of offshore service investors to access labour (Hardy et al., 2011b) and further sheds light on the role of foreign investors in actively embedding themselves, changing the local labour market and education policies (Manning et al., 2012; Spar, 1998). This development can be read as a step in the transformation of the Philippines into a dependent-market economy, similarly to Eastern European countries, which depend on moderately skilled but low-cost labour, and foreign investors to transfer technology and provide capital (Cimpoca, 2011; Nölke & Vliegenthart, 2009).
5.7 Conclusions

This research has highlighted some of the problems of transforming into a service-exporting country, a ‘knowledge economy’ based on foreign BPO investment. On the basis of this research, a few theoretical conclusions can be drawn. Industry-academe collaboration has been identified as a way to increase territorial embeddedness in the foreign-investment-dominated ‘footloose’ offshore service sector. What emerges from this study is that industry-academe collaboration can be seen as part of an active embedding and localisation strategy of foreign investors to access the human resources needed for their operations, confirming and providing more empirical detail to earlier findings (Manning et al., 2012; Hardy et al., 2011a).

The interventions by foreign investors have primarily focused on lower-end skills for routine job tasks. Back-office providers, who require specific professional-occupational skills for their operations, have been reluctant to establish linkages with HEIs. Despite some specific efforts by call-centre providers to retain employees through opportunities for continuing education, industry-academe collaboration has not generally advanced to higher-end technical or management skills. In the short-run, the existing industry-academe engagements can have positive outcomes in terms of employment creation, narrowing an education-labour market skills gap, and increasing national and regional competitiveness to attract further investment. However, this study cautions against overly optimistic accounts of industry-academe collaborations, due to the often-conflicting goals held by the private and public sector. Labour-market reproduction as a driver of industry-academe linkages can limit upgrading into higher-value-added functions. Longer-term national economic development goals are not realised through current industry-academe collaborations and curriculum changes, and may even be ill-served by them in the long run.

This research has linked debates on (territorial) embeddedness with political economy approaches of dependent development, yielding insights into how companies shape the institutional settings of the countries they invest in. It has highlighted how powerful MNCs, mainly standardised, lower-end service providers, such as third-party call centres, have been most active in establishing university linkages. These MNCs are among the largest employers in the country and are active agents in shaping the environments and labour markets they invest in, confirming points raised by Christopherson and Clark (2007). Given a weak Philippine state, new special interest groups (this time, comprised of foreign investors) have been able to capture the education sector (Maca & Morris, 2012). Institutional capture by foreign investors’ interests can lead to a dependent, low-end road of skill development. Future research on the offshore service sector in the Philippines could further analyse the potential for upgrading into higher value-added services and how this process can be facilitated.
Upgrading in business process outsourcing in the Philippines and India: Emerging South-South divisions of labour?
6.1 Introduction: The ‘second global shift’ and upgrading in services

With the enormous expansion in the scope of value chains in international trade and global production ‘upgrading’ in such chains has become synonymous with economic development. This has offered enormous opportunity for some countries to expand exports and move into the production of higher value added goods and services. China’s manufacturing success and India’s IT services boom are among the most visible examples (Milberg & Winkler, 2013: 23).

Equating upgrading in value chains and GPNs with economic development is one striking feature of this quote, making the conditions under which upgrading can occur a vital research topic. A second important aspect is the reference to upgrading in service industries, as previous studies have mainly focused on upgrading in the context of industrial production (Edgington & Hayter, 2013; Schmitz, 2004; Tokatli & Kizilgün, 2004, among others). While upgrading is widely referred to as a strategy in business and policy circles, it remains under theorised in the case of service industries.

The offshoring of BPO services to developing countries has led to the insertion of new spaces into the GPNs of service-delivery. This phenomenon has been identified as nothing short of revolutionary (Blinder, 2006; Bunyaratavej et al., 2011), and as a “second global shift” creating a new international division of service labour (Bryson, 2007). Some scholars argue that upgrading can be achieved much faster in offshore services than in manufacturing: “The opportunity to ascend the value ladder so rapidly is without question the most remarkable aspect of the services offshoring phenomenon” (Dossani & Kenney, 2009: 100).

Nevertheless, the successful economic upgrading of India often remains the only case upon which this analysis is based (Athreye, 2005; Dossani, 2013; Dossani & Kenney, 2007; 2009; Ghani, 2010; Milberg & Winkler, 2013: 307; Paus, 2007). It is, moreover, a popular case portrayed in business-association reports and marketing materials. In order to assess upgrading opportunities for developing countries in services, evidence from more than one country is required. Moving beyond the case of India, an upcoming offshore service destination is the Philippines, often seen as a main competitor of India by business reporters (The Economist, 2012). Is the Philippines following India’s trajectory and experiencing rapid upgrading in the offshore service sector?

For an analysis of upgrading in the offshore service sector, the literature on GPNs, global value chains (GVCs) and offshore services is combined. The value chain of offshore services is a complex one, comprising knowledge-intensive business services as well as more routine services (Gereffi & Fernandez-Stark, 2010a). At the low-end, call centres came to be seen as the maquiladoras of the twenty-first century, characterised by high work-pressure and surveillance (McFarland, 2002; Fernie & Metcalf, 1998)30. Attracting investment in call centres can, however, be justified if call centres are conceptualised as the first step to enter

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30 For a critique, see Taylor & Bain (2000).
Chapter 6

the knowledge economy and upgrading from lower-end sub-sectors to more sophisticated services is possible (Barrientos et al., 2011).

This case study contributes to the upgrading literature in several ways. It adds an analysis of firm-level upgrading trajectories in the offshore service sector to existing studies, which have either taken the entire or country or entire sector as units of analysis, without further differentiating according to firm types (Fernandez-Stark et al. 2011; Hardy et al., 2011a). The study identifies the opportunities and limitations for upgrading by different types of BPO firms. Moreover, this study differentiates between upgrading into more knowledge-intensive and higher-revenue-generating functions. These dimensions of upgrading present different opportunities for value capture – and thereby economic development.

This chapter empirically analyses upgrading in the BPO sector in the Philippines, using the Indian case as a reference point. The research is primarily based on in-depth qualitative data, stemming from 67 interviews with representatives of BPO firms, key stakeholders, and sector experts in the Philippines and India. In addition, a web-based survey among BPO firms in the Philippines is used, along with secondary quantitative data. I compare the upgrading trajectories in India and the Philippines, which demonstrate an unfolding Indian-Philippine division of labour.

The structure of the chapter is as follows. Section 6.2 discusses theories on upgrading in services, followed by an elaboration of the methodology in Section 6.3. Subsequently, Section 6.4 presents the empirical findings of upgrading by different types of BPO firms in the Philippines. Upgrading trajectories in India and the Philippines are compared in Section 6.5, which highlights an unfolding Indian-Philippine division of labour. In the end, Section 6.6 concludes and provides policy recommendations and ideas for further research.

6.2 GPNs, GVCs and upgrading in services

Upgrading can be defined as "a process of improving the ability of a firm or an economy to move to a more profitable and/or technologically sophisticated and skill-intensive economic niche" (Gereffi, 1999: 51). This definition requires specifying what is being upgraded, since the process refers to different units of analysis. Three levels of upgrading emerge from this: on a macro level, an economy can achieve growth in a more profitable sector, on a meso level, the sector can move into a higher level of sophistication, and on a micro level, individual firms can move into higher value-added activities. Moreover, what qualifies as upgrading needs to be specified. It can involve increasing levels of skills for tasks and/or increasing productivity, revenue, and profitability.

6.2.1 Upgrading in GVCs and GPNs

Upgrading is a concept intrinsically linked to the idea of value chains. Porter (1990) first discussed these chains in relation to the competitive advantage of countries. Later, global commodity chains (GCCs) were developed into an analytical tool, especially to evaluate the (unequal) integration of developing countries, stemming from world-system theory.
ideas (Gereffi, 1999; Kaplinsky, 2000). The core argument of the critical study of GVCs and GCCs is the existence of rents, which mark the most profitable parts of the chain. Barriers to entry and chain governance determine the distribution of rents, which are often kept within developed economies (Kaplinsky, 2000). These insights have led to a growing literature on how to facilitate producers in developing countries moving into higher-end processes (Humphrey & Schmitz, 2002; Gereffi, 1999; Gereffi et al., 2005).

GVC scholars postulate that the opportunities firms have to upgrade are related to governance structures in chains. A firm’s position within a chain matters for its upgrading potential; strong global buyers and a hierarchical organisation generally restrict upgrading possibilities (Humphrey & Schmitz, 2002; Gereffi et al., 2005). Chain governance, ranging from market-style to hierarchical, is therefore an important indicator regarding upgrading opportunities. Hierarchical relations in vertically integrated production networks can either take the form of direct ownership of subsidiaries, or of “quasi-hierarchy”, characterised by a strong power asymmetry between subcontractor and client (Humphrey & Schmitz, 2002: 1023).

Over the past decade, global production arrangements have become increasingly complex, pervasive and transnational. To capture the complexity and non-linearity of contemporary production processes, the GPN approach has been developed as an advancement of the GCC and GVC approaches. The GPN approach recognises value (specifically value creation, enhancement, and capture) as an important concept for the analysis of regional economic development opportunities (Coe et al., 2004; Henderson et al., 2002). Moving into higher value-added levels of the network does not automatically lead to positive developmental outcomes, but serves as a precondition for value capture (Coe & Hess, 2011). Offering a more contextualised and inclusive perspective, including non-company actors in its approach, the GPN framework presents problems of measurability. Parrilli et al. (2013) therefore advocate to eclectically integrate elements of the parallel GVC and GPN literature to arrive at a more complete territorial perspective on economic development in regions. Whereas the GPN framework defines upgrading only in general terms, the GVC literature has generated a more detailed framework for studying governance relations and their implications for value creation, including a four-type classification of upgrading dimensions (Parrilli et al., 2013: 977). These are process upgrading (increasing the efficiency of production), product upgrading (producing higher-end products), functional upgrading (entering into higher revenue-generating functions), and inter-sectoral upgrading (moving into different sectors or industries) (Humphrey & Schmitz, 2002). Though a useful distinction, in practice the taxonomy is not always straightforward and ambiguities over how to classify certain activities exist, even more so when applied to the case of services.

Barrientos et al. (2011) advocate to move beyond industrial upgrading and study upgrading processes also in agriculture or service-production networks and chains. They contend that a distinction should be made between ‘economic upgrading’, which focuses on improving the position of the firm, and ‘social upgrading’, which focuses on improving the position of workers.

31 For example, a study of gender dimensions of upgrading in GVCs conducted among call-centres in Egypt, showed that economic upgrading may lead to adverse effects for female workers (Ahmed, 2013).
Whereas process upgrading increases the efficiency of production processes (e.g. through the introduction of new technology) local outcomes for workers can also lead to lay-offs due to automation. Product upgrading\textsuperscript{32} usually requires a move into higher-skilled functions, which can have positive impacts on workers’ salaries and work conditions; functional upgrading and inter-sectoral upgrading increase opportunities for a firm’s value-capture (Barrientos et al., 2011).

6.2.2 Upgrading in offshore services

The fragmentation and unbundling of service-production chains and the ensuing commodification of services, in combination with innovations in ICT, allows for a complex functional and spatial division of service labour. The restructuring and spatial extension of GPNs has facilitated a rising global ‘trade in tasks’ (Grossman & Rossi-Hansberg, 2008). Offshore services are a broad category of services, which can be digitised, manipulated, and delivered at a distance, including IT services, engineering services, creative services, back-offices services, and customer services. These activities are part of different recipient sectors, or verticals, of which the financial services sector is the largest (Gereffi & Fernandez-Stark, 2010a).

Whereas industrial upgrading takes the form of an upward move along the value chain, services are more difficult to capture within this framework (Gereffi & Fernandez-Stark, 2010a). Services can be part of an industrial production network; for example, business services used as inputs or feedback loops for production, thereby crossing various value chains. Services can also form their own value chains, in which the final commodity is a service rather than a product, such as in the financial-services sector.

6.2.3 Upgrading tasks or upgrading the network position: Enhancing skills or revenues?

Following Gereffi (1999), upgrading can be based on the knowledge intensity of a firm’s activities or in terms of rising productivity (measured as revenue per employee). Two types of upgrading are analysed in the following: the upgrading of tasks, enhancing the skill level required for the operations (or product upgrading); and the upgrading of the position within the network, enhancing revenues (or functional upgrading). These have different outcomes for opportunities for value capture by firms, regions and workers. It is important to note that upgrading in services is not only crucial to increase value creation, but also to simply ensure survival since the lowest end of the offshore service value chain faces the most cost-competition and threats of automation (UNCTAD, 2004: 169).

Table 6.1 shows an overview of offshore services, from lower-end to higher-end sub-sectors, based on the skill-sets required and reflecting the knowledge-content involved.

BPO firms require skilled human resources for their operations, making learning and innovation key concerns for upgrading (Fernandez-Stark et al., 2011; Manning, 2013). Barrientos et al. (2011) affirm that in services, workforce development takes precedence

\textsuperscript{32} Product here signifies the end-product, please note that in services the final outcome could also be a service.
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Table 6.1: Classification of low- to high-skilled offshore services

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Indicator</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low-end</td>
<td>High level of routine (e.g. following script), low level of judgment, low value-added, generic skills required</td>
<td>Inbound and outbound customer-service/call-centre work, basic data processing, transcription</td>
</tr>
<tr>
<td>Medium-end</td>
<td>Combination of routine and judgment, medium value-added, some specific skills required</td>
<td>Advertising, marketing or publishing services, website development, software services, HR services, accounting work, online education, animation</td>
</tr>
<tr>
<td>High-end</td>
<td>Low level of routine, high level of judgment, creativity, high value-added, specific skills required</td>
<td>Knowledge-process outsourcing, financial analysis and forecasting, creative services, legal and medical process outsourcing, engineering services, R&amp;D, software development</td>
</tr>
</tbody>
</table>

(Based on UNCTAD, 2004: 151)

over capital investment and technology compared to manufacturing industries, making training and industry-academe linkages an important avenue for upgrading.

An implicit assumption underlying GVC research is that higher skills lead to higher profitability, despite the acknowledgement by authors that the extent to which this relationship holds true is unclear (Schmitz, 2004: 376). In services, generally, a slower rising productivity compared to industrial activities has been observed (Baumol, 1985). However, knowledge-intensive business services are arguably able to produce higher productivity rises (Milberg & Winkler, 2013). In India, the productivity growth in service labour is higher than in manufacturing, leading, according to Ghani, to a reconsideration of “the old view that services are low productivity growth areas, without the dynamic externalities often attributed to manufacturing” (2010: 94).

6.2.4 Domestic firms, foreign-owned firms and the role of government in upgrading

The literature on upgrading has usually looked at the potential for domestic-owned firms to upgrade within GVCs (Humphrey & Schmitz, 2002; Knorringa & Meyer-Stamer, 2007; Tokatli & Kizilgün, 2004; Schmitz, 2004). Domestic-owned manufacturing firms producing for local buyers are likely to upgrade fast in terms of processes and products, but can simultaneously be tied to relationships that make functional upgrading difficult (Schmitz, 2004). For the firms involved, “strategic intent” and substantial investments are required to achieve upgrading (Humphrey & Schmitz, 2002: 1024). The literature on industrial upgrading also emphasises the formation of clusters (Edgington & Hayter, 2013; Humphrey & Schmitz, 2002; Nadvi & Halder, 2002). In offshore services, however, clusters are less likely to arise, as the sector has limited input-output linkages (Magtibay-Ramos et al., 2008).

Debate exists about the relationship between FDI and upgrading possibilities. In a study on FDI in Southeast Asia, Felker (2003) shows that in MNC-coordinated international production networks, upgrading can be encouraged through government policy. In another
study on the role of foreign MNCs in developing countries, the firms are identified “as agents of technological upgrading”, performing a vital role in regional learning processes (Fromhold-Eisebith, 2002). Pietrobelli and Rabellotti argue that the interaction with foreign lead-firms in global networks allows firms from developing countries “access to knowledge and enhanced learning and innovation” (2011: 1261). This view is supported by findings from a long-term case study on Japanese MNCs investing in Malaysia (Edgington & Hayter, 2013).

On the other hand, studies find that subsidiaries of MNCs are able to ramp up the scale of production fast and can lead to “extensive development” but do little to upgrade local capabilities (Ravenhill, 2014: 270). Manning hypothesises that an overreliance on MNCs, in the case of knowledge-service clusters, is problematic since it makes the region “vulnerable to global competition from other similar MNC hubs, not least because MNCs have developed the ability to flexibly shift operations between locations” (2013: 387).

Government support seems to be crucial to enable domestic firms to enter into the rent-producing parts of the chain. Strategic national policies are needed if countries want to move out of a dependent integration into GVCs (Knorringa & Meyer-Stamer, 2007). Instead of accepting its existing comparative advantages, a country needs to carefully construct an industrial policy against this market logic to reach the higher end of the value chain, a strategy used by ‘developmental states’ such as Taiwan and South Korea (Amsden & Chu, 2003; Chang, 2002; Studwell, 2014). These strategies often include some form of domestic-industry protectionism, coupled with an export-discipline of domestic firms. In contrast, the Philippines is characterised by Bello (2009) as an “anti-developmental state”, embarking on structural adjustment programmes and economic liberalisation from the 1980s onwards. Implementing protectionist industrial policy has become increasingly difficult for developing countries in today’s global economy; instead, neoliberal strategies are often chosen (Neilson, 2014; Ravenhill, 2014). Yeung (2014) argues that the developmental state is losing its significance as firms become disembedded from national state systems and re-embed themselves in GPNs.

### 6.2.5 Differentiating types of BPO firms

Two dimensions of distinction for BPO firms are the company’s nationality and its position in the network. Firms can be either domestic-owned or foreign-owned; the latter set up subsidiaries for offshore service delivery through FDI. A second distinction can be made based on whether the task is internalised or outsourced to a third-party provider. The combination of these two dimensions leads to three different types of BPO firms in the offshore service sector: domestic-owned BPOs, foreign-owned BPOs, and MNC captives (see Chapter one, Table 1.1).

Both domestic-owned and foreign-owned BPO firms have quasi-hierarchical relationships with their clients. In such relationships, power asymmetries exist, because of the “buyer’s perceived risk of losses from the supplier’s performance failures” (Humphrey & Schmitz, 2002: 1023), which is more acute in customer-facing services, where the subcontractor has direct interaction with the lead firm’s customers. Foreign-owned BPO firms are, in addition to their relations with buyers, also in a hierarchical relationship with their...
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headquarters located abroad. In a hierarchical relationship of direct ownership, supposedly less room for upgrading exists; on the other hand, the closer relationship with the head office can also lead to faster learning from the lead firm (Humphrey & Schmitz, 2002). Being a captive of a MNC involves a closer relationship with the head office, which can make it easier to receive (new) technology from abroad or acquire new functions. The scaling up of activities is much slower for captive MNCs compared to third-party providers, because growth is not based on adding accounts but on transferring work from headquarters or other offices. MNC captives can be classified as the most hierarchical, followed by foreign- and domestic-owned BPO firms, whose clients hold them in quasi-hierarchical relationships.

6.3 Research design and methodology

The empirical account given in this chapter primarily focuses on the call-centre and back-office sub-sectors of the BPO services sector, and is predominantly based on qualitative data on offshore service firms operating in the Philippines, and, to a lesser extent, in India. Originally intended as a fully comparative case study, limitations of access to India-based firms obstructed the sampling of comparable numbers of firms. To compare and place the findings of the Philippine case study into perspective, I draw upon existing secondary sources and academic literature on upgrading in the Indian offshore service sector (Dossani, 2013; Dossani & Kenney, 2007; 2009; Parthasarathy, 2013).

Mumbai and Metro Manila are both mature offshore service destinations with a large number of BPO firms; therefore, I selected these as the two main sites for interviews. Between August 2011 and March 2012, I conducted 21 interviews in Mumbai and Pune, to gain a better understanding of upgrading in the Indian BPO sector. Subsequently, between April 2012 and April 2013, I conducted 46 in-depth interviews in the Philippines, primarily in Metro Manila. BPO firms tend to be secretive due to political backlashes against the offshoring of jobs in many sending countries (especially the US), which has implications for accessing firms. Sampling strategies therefore included personal introductions, networking, recommendations by the business associations (successful in the case of the Philippines, but not India), and snowballing, leading to a potentially less representative sample. I paid attention to include respondents reflecting the different types of BPO firms: 18 domestic-owned firms (10 in India, eight in the Philippines), 18 foreign-owned BPOs (four in India, 14 in the Philippines) and 13 MNC captives (five in India, eight in the Philippines).

Generally, respondents who spoke on behalf of their companies tended to be the highest-level manager available at the respective office. These ranged from founder-CEOs of domestic-owned firms, to country managers, operations managers, or site directors of foreign-owned firms. Moreover, I interviewed the HR managers of several firms to get an overview of the types of functions and skills required for working in the firm, and changes therein over time. In addition, I interviewed 16 representatives from business organisations, government, and industry experts in the Philippines. In India, representatives of NASSCOM and Software and Technology Parks of India were interviewed (see Appendix). With the
help of a qualitative data analysis program, the interview transcripts were thematically grouped, interpreted, and analysed for patterns in upgrading.

Qualitative data on firm strategies for upgrading were supplemented with quantitative data, which I gathered through an online survey in the Philippines, conducted in collaboration with BPAP, among its 623 members. BPAP represents almost the entire BPO industry in the Philippines, and without its institutional support, no survey could have been conducted reaching such a large pool of firms. Yielding a total of 111 responses, the survey ran from May to July 2013, during which time several email reminders were sent. The final response rate was 18%. Many large-scale company surveys suffer from low response rates (Bryman, 2008). The sample is non-representative and survey findings are only used to complement qualitative data from in-depth interviews.

I used secondary quantitative data collected by government agencies and the business associations to calculate productivity rates of the sub-sectors and compare upgrading in India and the Philippines. These can only serve as an illustration of trends, since the data are estimations by different bodies and according to different categorisations. In general, equivocality surrounds the terminology of services offshoring and outsourcing, as well as the specific activities and sub-sectors that comprise it (Bunyaratavej et al., 2011; Sass & Fifekova, 2011).

6.4 Upgrading opportunities by different types of firms in the Philippines

Offshore service firms in the Philippines are often subject to external decision-making and control, and are placed at the lower end of power relations, as governance and corporate power structures in the sector leave especially offshore outsourced firms in a dependent economic position (see Chapter four, especially Figure 4.2). The following sections discuss opportunities and limitations to upgrading in domestic-owned BPOs (offshore outsourced), foreign-owned BPOs (offshore outsourced) and MNC captives (offshored).

6.4.1 Domestic-owned firms: avoiding downgrading

Indian-owned businesses were early drivers of the offshore service sector, before a large number of foreign investors had set up in the country, and a handful of these companies have since become well-known actors with global operations. The three largest Indian-owned offshore service firms – TCS, Infosys and Wipro (who together employ more than 300,000 workers in India) – report revenues between $46,000 and $44,000 per FTE (Shivapriya & Mishra, 2010). In addition, several smaller companies and entrepreneurs deliver knowledge-intensive activities (Parthasarathy & Aoyama, 2006). In the Philippines, these actors are largely absent, elaborates a former executive director of BPAP:

Following the India model, wherein Indians made their mark by having small companies and growing them to large conglomerates, the Philippines tried it. But out of 50 Filipino-owned contact centres, only maybe five would become big (meaning 2000-3000 employees) and eventually those would get
bought off by the foreign-owned companies. So you would have US or Indian companies buying the Filipino-owned companies (Interview 120614).

Whereas in India, domestic-owned companies have been able to capture a larger share of the global market over time, most Philippine-owned firms are struggling to survive.

There are [Philippine-owned call centres], but they are all small. The big ones are all multinationals; that’s different from India. […] Some are just surviving, if that’s the right word, there are a lot of challenges and they cannot compete head-to-head with the MNCs. That’s a reality now (Interview 130227b).

Most of the Philippine-owned firms interviewed for this research occupy the lowest end of the market, such as outbound call-centre activities. One call centre, employing about 100 workers, has purely outbound business, involving hard-selling and cold-calling. The firm’s income is sales-based, facilitated by an online broker to get clients, and the firm has been struggling to avoid bankruptcy due to unreliable clients, non-payment and scams (Interview 120508e). The position of workers is insecure, since a large percentage of the firm’s income is performance-based. Under-performing agents were put on ‘floating’ status, temporarily suspending their contracts until new projects arise. In such a situation, a firm’s survival transcends upgrading strategies. Except for call centres, domestic-owned firms are found in the transcription market and in IT services, such as website design. Many of the smaller BPO firms operate in a grey market as home-based, self-employed micro-entrepreneurs, and are often not registered as businesses or as part of an association, thereby remaining invisible to BPAP and state agencies.

The visited domestic-owned firms show striking disparities in terms of their facilities and equipment compared with foreign-owned companies (for example, old desk-top computers, and the absence of air-conditioning). Investing in technology upfront can be difficult for small companies, especially if operating in an environment of unclear returns. The founder-CEO of a small call centre explains that instead of investing further in his business, he engaged in unrelated diversification strategies (importing construction materials) to balance out the volatility of his BPO business (Interview 130227a). In this environment, upgrading is not very much a concern for the managers of most domestic-owned BPO firms, who face a constant struggle not to downgrade and to remain in the market.

In order to receive higher-end services, aggressive selling to clients abroad is necessary, a route not often chosen by Philippine entrepreneurs, who often rely on domestic opportunities and existing client recommendations, instead of marketing activities (Interview 130424). Lacking personal relations and networks, businesses have to depend on chance encounters, brokers or competition on online platforms for short-term projects, competing often based on cost alone to enter the market. The more successful firms are those who’s CEOs have worked for US companies before and have established their own networks abroad (Interview 130423). Smaller firms often lack the financial resources and personal relationships to attract higher-end services and Philippine conglomerates have refrained from directly investing in the sector, with the exception of the Ayala conglomerate (Interview 130212a).
6.4.2 Foreign-owned BPOs: improving processes, cutting-costs

Process upgrading depends above all on the introduction of new and superior technology and increased efficiency of work processes. In order to achieve this, processes need to be re-organised, streamlined and optimised. Outsourced operations, especially, have to focus on process upgrading to generate revenue, as they provide services for clients based on lower costs or better quality than could be obtained through a client’s internal processes. One interviewee from a foreign-owned BPO firm said that the company’s route to upgrading is to collaborate with its clients to reduce costs by introducing more technology rather than adding staff. Technical solutions, such as making a video-clip for how to exchange a printer’s cartridge instead of employing additional call centre agents to explain the process on the technical support hotline, are devised by the firm’s research department in centralised offices in India and the US (Interview 120528d). It is important to realise that process upgrading in many incidences is not a local process but involves technology transfers from abroad to local subsidiaries in the Philippines. Local subsidiaries mainly implement but do not develop process upgrading in their operations, and the effects of automation may be negative for workers at the local office, leading to lay-offs.

Third-party providers of outsourced services are most likely to incrementally upgrade within existing functions. This form of upgrading is usually client-driven. After an initial satisfactory experience with smaller-scale outsourcing, clients increase the volume and complexity of the tasks (Interview 120517a). Several foreign-owned call centres have accumulated specialised knowledge of certain sectors (e.g. flight and hotel bookings in the case of tourism; technical support in consumer electronics) and have been able to gain further clients to their portfolio on the basis of existing sector expertise. The senior manager of a foreign-owned BPO company explains: "Most of our accounts are long-term accounts and they trust us enough to expand their business, that’s why some of the accounts we handle from end to end" (Interview 120529d).

In many instances, this has not led to a move into more knowledge-intensive activities. “Skills-wise, it has not changed a lot, because of course we still look for the same type of core competencies in applicants, like communications skills, and computer literacy, and things like that” (Interview 120502b). The country manager of a foreign-owned BPO observes:

> We are still primarily focused on voice – primarily interaction with consumers. We do some B2B [business to business] sales which is, I would say, that’s moving up the value chain a little bit ’cause the price points are higher and you’re trying to sell. In one case, we’re trying to sell multi-thousand dollar server equipment but those are very small groups. We’re looking at other avenues, other ways to kind of do more complex outsource solutions but nothing’s really there just yet (Interview 130320a).

As offshore outsourced operations, foreign-owned BPOs differ from simply offshored MNC captives in their relative stability and reduced cost-cutting concerns, since most subsidiaries operate as cost-centres, saving costs through offshoring as a result of labour arbitrage. In MNC captives
the pressure to work within the budget is there, but not to reduce costs, because you are a captive shared-service centre. That’s a main difference. In essence, people would feel more security [working for a captive], because in a call centre you’re as good as your last contract will last. If you win an account it’s for three years or for five years – that’s it. You can end up ‘floating’ or you can go to another account. So that’s the nature of the business, unlike in a shared service centre (Interview 120523).

The director of business development of a foreign-owned BPO explains that cost-considerations are the main factor in decision-making: “If another company offers ten cents lower per call, they [the clients] discontinue the relationship through ‘termination for convenience’” (Interview 120606b). This has implications for the stability of workers’ contracts, limiting the opportunities for social upgrading.

6.4.3 MNC captives: raising the skill level

Many firms engage in offshoring to both India and the Philippines. Especially large firms, many of which are Fortune 500 companies, offshore their back-office finance and accounting tasks to directly owned, captive shared-service centres. The Philippines is slowly maturing as a provider for banking and financial services. JP Morgan, Citibank, Deutsche Bank, HSBC, Wells Fargo and Bank of America operate fully-owned back-offices with up to 12,000 FTE each in the Philippines (Interview 120529a). Firms in other sectors, such as Chevron, Shell, and Procter & Gamble, also operate captive back-office operations.

Captive operations of MNCs are, in principle, able to acquire different functions, from back-office work for the company’s headquarters to services related to the firm’s core function33. One captive-owned call centre now employs a considerable number of staff working on social media to interact with the firm’s end-clients and create a positive brand image (Interview 120508d). The general manager of a logistics MNC captive explains: “we started with merely answering phone calls for queries and now the majority of our [company’s] shared services, whether it is finance and accounting, human resources, IT, are being done out of here in the Philippines” (Interview 120608a). During the initial offshoring process, firms recognised the capabilities of the local workforce and have since then relocated more and more functions from head offices to Metro Manila. Several MNC captives have changed the role of their subsidiaries from a geographical separation of tasks to a functional differentiation based on verticals (e.g. finance, HR, logistics), where end-to-end processes become integrated (Interview 120511b).

In the following, I elaborate on three examples of upgrading by MNC captives in the financial, legal and publishing sector. The senior vice president of operations of a large financial shared-service provider maintains that the work conducted in the Philippine subsidiary has upgraded into more highly skilled processes: “We are actually getting the more

33 For example providing services to the MNC’s end-clients.
complex stuff now. At first it was just data processing work, a little bit of accountancy work but now we get the hard-core banking, like lending, collateral management, really complex processes” (Interview 120523). First using a third-party provider to enter the market, the company decided to establish its own captive operations in the Philippines after a few years.

An international law firm commenced small operations in the Philippines in 2007, based on purely financial functions (financial analysis, accounting and billing). Since then, the firm has added a range of additional functions including IT support, graphic design, website maintenance, database management, market intelligence research, virtual concierge services (such as booking cabs for lawyers in offices around the globe), virtual secretaries, and HR shared services. Lastly, a confidential group of employees with legal expertise conducts background checks of potential lawyers to be hired by the MNC, and researches potential conflicts of interest. Upgrading into new tasks has been facilitated due to the legal standing as a subsidiary of the MNC: “As a captive, we can do more things because confidential things can be offshored” (Interview 120521). Using a similar strategy, an international publishing MNC decided to centralise its services in a captive shared service centre, because of the availability of the talent pool and their objective to “tap into that market, while at the same time keep our intellectual property” (Interview 130320a).

6.4.4 Analysing upgrading based on firm ownership and network position

Contrary to the Indian offshore service sector with large domestic firms, the growth of the BPO sector in the Philippines has been largely based on foreign direct investment. As domestic-owned firms have struggled to survive and not downgrade, upgrading, where it occurred, has been driven by foreign-owned firms and their clients and not by local stakeholders in the respective offices and subsidiaries.

Not all foreign-owned firms have moved into higher-end services. Firms providing outsourced services, faced with cost pressures and short-term contracts, mainly focus on running their current operations, and do not show any strategic intent to upgrade beyond process upgrading. MNC captives have led the move into higher-skilled sections of the value chain. Hierarchical relations, in the literature often seen as inhibiting upgrading opportunities, were in this case able to provide better opportunities for learning and upgrading through direct interactions with the lead firm, compared to the quasi-hierarchical sub-contractor relations. Functional upgrading through a change in network position into higher value-added functions, has remained limited. Push factors from advanced economies have played a role in transferring more knowledge-intensive functions to subsidiaries in the Philippines, a ‘passive upgrading’ trajectory stimulated by external actors to the knowledge-service cluster.

6.4.5. Reflections on Philippine policies for upgrading

Philippine government officials and industry representatives in interviews recognise the importance of ‘moving up the value chain’ in offshore services. While upgrading is mentioned as a commonly desired goal, few initiatives or clearly defined upgrading
strategies presently exist. It is the target of an industry roadmap and the Department of Science and Technology’s ICT Office for the Philippines to become a “destination of choice” in several sub-sectors: health-information management (which comprises low-end transcription work); back-office work in finance, accounting and HR; and creative industries (such as animation). Moreover, growth is targeted in engineering and IT services (which faces competition from India), and multilingual customer support (Interview 120525b).

The latter requires higher, or additional, skills but does not imply higher revenues, since the task (customer support) remains the same. Initiatives to change the position of Philippine-owned firms or subsidiaries operating in the Philippines in the network and move into higher-revenue sections of the value chain are absent.

While lip-service is paid to moving up the value chain, so far, no efforts to create domestic companies or stimulate entrepreneurship in the sector are taken. The vice president of BPAP reveals:

To be frank, it [initiative for domestic entrepreneurship in the BPO sector] is not in the forefront of our strategy, although personally I would like it to be. [...] It needs to be started and it needs to be encouraged by government. At the end of the day, foreign companies will always look at where they can get maximum returns and there will be other countries that can provide that at a future point in time. So we need to balance that off with providing more higher-value-added services so that the stickiness factor continues to be there, but at the same time also developing home-grown companies to sustain what we have here (Interview 120611a).

Government initiatives towards upgrading seem less strategic in their outlook and focused on relatively non-discriminate investment attraction through marketing missions abroad. Typically, neoliberal reforms to open up the market and incentivise foreign investments through special economic zone policy are followed, in line with Neilson’s (2014) findings on Indonesia.

6.5 Comparing upgrading experiences in India and the Philippines

India and the Philippines present two contrasting cases of upgrading. This section starts with discussing some key differences between the offshore service sectors in both countries, then shows different upgrading trajectories, and finally outlines emerging specialisations of both countries in a South-South division of labour.

The Indian offshore service sector is, with about $69 billion in export revenues in 2012, much larger than the Philippines’ $13 billion sector. However, taking into account the population size of both countries (India has a population 12 times of the Philippines), in relative terms, the Philippines’ offshore services sector is much larger. India was an early

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34 Recently, however, an incubator facility at the UP-Ayala Technohub was created for about 50 companies, which aims at creating innovative firms; the outcome of this initiative remains to be seen.
mover in the offshore service sector, whereas the Philippines was a later entrant. Chapter two
discusses the differences in the emergence of the offshore service sector in both countries,
which have set both countries on different trajectories. Table 6.2 gives an overview of key
differences between India and the Philippines, which are discussed in the following.

Today, India’s offshore service sector is dominated by knowledge-intensive IT,
engineering and R&D services (Dossani & Kenney, 2009), whereas in the Philippines,
lower-end voice-based BPO services dominate, as shown in Table 6.3. In 2012, annual
revenue per full-time employee in India was almost twice the size ($31,700) as in the
Philippines ($16,800). The categorisations in Table 6.3 are based on the business association’s
internal classifications and can only provide an indication of activities, employment size,
and revenues. Interestingly, higher-skilled functions in the Philippines, such as back-office
operations (non-voice BPO), animation and game development, exhibit lower revenues
per employee than the voice-BPO sub-sector. One explanation for higher productivity in
voice-based services are economies of scale in large call centres. Another explanation is
a temporal distinction: call centres were early movers in the sector and have existed for
more than a decade in the Philippines, while other services started more recently. Low
productivity in the ‘health care’ sector seems to suggest that low-value-added activities,
such as medical transcription, dominate the sub-sector.

According to data from NASSCOM (India) and BPAP (Philippines), in the period from
2008 to 2012, revenue per employee in the BPO (sub) sector increased by 17% in India,
whereas it remained unchanged in the Philippines. Recently, NASSCOM renamed the BPO
sector in India business process management (BPM), to signify a move away from the
lower-end services sector towards “being a full-service value provider” (NASSCOM, 2014).

Table 6.2: Key differences in offshore service-delivery and upgrading in India and the Philippines

<table>
<thead>
<tr>
<th>Key differences</th>
<th>India</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entrepreneurs</td>
<td>Well-established</td>
<td>Underdeveloped, no large firms</td>
</tr>
<tr>
<td>Workforce</td>
<td>Large, with capacity to upscale and technical capabilities</td>
<td>Limited number of highly qualified personnel, English-language advantage</td>
</tr>
<tr>
<td>Sub-sectors</td>
<td>IT, engineering services, R&amp;D, smaller share of BPO</td>
<td>Voice-based focus, lower-end BPO, smaller share of IT and creative services</td>
</tr>
<tr>
<td>Process upgrading</td>
<td>Improving technology and management processes</td>
<td>Implementing technology developed abroad</td>
</tr>
<tr>
<td>‘Product’ upgrading</td>
<td>Moving into knowledge process outsourcing, specialised skills by niche providers</td>
<td>Increasing skill-levels of functions, driven by foreign-owned firms (especially shared service centres)</td>
</tr>
<tr>
<td>Functional upgrading</td>
<td>Changing network position to higher revenue-generating functions by domestic-owned firms</td>
<td>Limited, revenue remains linear</td>
</tr>
<tr>
<td>Inter-sectoral upgrading</td>
<td>Lateral move from IT to BPO services</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Interviews, reports by NASSCOM and BPAP)
Upgrading and emerging divisions of labour

6.5.1 Upgrading experiences in India

The Indian offshore service sector grew on the basis of technological abilities of engineers and software developers, first engaging in ‘bodyshopping’, the short-term labour migration to client’s sites in the Global North, before conducting services from a distance from India (Athreye, 2005; Dossani & Kenney, 2009; Parthasarathy, 2013). Many domestic-owned firms emanated from old conglomerates, such as Tata Steel in the case of Tata Consultancy Services. The six largest Indian IT firms were founded between 1968 and 1986 and the business association NASSCOM was founded in 1988. A mixture of (infant-industry) protectionism by the Indian state and export orientation among Indian-owned IT firms created a situation in which, according to a vice president of NASSCOM in Mumbai, Indian firms were forced to upgrade in order to “meet benchmarks internationally, since no domestic market for IT was existing in India” (Interview 110801). The Indian BPO industry had a very different entry point into the BPO sector compared with the Philippines. After having built a strong base in IT services, domestic firms started to take on BPO functions in addition to their IT business. This can be interpreted as a lateral move into a different sector or as inter-sectoral/chain upgrading into a different type of offshore services (Fernandez-Stark et al., 2011: 228).

Several important factors that facilitated the upgrading of Indian firms are identified by interviewees in India and supported by existing literature; namely: the existence of (a) a highly skilled workforce in the country, (b) large domestic conglomerates diversifying into BPO services, (c) personal relationships with clients in developed countries (especially in the US) through diaspora networks (Saxenian, 2005), and (d) aggressive selling strategies by domestic-owned firms (see also Chapter two).

Building up trust and changing the vendor-client relationship is crucial for upgrading into both higher-skilled and higher value-added functions. Indian firms invested in the

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**Table 6.3: Revenue per employee in offshore services (2012)**

<table>
<thead>
<tr>
<th>Subsector</th>
<th>FTE</th>
<th>Revenue ($ bn)</th>
<th>Revenue ($) per FTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IT, engineering, R&amp;D</td>
<td>1,296,000</td>
<td>53</td>
<td>40,895</td>
</tr>
<tr>
<td>BPO</td>
<td>879,000</td>
<td>16</td>
<td>18,203</td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voice BPO</td>
<td>497,000</td>
<td>8.70</td>
<td>17,499</td>
</tr>
<tr>
<td>Non-voice BPO</td>
<td>154,380</td>
<td>2.47</td>
<td>16,000</td>
</tr>
<tr>
<td>IT</td>
<td>57,078</td>
<td>1.16</td>
<td>20,323</td>
</tr>
<tr>
<td>Health care</td>
<td>45,000</td>
<td>0.46</td>
<td>10,222</td>
</tr>
<tr>
<td>Engineering</td>
<td>10,836</td>
<td>0.21</td>
<td>19,011</td>
</tr>
<tr>
<td>Animation</td>
<td>9,000</td>
<td>0.13</td>
<td>14,667</td>
</tr>
<tr>
<td>Game development</td>
<td>3,500</td>
<td>0.05</td>
<td>14,286</td>
</tr>
</tbody>
</table>

(Source: NASSCOM and BPAP data for 2012)
quality of service delivery through improvements in technology, enhanced work processes, and quality management (Interview 120210), as well as by building relations with clients abroad (Interview 120307a), leading to process and product upgrading. Most important were strategic decisions of firms to change their positions within the network. From a simple ‘input-output’ process, in which no decision occurs and the result is reviewed outside of the region, functional upgrading involves the transition to ‘input-decision-output’, wherein the output is reviewed internally. In India, this step has taken place in a number of firms, requiring innovation of processes, technology, and human resources. From simple functions, up-selling and diversification into other service lines has taken place (Interview 120210).

The head of HR of an Indian-owned knowledge process outsourcing firm explains that the transition from predominantly voice-based service delivery, to integrated, complex transactions for back offices “was a conscious business strategy not to conduct ‘vanilla-type projects’ because they do not have any entry restrictions” (Interview 120215a). The head of HR of an Indian-owned BPO firm explains that, similarly, the company decided to offer customer services only as part of an integrated solution, as the firm is are no longer interested in running a purely call-centre business, due to the margins being too low (Interview 120320).

Finally, strategic choices made by Indian-owned conglomerates like TCS’ acquisition of Citigroup’s back office, provide a firm with sector-specific knowledge that can be used and offered to other financial service clients (Interview 120309). Several Indian offshore service firms have expanded globally by opening subsidiaries abroad, both to access markets in advanced economies such as the US (The Economist, 2011), and to broaden the delivery network by adding subsidiaries in other developing countries, such as the Philippines.

6.5.2 Upgrading experiences in the Philippines

The Philippines started out with delivering lower-end BPO services after the year 2000. Without an earlier foothold in IT services, the Philippines upgrading trajectory was based on call centres, which, according to the vice president of BPAP provided an important stepping-stone for higher value-added service delivery:

> the foundation of the contact-centre sector is really very important, because when we started out with outbound work, then started doing level-one type of service and technical support… Eventually our customers were asking: What else can you do? So whether you are looking at upstream or downstream processes, can you actually do that for us? And that enriched the type of services that companies can do here in the Philippines. There are now more specialised companies that are looking [to invest] (Interview 120611a).

In the Philippines, ‘product’ upgrading into higher-skilled tasks has taken place over the past years. In the survey, BPO firms in the Philippines were asked to specify all activities carried out five years ago (in 2008) and currently (in 2013), allowing multiple options. Table 6.4 shows the percentage increase for each service by calculating the difference between the base year 2008 and the final year 2013. The growth in activities can be attributed either to
new firms entering the market and delivering specific services, and firms expanding their service offerings to include more tasks.

In general, the offshore service sector in the Philippines has grown, and all services were being delivered more often in 2013 than in 2008. The services are grouped according to low-end, medium-end, and high-end services. An interesting pattern emerges, in which low-end services have risen much slower than medium-end or high-end services over the five-year period. This suggests that the skill-intensity of work has been rising over the past years. IT and software services show only relatively low growth, compared to all other offshore service sub-sectors. The slow growth of IT and software services in the Philippines, India’s competitive advantage, may suggest an emerging specialisation and an unfolding South-South division of labour.

Table 6.4: Change in service activities by BPO Firms in the Philippines 2008 – 2013 (n=111)

<table>
<thead>
<tr>
<th>Activity</th>
<th>No of activities 2008</th>
<th>No of activities 2013</th>
<th>Percentage change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low-end services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contact centre</td>
<td>42</td>
<td>76</td>
<td>81%</td>
</tr>
<tr>
<td>Product support</td>
<td>12</td>
<td>23</td>
<td>92%</td>
</tr>
<tr>
<td>Tech support</td>
<td>31</td>
<td>49</td>
<td>58%</td>
</tr>
<tr>
<td>Non-voice customer care</td>
<td>27</td>
<td>51</td>
<td>89%</td>
</tr>
<tr>
<td>Back-office services</td>
<td>38</td>
<td>71</td>
<td>87%</td>
</tr>
<tr>
<td>Data services</td>
<td>22</td>
<td>43</td>
<td>95%</td>
</tr>
<tr>
<td>Legal transcription</td>
<td>7</td>
<td>17</td>
<td>143%</td>
</tr>
<tr>
<td>Medical transcription</td>
<td>12</td>
<td>21</td>
<td>75%</td>
</tr>
<tr>
<td>Medium-end services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publishing services</td>
<td>6</td>
<td>19</td>
<td>217%</td>
</tr>
<tr>
<td>Marketing/Advertising services</td>
<td>16</td>
<td>38</td>
<td>138%</td>
</tr>
<tr>
<td>Software services</td>
<td>22</td>
<td>40</td>
<td>82%</td>
</tr>
<tr>
<td>Website development</td>
<td>21</td>
<td>30</td>
<td>43%</td>
</tr>
<tr>
<td>Animation and graphics</td>
<td>13</td>
<td>27</td>
<td>108%</td>
</tr>
<tr>
<td>E-learning</td>
<td>8</td>
<td>26</td>
<td>225%</td>
</tr>
<tr>
<td>High-end services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Back-office KPO</td>
<td>16</td>
<td>40</td>
<td>150%</td>
</tr>
<tr>
<td>Financial KPO services</td>
<td>4</td>
<td>25</td>
<td>525%</td>
</tr>
<tr>
<td>Industry supplier</td>
<td>7</td>
<td>17</td>
<td>143%</td>
</tr>
<tr>
<td>Software development</td>
<td>25</td>
<td>41</td>
<td>64%</td>
</tr>
<tr>
<td>Legal KPO</td>
<td>6</td>
<td>18</td>
<td>200%</td>
</tr>
<tr>
<td>Medical KPO</td>
<td>13</td>
<td>31</td>
<td>138%</td>
</tr>
<tr>
<td>Engineering services</td>
<td>3</td>
<td>13</td>
<td>333%</td>
</tr>
</tbody>
</table>

(Source: Survey 2013)
6.5.3 Towards a South-South division of labour?

The trajectories of BPO service delivery in India and the Philippines differ due to a number of reasons, including the different time of entry into the GPNs, the role of domestic-owned firms and entrepreneurs, and differences in the labour pool. Whereas the Philippines’ main advantage is English language skills, India’s technical and management capabilities are an important advantage over competitors (Interview 130227b). As Indian firms have grown, they have become global actors in their own right and invested in the Philippines; mainly establishing subsidiaries offering voice-based services to clients in the Global North. Genpact, WNS, Firstsource, Hinduja, and Aegis are among the Indian firms which have opened a Philippine branch since 2008. An estimated 15 out of the top 20 Indian BPO firms have set up an office in the Philippines, primarily due to client demands for voice-based services from the Philippines, explains an investment specialist at the Philippine Board of Investments (BOI):

There was an American client whose contract was outsourced to an Indian BPO company. They said: we’re going to give you the account if it is served from the Philippines. And we’ve heard quite a few of whose arrangements are of that sort. Especially in the past three to four years, the Indian companies came and supplied quite some growth (Interview 120529a).

The Associated Chambers of Commerce and Industry of India states that 70% of Indian BPO services, particularly call centres, are being lost to foreign competition – primarily to the Philippines (Diola, 2014). This points to an emerging fine-grained division of labour, with regional specialisations in service delivery. Industry experts from the Asian Development Bank expect that India will retain management and control functions, as well as higher value-added services, and only the low-value segment will relocate to the Philippines (Interview 130422). Indian firms, therefore, orchestrate the formation of a deeper international division of labour, by shedding lower-value activities to the Philippines while simultaneously moving up the value chain into higher-end services. NASSCOM’s (2014) vision for the Indian BPO sector supports this trajectory, asserting that “the Indian industry needs to leverage the low-end skills available in other emerging destinations, while itself moving up the value chain.”

A spatial division of labour is also manifesting itself within foreign-owned BPO firms. The offshore service sector consists of several large global outsourcing firms, many of which are US-based. They provide business- and customer services from several locations (including often India, the Philippines, and other locations) to client firms globally. Most of the foreign-owned BPOs in the Philippines operate as contact centres, such as Convergys, Sykes or Teleperformance. A few firms offer integrated services (Accenture, IBM), including voice-based and back-office services. Although the same foreign-owned BPO firms operate both in India and the Philippines, the types of services conducted out of each office differ. For example, an integrated service provider’s 26,000-FTE strong workforce in the Philippines primarily caters to lower-end BPO functions, whereas the Indian operations include high-end ‘offshore consulting’, which requires direct interaction with global clients (Interview 120214a). For the Philippines, breaking out of a low-value-
Upgrading and emerging divisions of labour

added position through upgrading into higher-end non-voice services is affected by India’s capabilities (Interview 120601b).

This supports Dossani and Kenney’s conclusion that “while countries like India may address the entire spectrum of services, there will be opportunities for smaller countries to develop particular niches in terms of skills, temporal availability, and simply as back-up locations” (2007: 788). The Philippines’ niche so far remains in relatively low-end voice-based service delivery, moving out of which requires concerted efforts and government support. Identifying the different types of firms operating in the sector and their respective abilities and limitations to upgrade can increase understanding of the sector and be a first step in designing policy interventions.

6.6 Conclusions: Upgrading in services and emerging South-South divisions of labour

Economic upgrading is a multi-dimensional phenomenon. This study distinguished between product upgrading (into higher-skilled and more knowledge-intensive functions), and functional upgrading (into functions in the offshore service sector that generate higher revenue). Whereas Indian firms have also achieved functional upgrading over time, Philippine operations have not changed their power position in global networks and revenue growth has remained linear.

I analysed the differences in opportunities and limitations for upgrading by three different types of firms active in the BPO sector in the Philippines. Captive operations of multinational corporations have been best positioned and most successful in upgrading into higher-skilled tasks. Relocating more skill-intensive processes to the Philippines, driven by global cost-saving strategies, can lead to the social upgrading of workers, due to higher salaries and/or better working conditions (e.g. daytime work rather than night-time work). Whereas scholars have argued that cost-cutting is increasingly replaced by the motive to gain access to specific skills or “talent” abroad (Lewin et al., 2009) it seems that labour arbitrage is still the main driver in the Philippines. Despite a faster rise in more knowledge-intensive activities compared to more routine activities, the challenges and limitations for further upgrading in the foreign-investor-dominated offshore service sector in the Philippines become apparent.

The findings from the Philippine case study provide a counterexample to India’s fast upgrading in the services sector and show that upgrading in the Philippines is limited by the absence of large domestic-owned firms, skill-sets of the labour force, and a lack of concerted governmental policies for upgrading. Emerging specialisations in offshore service delivery and the expansion of lead firms from India may further reduce opportunities for the Philippines to follow India’s rapid upgrading into higher-end services.

The decision on where the most sophisticated part of a firm’s operations occur is taken by foreign investors abroad. The Philippines is only one of several locations in their (constantly changing) global strategy, remaining vulnerable to relocation decisions (Manning, 2013). Few spillovers to other domestic-owned companies occur (due to low
input-output linkages) and even less spin-offs result from the sector. The enhanced value is not necessarily captured in the regional economy, as profits from cost-savings may be reinvested abroad. A move towards higher value-added functions and increased power positions within GPNs would require strong domestic firms, strategic intent to move up into higher rent-generating sectors, and quite possibly, government support for this endeavour.

The question of how to stimulate the growth and upgrading of globally competitive domestic-owned firms in GPNs, in times when the developmental state is losing its power and relevance (Yeung, 2014), is key for developing countries. It seems that the Philippine state has a role to play in stimulating local entrepreneurship and supporting the growth of domestic-owned BPO firms, in addition to investments in tertiary education and professional skills training for higher-value added functions. More research is required on the role of Indian firms in leading and organising the GPNs of service delivery, moving beyond lead firms that originate in the Global North and considering new contours of South-South divisions of labour. The question of where value from cost-savings and upgrading is captured and who locally benefits from developing countries’ integration in GPNs and export services requires further attention.
Chapter 7

Islands of globalisation: The rise of service-based special economic zones in Metro Manila, the Philippines

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7.1 Introduction: Services offshoring and the changing spatial division of labour

Contemporary globalisation and the “new international spatial division of service labour” (Bryson, 2007) have created opportunities for developing countries to export services to the developed world. Improvements in technology have enabled unbundling, digitisation and a spatial reorganisation of services production, allowing firms to weigh production conditions around the world in their efforts to optimise production networks. The offshore service sector has risen dramatically over the past two decades and is still expected to grow as “we have barely seen the tip of an offshoring iceberg” (Blinder, 2006: 2). Telephone calls can be taken, credit-card information provided, hotels booked, interviews transcribed, and administrative tasks outsourced to almost anywhere on the globe.

Friedman (2006) sees the combination of globalisation forces and technological revolutions creating a “flat world”, a level playing-field for individuals to enter into competition with each other independent of their geographic location. Economic geographers, however, have long noted capitalism’s inherent reproduction of spatial unevenness and existing inequalities, as well as its ability to create new inequalities (Harvey, 1982; Massey, 1984; Smith, 1990). Today, “intensified processes and patterns of uneven development are increasingly expressed in enclave spaces” (Sidaway, 2007: 332). The integration of new locales into global production circuits can be studied using the GPN framework (Coe et al., 2004; Henderson et al., 2002). Although GPN studies have focused on various aspects beyond the firm, the framework was recently criticised for neglecting the impact of spatial transformation and development in specific places (Kelly, 2013).

Since the late 1980s, services have been offshored to developing countries, most prominently to India, and more recently to the Philippines. The spatial patterns and transformations resulting from the offshoring of services to developing countries have not been explored, a lacuna this chapter aims to address. Using a case study approach, I explore the geographies of global service production to increase our conceptual understanding of contemporary global production landscapes in the ever-changing spatial division of labour.

The case study primarily concerns the following question: Where do offshore service firms invest in the Philippines, which spatial transformations occur as a result, and why? Analysing the spatialities of services in the Philippines gives insights into possible local economic development outcomes for other recipient countries. This is especially relevant given that the offshore service sector is advocated as an opportunity for economic development in developing countries (Dossani & Kenney, 2007).

The Philippines has long been considered a development laggard in Asia, while its neighbouring countries industrialised at high speed (Baliscan & Hill, 2003). In the first quarter of 2013, however, the Philippines became the second-fastest growing country in Asia after China. Economic growth rates are supported by a rising services sector (Asian Development Bank, 2012). The BPO sector in the Philippines has grown to 780,000 employees over the past 15 years, contributing $13 billion in foreign exchange to GDP in 2012 (Mitra, 2013). Despite high
GDP growth, poverty and unemployment rates in the Philippines remain high; this raises the question of who benefits from the growing BPO sector (Ubac & Remo, 2014).

This study’s findings are based on secondary data on company locations and 30 interviews with key stakeholders and companies in the offshore service sector in the Philippines. The central argument developed here is that services-based SEZs are being formed around the offshore service sector in the Philippines, due to (1) the location-choice factors of foreign investors, which require skilled labour and prefer modern and secure environments modelled according to their country of origin; (2) a domination of private urban planning and oligopolistic real-estate developers; (3) changing spatial policies for export-oriented economic development, especially government policies allowing the sprouting of SEZs in central business districts and even in individual high-rise buildings.

In the following sections, I present the theoretical background of the study, give a short overview of the methodology, and explain the context of offshore service investments in the Philippines. The empirical part of the chapter addresses three connected points: First, it maps foreign offshore service sector investments in the Philippines. Second, it examines the factors that determine companies’ choice of location for their investments, as well as government policies for FDI attraction, to explain the conditions enabling a spatial structure of privatised global enclave development. Third, it discusses the features of service-based SEZs, including a brief discussion on who benefits from these developments. The chapter concludes by providing guidelines for further research.

7.2 Conceptual framework: From manufacturing- to service-based SEZs

Outsourcing and offshoring have occurred since the 1960s, when companies started to relocate manufacturing tasks to lower-cost destinations. The vertical disintegration of production led to a shift of routine blue-collar jobs from developed countries to developing countries for labour arbitrage. Consequently, developing countries have become increasingly integrated into GPNs in a new international division of labour (Fröbel et al., 1980).

Manufacturing offshoring has been spatially manifested by the creation of SEZs or export processing zones (EPZs). Mezzadra and Neilson argue that SEZs “provide a privileged perspective on globalization and its accompanying tensions” (2003: 211). These economic enclave spaces are a crucial, but under-researched feature of today’s world. Veltz uses the term “archipelago economy” to describe the way multinational corporations create identical environments for standardised production across the globe “which appear often as islands in their broader local environment” (2004, section 3.4). SEZs are “defined as geographically delimited areas, frequently physically secured, that are usually, but not always, outside the customs territory of the host country” (Arnold, forthcoming). Many authors have discussed the suspension of existing national laws, or application of differential legal rules within these zones, as leading to territorial exceptionalism, denationalisation of land, plurality or hybridity of legal and social order, and “graduated sovereignty” (Mezzadra & Neilson, 2013; Ong, 2006; Phelps & Wu, 2009; Sassen, 1996).
Many developing countries have implemented SEZ policies as central components of their export-oriented development, primarily for manufacturing activities (Carter & Harding, 2011; Farole & Akinci, 2011). In 40 years, the number of SEZs rose from 76 globally to approximately 3,500 zones in 135 countries (Milberg & Winkler, 2013). The strength of SEZs in attracting FDI lies not merely in their preferential laws, but in the provision of enclaves of good business environments (e.g. simplified bureaucratic procedures, good infrastructure, and fast internet connectivity) in countries generally lacking these (Engman, 2010; Yi, 2012). These economic enclaves differ in scale and size, ranking from entire city states to clusters of buildings (Sidaway, 2007).

By creating spatially demarcated zones for foreign investors and export-oriented firms, a dual economy of advanced production for global markets co-exists with the local economy35, with often limited interaction between the two. The rise of FDI in Wroclaw (Poland) for example, led to “cost-oriented enclaves of foreign capital” (Hardy, 1998: 461) in which firms produced for the export-market with limited local linkages. In Guadalajara (Mexico), FDI attraction in SEZs has led to a bifurcation of the Mexican economy “into a foreign ‘enclave economy’ and a domestic economy” (Gallagher & Zarsky, 2007: 2).

Manufacturing SEZs in Southeast Asia often described as places for the unhindered exploitation of workers, characterised by poor working conditions, excessive working hours, and low wages (Arnold & Pickles, 2011; Klein, 2000). In the Philippines, the sub-urban fringe of Metro Manila became the site for manufacturing textiles and assembling electronics (Kelly, 2000; McKay, 2006). Klein described the atmosphere in a Philippine SEZ dedicated to manufacturing textiles, in the 1990s, as a “place of pure work”, dominated by female workers in low-end ‘sweatshop’ factories, patrolled by armed guards, and devoid of consumption spaces, where “not even candy and drink vending” (2000: 211-212) occurs. These ‘manufacturing-based’ SEZs are juxtaposed to ‘services-based’ enclaves, which provide office space to host foreign investors in offshore services.

7.2.1 Services offshoring and SEZs

Traditionally, services were considered non-tradable and had to be produced and consumed in the same location. With the commodification of services (Davenport, 2005) and ICT developments, the processes of production and consumption could be spatially separated, opening up possibilities to shift back-office tasks, of which Ireland became a prime destination (Breathnach, 2000; Sokol, 2007; White, 2004). In search of further cost reductions, production was shifted to regions with lower labour and office costs, and favourable tax regimes.

It could be assumed that the offshore service sector is more flexible in its location choice compared to the manufacturing sector, due to lessened physical infrastructural demands (Goswami et al., 2012). Existing studies analysing the distribution of offshore services on a national scale in developed countries have found contradictory evidence. Several studies have

35 The term dual economy can refer to the distinction between a formal and an informal sector (Kanyenze & Kondo, 2011), or a traditional and modern one.
stressed an uneven distribution of offshore services in a few large cities (Bristow et al., 2000; Hardy et al., 2011b; Sokol, 2007; White, 2004). Other studies, however, found that peripheral and rural areas can benefit from employment creation through call centres (Richardson & Gillespie, 2003; Richardson & Marshall, 1996). The geography of service delivery, moreover, presents a contrasting picture of concentration of high-end services in global cities and lower-end services dispersing to more peripheral areas (Castells, 1989; Dicken, 2011; Sassen, 2001).

New production landscapes, or “territorial production complexes” (Storper & Walker, 1989), are created to match the changing requirements of capitalism. Similar to lower-end manufacturing SEZs, higher skill-intensive SEZs form enclaves with limited domestic economy linkages, except for drawing on the high-skilled labour force (Milberg & Winkler, 2013: 247). Service-based SEZs employ highly-educated labour, who perform services often in direct interaction with brands’ end-clients in developed countries (Bryson, 2007). Attracting skilled urban workers necessitates a different work environment from the manufacturing SEZs described earlier. It is important to note that these service-based SEZs do not immediately abolish or replace the manufacturing SEZ model; instead “over-lapping global divisions of labour” can co-exist within one country (Coe, 2011: 99).

In contrast to the offshoring of manufacturing work, the service sector provides employment only for a small, highly educated sector of society, thereby creating only limited opportunities for inclusive growth and potentially aggravating existing inequalities (Chandrasekhar & Ghosh, 2006; D’Costa, 2011; Dittrich, 2005; Usui, 2011). The emergence of the offshore service sector in India has led to a hierarchical integration into the global economy and the formation of an inherently unequal and segmented ‘dollar economy’ and ‘rupee economy’ (Krishna & Nederveen-Pieterse, 2008). Increased fragmentation and inequality, resulting from offshore services and SEZ development, becomes manifest in terms of rising internal frontiers of economic development, status, consumption, and cultural styles (ibid.; Mezzadra & Neilson, 2013).

The actors involved in creating service-based SEZs, and the spatiality of these developments, however, remain opaque. Nowhere in the world have service-based SEZs proliferated faster than in the Philippines. A case study on the Philippines can therefore offer insights into this contemporary phenomenon. Tracing the development of service-based SEZs in the Philippines offers a grounded analysis of the spatial dimensions of global processes, while simultaneously highlighting the role of domestic actors in mediating and translating global flows locally.

### 7.3 Methodology and data collection

This research is based on quantitative and qualitative data. Secondary quantitative data was used to show the spatial distribution of offshore service investments, and their concentration in maps. The maps are based on locational data stemming from the Philippine Economic Zone Authority, the registering office of all offshore service firms locating in Philippine SEZs. The data (from August 2013) include the addresses and sizes of each IT business park or business
Value capture and service-based special economic zones

centre (IT-SEZs)\(^{36}\), the number of companies operating within each zone, and a separate list of
planned parks. PEZA refers to the firms locating in these IT-SEZs as IT-BPO firms; I use the
term IT-BPO synonymously to offshore service firms. The data is updated regularly and fairly
reliable, since companies need to register to be eligible for tax exemptions and other benefits.
A geographic information system was used to transform the data collected into maps.

Twenty interviews with offshore service firms’ representatives in Metro Manila and
three second-tier Philippine cities were conducted between April 2012 and April 2013. The
interviews focused on location-choice criteria and the investment process of offshore service
companies. Moreover, I interviewed ten key stakeholders of the industry to understand
changing SEZ- and FDI attraction policies.

7.4 The spatial distribution of offshore service investments in the Philippines

The offshore service sector in the Philippines has benefited from close relations with the US,
the dominant market for offshore service exports, due to a shared past of colonialism (1898 – 1946).
Voice-based services, especially, such as customer-support services for American
customers, have been relocated to the Philippines. Call-centre employment, a relatively
low value-added process, constitutes more than two-thirds of total offshore service sector
employment (DoST-ICT Office & BPAP, 2012). Most BPO firms require a minimum of two
years’ college education, and many employees hold a university degree. Offshore services
have been identified as an investment-priority sector by the Philippine government. Firms
locating in SEZs receive tax incentives and other benefits.

After a shift from import-substitution industrialisation to export-oriented industrialisation
and subsequent privatisation of SEZ development in 1995, the Philippine government has
encouraged SEZ-creation to attract FDI and stimulate exports. McKay refers to this as the
“intensification of the ‘enclave economy’ approach” (2006: 60). The majority of all manufacturing
exports in the Philippines have traditionally originated from SEZs, making their location a
central decider for regional development processes (Balisacan & Hill, 2007).

Interestingly, several SEZs in the Philippines are built on the grounds of former US
military bases (Casanova, 2011). In order to mitigate the negative impact of job losses
resulting from closing of the bases, the Philippine government created manufacturing EPZs.
One example is Mactan, which became the second-largest zone after its use as an US airbase
during the Vietnam War. Likewise, the Philippine government transformed Subic Freeport
into a SEZ (from where the first BPO operations of the US communications firm, AOL,
started in 1997), and more recently approved Camp John Hay’s (Baguio) transformation
into a tourism- and offshore services SEZ. In this way, older (military) enclaves are giving
way to subsequent generations of enclaves.

\(^{36}\) Please note that the official designation of ‘IT Park’, given by the government, is imprecise; the majority
of firms in these parks engage in business process outsourcing, especially call-centre work.
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Historically, the Philippine archipelago has been characterised by an uneven distribution of industry and economic development (Claussen, 2010; Manasan & Chatterjee, 2003). Since 1995, a total of 273 SEZs have been created in the Philippines, dedicated to manufacturing (65), agro-industry (17), tourism and medical tourism (17) and IT (174), (PEZA, 2012). Information technology clearly accounts for the strongest growth; the size of IT-focused SEZs ranges from individual offices to multi-firm compounds. The spatial distribution of offshore service firms is analysed in Figure 7.1, which shows the number of companies registered in service-based SEZs.

Out of 802 PEZA-registered IT-BPO firms, 671 (or 84%) are in Metro Manila. 78 firms are located in the Central Visayas, 64 of which are in Cebu City, the second-largest urban agglomeration in the Philippines. BPO employment has been generated in areas with the lowest poverty rates, shunning high poverty regions (see Figure 7.2). The sector’s direct employment constitutes only 2.1% of total employment, but is heavily concentrated in the NCR (75% of BPO employment, 82% of BPO revenue). Metro Manila attracts the largest share of investment and constitutes a global hub for offshore service delivery. Of all formal-sector employees in Metro Manila, 13% work in the offshore service sector.

7.5 ‘Islands of globalisation’ in Metro Manila

In Metro Manila offshore service firms are mainly located in the central business districts (CBDs) of Makati, Ortigas and the upcoming new financial centre Bonifacio Global City (BGC). Underfunded metropolitan government, deficient urban planning, and the fragmented political nature of the city, has led to a proliferation of private sector urban development. In a recent publication by the Urban Land Institute, it is stated that due to private-sector involvement, “some areas of Metro Manila, such as Makati CBD and BGC stand out from the rest, shaping the region and creating a distinctive identity”; both “constitute world-class destinations for multinational corporations looking for a place to locate their BPOs” (2013: 11).

Figure 7.3 shows the locations of IT-BPO firms in Metro Manila. These ‘islands of globalisation’ feature pre-existing business districts (Makati and Ortigas); a newly created business district (Bonifacio Global City/McKinley Hill; Alabang/Filinvest); one of the largest shopping centres on the continent (Mall of Asia Business Hub); a mixed-zone development on the area of a former textile plant (Eastwood City); and a business park on land of the University of the Philippines (UP-Ayala Technohub). A key difference from earlier manufacturing SEZs is that this new generation of SEZs is largely developed by private developers, sometimes in cooperation with the public sector. Together these seven zones host 94 % of all registered BPO firms in the NCR.

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37 Based on 4.5 million employed workers in the NCR, according to the National Statistics Office.
38 There is considerable overlap of these areas with the integrated urban megaprojects and “bypass urbanism” in Metro Manila discussed by Shatkin (2008), which also include residential and consumption-oriented enclave spaces.
Figure 7.1: Offshore service firm locations in the Philippines

(Source: PEZA data, 2013)
Figure 7.2: Percentage of families below the poverty line

(Source: NSCB data, 2013)
Call centres, and other BPO providers, are located in high-rise buildings in the most expensive districts of the city. Ayala Avenue alone, Manila’s equivalent of Wall Street, hosts 135 BPO companies. The findings show that location patterns for back-office and call-centre work change when relocated across countries: from peripheral areas in the Global North they migrate towards the most prestigious addresses in developing countries, as shown by the office-rental rates in Table 7.1. This is counter-intuitive to the underlying rationale of offshoring as cost-saving, vertical investments (Hardy et al., 2011b; Milberg & Winkler, 2013).

7.6 The rationale for enclave development

What explains these spatial dynamics of BPO firms’ concentration in high-end areas of the city? Who drives and enables this process of urban enclave creation? The following discussion presents three explanations for services-based SEZ development: First, offshore service investors’ location-choice factors; second, the dominance of private actors in urban planning and development; and third, changing government-zoning policies.

7.6.1 Offshore service firms’ location-choice factors

Agglomeration economies and the benefits of clustering for BPO companies are mainly realised in the shape of urbanisation economies, such as reduced costs for (electronic) infrastructure, security, and a skilled workforce. Traded and un-traded interdependencies, such as face-to-face contacts, often crucial for high-end services, are less relevant for offshore services. Simultaneously, agglomeration diseconomies exist, such as a high labour turnover due to competitor’s poaching.

The most important location-choice criterion is the proximity to ‘talent’, which means readily employable graduates with English-language communication skills. More than 30% of all students are enrolled in Metro Manila; this geographic concentration of skilled labour partially explains investors’ choice of the metropolis as a preferred location. The relatively advanced position of call-centre workers, compared to the national Filipino labour market, gives experienced workers higher bargaining powers and increased remuneration opportunities, thereby leading to job-hopping (James & Vira, 2012). Firms thus engage in competition for skilled labour, a key difference to sectors requiring less-educated labour. In order to attract well-educated urban youth, firms have to create a conducive working environment, a modern workplace in a convenient and secure location. Many graduates see Makati as an aspirational district for their first job; therefore, the location in itself offers important benefits for firms recruiting staff.

Moreover, BPO firms require internet connectivity and secure office spaces. The general manager of a European-based BPO firm in Makati tells me: “You can see, this building is like a fortress, that’s the same with all BPO offices here. We want to make sure our stakeholders are satisfied with what they see here in terms of security” (Interview 120608a). In an insecure business environment and a chaotic megacity, foreign investors, who are likely to receive international client visits at their local branches, seem inclined to invest in the most trusted, high-end office space. Finally, clustering can result from the advice of management
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Figure 7.3: Islands of globalisation: Offshore service enclaves in Metro Manila
Value capture and service-based special economic zones

### Table 7.1: Islands of globalisation in Metro Manila: office space and consumption

<table>
<thead>
<tr>
<th>Developments (NCR)</th>
<th>Developer</th>
<th>Supply of office (in million sqm)</th>
<th>Rental price per sqm ($1)</th>
<th>No. of BPO firms</th>
<th>No. of BPO seats(^2)</th>
<th>No. of Starbucks Coffee outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 UP-Ayala Technohub</td>
<td>Ayala Land</td>
<td>ca. 0.30</td>
<td>9-14</td>
<td>27</td>
<td>17,000</td>
<td>3</td>
</tr>
<tr>
<td>2 Eastwood City</td>
<td>Megaworld Corporation</td>
<td>0.31</td>
<td>9-14</td>
<td>74</td>
<td>32,000</td>
<td>4</td>
</tr>
<tr>
<td>3 Ortigas CBD</td>
<td>Ortigas Group</td>
<td>1.43</td>
<td>13-16</td>
<td>151</td>
<td>32,000</td>
<td>24</td>
</tr>
<tr>
<td>4 Makati CBD</td>
<td>Ayala Land</td>
<td>3.04</td>
<td>14-22</td>
<td>220</td>
<td>70,000</td>
<td>30</td>
</tr>
<tr>
<td>5 Bonifacio Global City / McKinley Hill</td>
<td>Ayala Land / Megaworld Corporation</td>
<td>1.00</td>
<td>15-18</td>
<td>113</td>
<td>53,000</td>
<td>15</td>
</tr>
<tr>
<td>6 Mall of Asia Business Hub</td>
<td>SM Land</td>
<td>0.20</td>
<td>11-13</td>
<td>9</td>
<td>12,000</td>
<td>5</td>
</tr>
<tr>
<td>7 Alabang/ Filinvest Cyberzone</td>
<td>Ayala Land / Filinvest Corporation</td>
<td>0.32</td>
<td>9-14</td>
<td>38</td>
<td>11,000</td>
<td>7</td>
</tr>
</tbody>
</table>

(Sources: PEZA, 2013; Jones Lang LaSalle, 2013; Colliers International, 2012; Starbucks, 2014)

1 Based on exchange rates on www.oanda.com (on 20 July 2014).
2 Number of work-spaces. Note that this figure is lower than number of FTEs, as one seat can host up to three employees over several shifts.

consultants, who compile the same statistics and reports for various companies, or herding behaviour, as many companies follow an initial leader to the same location (Milberg & Winkler, 2013). Costly and laborious due-diligence research on location choice leads to incumbency advantages for specific places (Majluf, 2007).

### 7.6.2 Privatised urban planning and real estate development

Enclaves and the segregation of the urban rich and upper-middle classes from the urban poor have long existed in the Philippines in the form of gated communities, or so-called ‘subdivisions’ or ‘villages’ (Berner, 2001; Connell, 1999; Michel, 2010). Private planning has been the dominant mode of urban development in the country, from the Ayala family’s development of large sections of City of Makati since the 1950s, to more recent high-end residential and mixed-use enclaves, such as Rockwell Center (Michel, 2010; Shatkin, 2008).

Traditionally, land conversion and re-zoning of land have been contentious political issues in the Philippines, where land ownership remains concentrated in the hands of elites (Kelly, 1998; Krinks, 2002). The close connection between economic elites and the state apparatus has historically inhibited economic development efforts (Hutchcroft, 1998). Concurrent with the rise of the BPO sector, real-estate owners and developers have advocated a change of SEZ policy to be able to benefit from new income opportunities: “A lot of building owners wanted to have reinterpretation of the minimum zone from a horizontal to a vertical space. This was granted, making many high-rise buildings eligible for a special economic zone” (Interview 120424).

Real-estate developers benefit from SEZs through tax exemptions, above all from the exemption of land- and property taxes, explains the president of a real-estate conglomerate:
We find that if we put up the buildings with [tax] incentives, the biggest thing for us as developers is 12\% VAT [value-added tax]. […] So immediately when you buy land, you have a 12\% initial cost that you do not have to incur. And when we start to put up the building, again it is zero VAT (Interview 130322).

In addition to incentivising the construction of new buildings, owners of existing buildings in Manila’s CBDs were exempted from value-added tax, essentially subsidising existing commercial-property owners. The same developer expounds: “Incentives are going to those who have already built, and don’t need to be incentivised!” The developer concedes, however, that “the market is large enough for all”, showing the protected nature of the oligopolistic real-estate sector from new entrants and foreign competition. A handful of large conglomerates dominate the sector (Michel, 2010). These domestic actors are the main enablers but also local beneficiaries of SEZ development, as will be discussed in more detail below.

### 7.6.3 Changing government SEZ policies: from horizontal to vertical space

After the Asian financial crisis in 1997 brought down property prices and led to high vacancy rates for office spaces in central business districts, PEZA, under the leadership of its general director, Lilia de Lima, changed its policies. The redefinition of space from a previously horizontal concept to include vertical spaces to fulfil minimum size restrictions, led to a re-classification of existing high-rise buildings (and even individual floors within buildings) as SEZs. A member of the Foreign Trade Service Corp explains:

> The government took it upon itself to incentivise it [the BPO sector] in a big way. I think the idea of putting up what we call IT Parks is a stroke of genius. Before it was horizontal, now we are talking of vertical (Interview 120607).

PEZA was inspired by Indian policies for software-technology parks.

> It was the management of PEZA, who went to India to see the possibility to replicate this in the Philippines. We crafted the guidelines and presented them to the board of PEZA. So the very first information technology park that we declared as an economic zone is an existing commercial district in Metro Manila (Interview 120525c).

This contrasted with the initial purpose of SEZs, but a loophole in the legislation allowed the creation of private SEZs even in CBDs, reversing earlier policies of suburban employment generation.

The preceding discussion shows that enclave development has been driven by foreign investors, the Philippines government, and domestic real-estate actors; an alliance of global and local, private- and public sector actors. Global processes and a changing spatial international division of labour are enabled, mediated, and translated through local actors and processes, to take the shape of service-based SEZs, which are not only characterised by global production but also as places of consumption.
7.7 Enclaves and the dual economy: SEZs as spaces of production and consumption

Service-based SEZs differ in shape and function from earlier enclaves. Bonifacio Global City is an example of a development, which hosts not only office space for call centres and back offices of international banks, but also entertainment, shopping, and residential spaces. Service-based SEZs go beyond simply segregated spaces of living and consumption, but constitute globally-oriented 24-hour enclaves engaging in export-service delivery. The privately owned, highly securitised and sanitised spaces, are shaped according to a highly Americanised model of modernity, in which call-centre agents take calls during US working hours (Filipino night-time), speak with American accents, and pay dollar-equivalent prices for a breakfast at McDonald’s, or a coffee at Starbucks. Entertainment opportunities abound in these space, which almost resemble theme parks. Options range from bowling, to watching the newest Hollywood blockbusters, to buying American-branded goods in the air-conditioned shopping malls.

This form of development should not be read as a convergence with a Western model of development (Shatkin, 2006). Instead, we can observe a process of enclave creation. While Americanised upper-middle classes have existed in the Philippines for a long time, the ‘virtual migration’ of workers39 and adoption of American working hours to service clients overseas is a direct consequence of the offshoring of services. Though enclaves are not a new phenomenon, the emergence of offshore service FDI has led to an amplified process of enclave creation.

BPO workers’ above-average earnings and discretionary spending power also changes consumption habits (Bautista, 2011; Murphy, 2011).

The retail outlets are booming thanks to the well-paid young people. They are the ones who go eat in the restaurants, etcetera. In Eastwood [SEZ], at three o’clock in the morning, it’s like Broadway at 12 noon, because of the tremendous spending power (Interview 130404).

According to calculations of the Fort Bonifacio Development Corporation (n.d.), BPO workers spend the largest share of their income (41%) on food, creating a need for (international) food chains in proximity to BPO offices.

An industry expert argues that the offshoring of services leads to increased consumption of US products and services, thereby creating benefits for offshoring countries, as locally created value partially flows back:

Filipinos are consuming more non-Filipino products. […] the Starbucks is a good example. And many US businesses know that it is to their advantage that there is a growth in terms of domestic consumption.[…] It’s about increasing economic activity, markets for their products (Interview 130227b).

39 See Aneesh (2006) for a discussion of the concept of ‘virtual migration’ by Indian software specialists.
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As a way of illustrating the argument of a spatially demarcated dual economy, one of globally linked production and consumption in the ‘dollar economy’, in contrast to a traditional, locally oriented ‘peso-economy’, the location patterns of the high-priced US-based coffee chain, Starbucks, are collated with the locations of offshore service firms. The difference between the dollar economy and the peso economy becomes clear when juxtaposing a Starbucks ice-blended coffee, costing up to ₱175 (almost $4) to the daily minimum wage of ₱429 to ₱466 (about $10).

In Asia, Starbucks first entered the markets of Japan and Singapore, both significantly richer than the Philippines. Low income-levels suggested limited business opportunities for the Philippine market. The intervention of a local business group, nonetheless, brought in the coffee chain as a joint-venture to the Philippines. Starbucks opened its first store in December 1997 on Ayala Avenue in Makati and expanded rapidly to 221 stores in the country. This rise occurred over the same period as the inflow of investment in offshore service and shows a strikingly similar location pattern as the offshore service firms: 156 of all Starbucks coffee shops are located in Metro Manila. An analysis of coffee-shop locations (see Table 7.1) reveals that 56% of Starbucks outlets are located within the seven ‘islands of globalisation’ in Figure 7.3. Expansion plans to open another hundred stores by 2017 were announced in April 2013 (Carpio, 2013).

Anecdotal evidence shows that BPO workers are the main customers of Starbucks: night-time opening hours, vouchers as performance incentives (Interview 130306d), and conspicuous consumption of expensive coffee “as a treat, a just-affordable luxury” (Simmons, 2005: 143). Another influencing factor might be cultural. By being connected and embedded in American culture through conversing with US clients all night, and by adopting American lifestyle choices, workers distance themselves from their local environment. The consumption choices and patterns of the so-called ‘new middle classes’, especially workers in offshore services, in developing countries are beyond the scope of this chapter. Here, it suffices to illustrate the emerging dual economy, whose dichotomies separate local/global, peso/dollar, manufacturing/services, poor/wealthy, day/night economies, which are spatially segregated.

It is important to realise that these changes to the built environment do not occur automatically or coincidentally, but are carefully crafted by foreign investors, who actively construct and develop the enclave economy. The country manager of one of the largest BPO companies in the Philippines, with more than 30,000 employees nationwide, explains the company’s site-selection strategy. Next to access to talent, transportation and security, convenience for their employees is an important criterion:

Because we have a 24-hour lifestyle so we need to make sure that there’s a Starbucks, there’s a 7-Eleven [convenience store]; there’s a bank for them to be used any time of the day. For this building […], because we signed up for this already while it was being constructed, and again that’s part of our

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40 For non-agricultural labour in the NCR (Department of Labor and Employment, 2013).
philosophy, we had an agreement, a tie-up with [a property developer] that the ground floor would be all retail and then all the shops on the ground floor should be open at least 18 hours a day so that they can provide for our hours. Because if we don’t do that they’ll open the regular [hours], they’ll open at 7[am] and they’ll close at, let’s say, 9 in the evening. But 9 in the evening is when people are coming to work, that’s very critical (Interview 120606b).

Through collaborations with local real-estate actors, foreign firms are able to create a modern environment with international brands operating along their requirements of the 24-hour economy.

7.8 Who are local beneficiaries of SEZ development?

The rise of global enclaves in conjunction with the foreign-investment-driven offshore service sector allows local value capture. Apart from educated urban workers, other domestic beneficiaries of the offshoring of services are the actors building and servicing these enclave spaces. Above all, the real-estate sector has been the prime beneficiary of the changing SEZ policy (Raquiza, 2012). The Philippine Department of Trade and Industry estimates that 20% of a BPO firm’s operating costs (the second-largest share after salaries) flow to real estate (Rodolfo, 2006: 31). The recent real-estate boom has been fuelled by the BPO sector, which accounts for approximately 60% of all commercial real-estate projects (Cordero quoted in Salazar, 2013). The existing oligarchic elites of the country profit from these developments, as illustrated by the fact that nine out of ten Philippine billionaires on the 2014 Forbes Magazine list of world billionaires are involved in real-estate (Cardenas, 2014).

Real-estate owners have been granted incentives, originally intended for the construction of new office spaces, simply for converting their buildings into SEZs. Only established business conglomerates are able to compete in the market, as they have access to large plots of land, financial resources, as well as an insider’s knowledge of developments. Moreover, utilities and telecommunication providers are able to reap benefits from servicing foreign investors in the enclave, as are mall developers, retailers and local joint-venture partners of global consumption outlets. Existing Philippine conglomerates have chosen to diversify into these rent-generating sectors (Gutierrez & Rodriguez, 2013). Other scholars have argued that government policies focusing on FDI attraction and real-estate development in the Philippines leave existing economic power structures intact and reinforce exclusions (Andriesse, Beerepoot, Van Helvoirt & Van Westen, 2011).

7.9 Dynamic spatial divisions of labour: An outlook on the future

The spatial division of labour within the Philippines is not fixed but is continuously changing. One direction of change discernible so far is the active encouragement of FDI attraction in second-tier cities (BPAP, 2011). The reasons are agglomeration diseconomies of traffic, high labour-turnover, and rising costs within Metro Manila. Depending on several
pull factors, including the role of local institutional actors, several cities have managed to attract expansionary FDI (see Chapter three). Figure 7.4 shows that service-based SEZs are planned in a limited number of provinces outside of Metro Manila.

While increasing employment opportunities outside the NCR, it is likely that the same enclave-based format of real-estate development will be adopted in the provinces. Expanding BPO firms usually contract the same real-estate developers who built their offices in Manila to construct office spaces in second-tier cities (Interview 130417). One example of this strategy is a 70-hectare business park in the city of Iloilo, developed by Megaworld Corporation and built on the site of a former airport.

It is important to realise that spatial divisions of labour are continuously evolving and may continue to change the spatial dynamics of the Philippine offshore service sector. Given low sunk costs, foreign investors may be able to relocate service production. They can either offshore to new destinations, in case cheaper (but equally skilled labour pools) can be accessed elsewhere, or re-shore operations back to their home countries, in case offshoring benefits do not materialise.

7.10 Conclusion: Islands of globalisation and socio-spatial inequalities

Contrary to the idea that service delivery is freed from geography and can take place from anywhere, the offshore service sector exhibits strong concentration in Metro Manila. Instead of a flat world, it is rather a “spikey world” (Florida, 2005); however, one in which multiple fault lines intersect even within cities and regions. While industrial complexes in the Philippines have moved outside of the mega-city region to adjacent provinces, investment in the offshore service sector is highly concentrated in existing CBDs and in recently created private enclave developments. ‘Islands of globalisation’ resembling first-world environs are created within the megacity of Metro Manila. Simultaneously, Metro Manila itself can also be conceptualised as one larger-scale island of Scott’s “islands of relative prosperity” within the “emerging mosaic of global city-regions” (2012: 61).

The creation of service-based SEZs, in conjunction with conspicuous consumption outlets, adds a spatial analysis to Krishna and Nederveen-Pieterse’s (2008) earlier findings of uneven development in India. This case study concurs that enclave spaces are powerful shapers of the spatial contours of globalisation and development (Sidaway, 2007). It highlights the transformations of the built environment and urban form resulting from integration into global networks of services, which remain hidden in most GPN analysis (Kelly, 2013). Moreover, it explains the role of foreign investors, government, and real-estate actors in creating these urban enclaves in the specific context of the Philippines.

In many ways, service-based SEZs continue to fulfil the same role as manufacturing SEZs in the Philippines by creating spaces for foreign investors’ profit accumulation. Key features of service-based SEZs are the substitution of factory workshops for office floors, the urban shape in horizontal office spaces, a mostly privatised ownership structure, and the combination with conspicuous consumption outlets. Several of the observed features are likely to be inherent to a global service-production model driven by international investors’ location requirements.
Figure 7.4: Planned service-based SEZs in the Philippines

(Source: PEZA data, 2013)
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Future research could extend to other cases to assess the importance of context-specific features of globalised enclaves. Ethnographic research and case studies of production and consumption spaces could provide an increased understanding of the internal workings of enclave spaces, stressing the inclusions and exclusions resulting from SEZ development.

The role of local elites in facilitating and benefiting from contemporary globalisation deserves more attention, as this study has shown that locally captured value has occurred primarily in sectors in which powerful family conglomerates dominate. Scepticism ensues about the ability of a new phase of globalisation to change existing structures of inequality in the context of rentier capitalism in the Philippines. If our aim is to understand local territorial development outcomes of FDI flows and changing spatial divisions of labour, future GPN studies should include an investigation of related sectors, which, albeit not directly linked in the production process, are dependent on each other, such as the nexus of real-estate and offshore services.
CHAPTER  8

Conclusions
8.1 Offshore services and economic development in the Philippines

The concluding chapter first provides a brief discussion of empirical findings, after which I position the findings in broader academic debates. The chapter also provides the theoretical and policy findings of the study.

This research started with the observation that the offshoring of services has been identified as a critical economic development issue and as one that has the potential to improve social and economic conditions in developing countries engaged in service exports. These high hopes of economic development have been addressed with a grounded study of the realities of offshore service delivery by subsidiaries and firms in the Philippines. I have used the GPN framework to elucidate developments in networks and territories simultaneously, and gain a better understanding of complex processes of contemporary globalisation, shaped by different firm and non-firm actors.

The relocation of services to developing countries presents a change in the international division of labour. As Massey (1984: 8) writes, new spatial divisions of labour “represent whole new sets of relations between activities in different places, new spatial patterns of organisation, new dimensions of inequality and new relations of dominance and dependence. Each new spatial division of labour represents a real, and thorough spatial restructuring”. This study has observed the integration of the Philippines into expanding GPNs of service delivery. It has explored how and why the offshore service sector in the Philippines emerged, how it has evolved, and how it impacts economic development.

The empirical findings show that the BPO sector rose very fast in the Philippines, leading to considerable employment generation over the past decade and, in 2014, employing approximately one million workers. The sector’s growth has primarily been driven by foreign investment. Some foreign-owned firms have sought linkages with higher-education institutions, thereby increasing their embeddedness. A transition towards higher-skilled services has occurred primarily through captive subsidiaries of MNCs, which conduct back-office work in addition to customer-service operations. Overall, the offshore service sector is dominated by call-centre functions, and is heavily concentrated in urban areas. In the following section, the empirical findings are summarised along the dimensions of the GPN framework.

*Emergence: FDI attraction and strategic coupling*

Chapters two and three discussed the emergence of the BPO sector in the Philippines, using the concept of ‘strategic coupling’. Comparing the emergence of the BPO sector in the Philippines and India, Chapter two showed that both countries became integrated into expanding GPNs of service delivery at different points in time, with India being a forerunner and the Philippines a later entrant into the sector. In the process of integration, strategic coupling depends primarily on the existence of regional assets, which can be linked with the needs of firms in global networks.

Several differences in both countries’ regional assets for offshore service delivery can help to explain their respective trajectories in offshore service sector development. First, the
most important asset is skilled labour; therefore, differences between the education systems and skillsets of the labour force are important explanatory factors. In India, technical education has been prioritised, and firms are therefore able to deliver a mix of IT, knowledge services, and more standardised BPO services. In the Philippines, the country's comparative advantage has mainly been built on its workforce's English-language skills and 'neutral' accents. Thus, its predominant share of services are voice-based customer-service activities.

Second, domestic entrepreneurs have been largely absent or delegated to the lowest ranks of service delivery in the Philippines, where the sector is largely based on exporting services through foreign-owned firms' subsidiaries. Instead, in India, large Indian-owned firms have been a driving force behind the sector. Third, many Indian entrepreneurs have benefited from diaspora networks and returnee migrants have provided an important link between clients' markets and India-based offshore service firms.

In the Philippines, the offshore service sector has experienced fast growth and the sector's total share of GDP in 2013 was 5.5%. The main driver of growth has been foreign firms investing or expanding upon their existing investments in the Philippines. As foreign investors explore new frontiers, they have brought second-tier cities into their production networks. Chapter three analysed the role of local institutional actors in facilitating the 'strategic coupling' of second-tier cities in the Philippines with offshore service sector investors. In addition to regional assets, the agency of local coalitions for inward-investment attraction influences and co-shapes the integration of places into the GPNs of service delivery.

Combining the concept of strategic coupling with earlier literature on investment attraction, this chapter showed how local institutional actors are complicit in processes of globalisation and can play an important role in enabling processes of BPO investment attraction.

**GPN position: Power relations and the branch-plant syndrome**

The emergence of the BPO sector and investment attraction present the first step for achieving economic development through integration into GPNs. For assessing developmental outcomes, the position firms and subsidiaries operating in the Philippines occupy in the GPN matter. Chapter four mapped existing offshore service delivery networks from the perspective of actors in the Philippines. For an analysis of dependent or developmental outcomes, I analysed power relations in offshore services in the Philippines by combining the GPN framework with indicators from the older branch-plant literature. Empirically, findings from Metro Manila and three second-tier cities were used to assess power relations and positions in GPNs.

The findings show that branch-plant economies result, in particular in second-tier cities, which are dependent on decisions taken elsewhere. The functional and spatial disintegration of value chains through outsourcing increases the number of actors involved in decision-making, with the Philippine operations often remaining the lowest-ranking unit in power relations. As global outsourcing firms often operate as MNCs with office networks spanning the globe, the Philippine operations are but one of many locations within the GPNs of service delivery. Offshore service sector hubs are susceptible to global competition and 'switching' between subsidiaries can occur relatively easily, especially in low-end services. GPNs are
dynamic and remedies for countries to counter this may be to increase embeddedness and to upgrade into higher-end services in order to avoid these challenges.

**Evolution: territorial embeddedness and upgrading trajectories**

The evolution of the offshore service sector in the Philippines was addressed in Chapters five and six. Increasing territorial embeddedness in offshore services is more difficult compared to manufacturing, because BPO firms require fewer relations with local firms for sourcing inputs. The most important local asset in the production process of offshore services is skilled labour. Securing access to labour is an avenue for territorial embeddedness of foreign-owned BPO firms, therefore, Chapter five investigated the development of linkages between BPO firms and universities.

The findings showed that many foreign investors have developed linkages with the education sector, thereby investing in longer-term relations with the host territory and increasing their level of embeddedness. Industry-academe collaborations are part of active embedding strategies of foreign investors; however, the interventions seem to be primarily aimed at securing the lower-end skill-supply for their voice-based operations, thereby redirecting institutions to fulfill their short-term needs. This ‘institutional capture’ of the education sector by foreign investors is a pitfall of increased embeddedness, potentially leading to dependent development outcomes and presenting problems for a move into higher-skilled employment and upgrading into higher value-added services.

Chapter six analysed to what extent upgrading efforts into higher-skilled and higher value-added services have been successful in the offshore service sector in the Philippines. I showed that limited upgrading has taken place into higher-skilled services, which has mainly been driven by foreign actors instead of Philippine-owned firms. Captive shared service centres, especially, have been able to move into more knowledge-intensive segments of business process outsourcing. However, such firms have not changed their power position within their respective GPNs and functional upgrading into higher-revenue functions, as achieved by domestic-owned firms in the Indian offshore service sector, has not occurred. Instead, the findings showed that Indian firms are expanding investments into the Philippines, pointing towards emerging specialisations and a South-South division of labour in offshore service delivery.

**Impacts beyond the GPN: value capture and urban transformations**

Economic upgrading, or value enhancement, does not necessarily involve capturing value in the same location. Chapter seven addressed the issue of where value capture occurs and who is able to benefit locally from the rise of the offshore service sector. Mapping FDI in offshore services, I showed that firms are highly concentrated in urban service-based special economic zones. Employment opportunities are concentrated in urban areas, leading to an increasing urban-rural divergence of economic development as investment is heavily concentrated in already more-developed regions of the country, most prominently the National Capital Region. In Metro Manila, it is estimated that 13% of all formally employed
persons, in 2013, worked in the BPO sector. The redrawn geography of services therefore resembles not a flattened topography but rather a ‘spikey world’ (Florida, 2005).

Services offshoring to the Philippines largely follows the cost-saving rationale of firms based in the Global North. The savings, achieved through labour arbitrage, are not reinvested in the territories where they occur, but are often transferred to the headquarter location of the MNC. This corroborates Levy’s (2005) observation that offshoring makes it possible for value creation and value capture to occur in different places. SEZ incentives further enable the repatriation of profits to the Global North. The generous tax incentives for BPO firms limit government revenue to indirect tax collection, primarily in the form of income taxes and sales taxes on consumption (Mitra, 2011).

Chapter seven explained the rise of globalised enclaves as places for 24-hour production and consumption, modelled according to foreign investors’ home countries. The rise of the offshore service sector thereby leads to spatial transformations, which remain hidden in traditional GPN analysis. In the service-based SEZ spaces, the local beneficiaries of BPO become visible: the young, urban, well-educated workers, real-estate developers, telecommunications- and electricity companies, and mall operators. Domestic value capture is limited to two main groups: workers (through their salaries) and domestic elites (engaging in rent-seeking from foreign multinational corporations).

8.2 A new model of economic development?

To what extent is the emergence of the offshore service sector following a new model of economic development? This section contrasts the offshore service sector with earlier forms of export-oriented development based on manufacturing. Three similarities can be found: both are based on foreign investment, and in both cases ‘production’ takes place in special economic zones, and labour arbitrage forms the core rationale behind relocation. However, differences are discernible. First, offshore service industries generally employ a highly educated workforce, and for this reason are not only driven by cost competition. An important factor that influences companies’ choice of where to locate their operations is the quality of higher education available in the area, especially English-language skills. Second, the BPO phenomenon is office-based instead of factory-based, providing higher wages and better working conditions compared with manufacturing. These advantages, however, also make the sector less inclusive, unable to provide employment opportunities for unskilled agricultural labourers in the same way as the manufacturing sector promised to do.

In India, a fierce debate is taking place on the social inclusiveness of the offshore service sector. Some authors stress how existing spatial and social inequalities are sustained and reinforced by the sector (Dittrich, 2005; Krishna & Nederveen-Pieterse, 2008). Others argue that its role in advancing economic development is exaggerated (Chandrasekhar & Ghosh, 2008). Based on BPAP statistics of the size and sectoral concentration of the BPO sector in the NCR (in Mitra, 2013), and a labour force of 4.5 million in the NCR, according to the National Statistics Office.

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42 Based on BPAP statistics of the size and sectoral concentration of the BPO sector in the NCR (in Mitra, 2013), and a labour force of 4.5 million in the NCR, according to the National Statistics Office.
Conclusions

2006). Eichengreen and Gupta (2010), writing on India, state that both manufacturing and services employ increasingly skilled labour. Instead of seeing strategies of manufacturing- and service sector-led development as being contrasting, they believe both are compatible and can grow simultaneously. Economists in the Philippines also stress the importance of industry development in tandem with a booming services sector to allow the country to ‘walk on two legs’; the services sector alone seems unable to create sufficient employment opportunities, especially for less skilled workers, and to create inclusive economic growth (Usui, 2011; 2012).

The creation of domestic employment opportunities in the Philippines could lead to a reduction of overseas labour migration. Thereby, the offshore service sector could have a positive impact by reducing contract migration overseas, which involves considerable social costs to individuals and families (Rodriguez, 2010). BPAP launched a social-media campaign titled “work abroad, live here” to attract more workers into offshore service work (BPAP, n.d.). The campaign links the two main export-oriented economic development strategies of the Philippines and the resulting opportunities for labour: a decision between physical migration and “virtual migration” (Aneesh, 2006). So far, the first remains the favourite choice; remittance levels are increasing and the outflow of overseas workers has not decreased. In fact, preliminary evidence points to the fact that many BPO workers seem to see the sector as a ‘springboard’ for overseas employment, rather than as an alternative (Beerepoot & Hendriks, 2010). Thereby, a previous development strategy of the Philippines remains intact.

Also remaining unchanged are other, more structural conditions in the country, identified by political scientists as the main obstacle to economic development in the Philippines. Elite families and oligarchs continue their rent-seeking model using the new sector as a new source to be tapped. Instead of investing in new technology and productivity, they provide services in protected sectors, including banking, telecommunications, electricity and real-estate. The latter signifies a return to land ownership as the main source of profit, to the benefit of existing elite families (Cardenas, 2014).

Families are the most important unit of Philippine society, and elite families have been able to control economic and political power in the Philippines for a long time (McCoy, 1994). In 2011, the 40 richest families in the Philippines, according to the Forbes wealth list, together accounted for 76% of GDP growth; the highest income disparity in Asia (Agence France Presse, 2013). In 2012, a further concentration of wealth occurred, with an increase of 12% in total wealth recorded among the richest 50 families on the list over the previous year, bringing their collective wealth to to $74 billion (Forbes, 2014). The BPO sector has enabled the further concentration of wealth by elite families as indirect beneficiaries of the sector, especially in the fields of telecommunications and real-estate. In the first half of 2012, the real estate firm SMDC, owned by the Sy family (ranked in first position on the Forbes list for the Philippines), reported a net income of ₱2.7 billion, equalling a rise

43 Land ownership and political elites in the Philippines are often interlinked. Land conversion and real-estate developments are inherently political processes, requiring political power or the use of ‘grease money’ (Kelly, 1998; Magno-Ballesteros, 2000).
of 38% (Dumlao, 2012). In the first half of 2014, real-estate and telecommunication firms reported exorbitant profits44. These firms’ profits are strongly dependent upon income from foreign BPO investors. Interestingly, these elite family-dominated, domestic service support-sectors are also represented in the business association of the Philippines. Out of the eight members of the board of trustees, four represent the interests of real-estate and telecommunications conglomerates (BPAP, n.d.).

These actors fit precisely Studwell’s (2007) description of “Asian godfathers”, who refrained from developing export-oriented manufacturing firms and instead relied upon wealth extraction through a combination of political and economic power:

In this relationship, a political elite grants to members of an economic elite monopoly concessions, normally in domestic service industries, that enable the latter to extract enormous amounts of wealth, without a requirement to generate the technological capabilities, branded corporations and productivity gains that drive sustainable economic development (2007: xiii, emphasis added).

In this sense, the rise of the offshore service sector does not present a new model but rather a variation on a common theme. The nexus between real-estate and offshore services benefits the same actors (e.g. Megaworld), who had been at the verge of bankruptcy due to the overbuilding of residential and commercial property occurring in the wake of the Asian financial crisis (Bello, 2009: 103-106).

**Long-term growth prospects**

What long-term prospects for economic growth does the BPO sector present? The geographies of service delivery have become more dynamic and the number of countries trying to attract BPO investment is increasing, leading to competition in the sector. So far, the Philippines’ large English-speaking labour pool offers ‘scalability’ and competitive rates for voice-based service delivery. The Philippines is one of the only remaining countries within the region with a fast-growing population, leading to a continued abundance of labour for years to come, and thus creating downward pressure on wages. The rates, like all exports, are impacted by currency exchange rates. The low valuation of the Philippine peso is required to remain competitive as an exporter of services. The appreciation of the peso has worried foreign investors and stakeholders have lobbied the Philippine government to keep the peso undervalued, especially to remain competitive vis-à-vis India (Aquino & Batino, 2013; Noda, 2012). Foreign investments continue to be driven by efficiency-seeking and not asset-seeking; firms choose to set up offshore operations in the Philippines not because they are searching for better English-language skills than those found in their home countries; they are looking for comparable skills at lower costs.

44 The net income of Ayala Land rose by 25% to ₱7.1 billion, Globe Telecommunications’ net income rose by a staggering 385% to ₱6.8 billion (both owned by the Ayala family who rank ninth on Forbes list), Megaworld (fourth on Forbes list) increased its net income by 289% to ₱16.4 billion (Rappler, 2014).
The re-shoring of services to sender countries could change the geography of service delivery yet again. As the wage gap between developed and developing countries becomes lower due to stagnant wages in the Global North and rising wages in developing countries, the cost advantage of developing countries diminishes. Moreover, new delivery models involving even further decentralisation and lower wages, such as call-centre services being delivered from home-based individuals in the rural US, or competition from upcoming destinations like Kenya. Another threat to the industry comes from automation due to technological advances. Automation may affect different sectors and professions but is becoming increasingly visible in voice-based customer services. The economist Roubini (2014) argues in a recent blog article that “soon enough voice recognition software will replace the call centers of Bangalore and Manila”.

8.3 Lessons from the Philippine case

On the basis of this research, some tentative policy advice can be given. Three issues could be addressed by the Philippines in moving forward in offshore service delivery. First, large and successful Philippine-owned firms are currently absent in the Philippine BPO sector, a striking contrast to the Indian case. The existence of domestic-owned firms is an important determinant of local value- capture. Most Filipino companies in the offshore service sector occupy the lowest-end of the market, including insecure (and sometimes illegal) outbound call-centre operations. The most successful Filipino-owned firms, which stem from the early years of the country’s advance into BPO services, were taken over by larger foreign companies. The absence of powerful Philippine-owned BPO firms decreases the country’s opportunities for value capture and simultaneously makes the Philippines more dependent upon decisions taken in faraway headquarter locations. Efforts to stimulate domestic entrepreneurship and support locally owned small and medium enterprises are therefore important. These could involve incubator centres and entrepreneurship training in the start-up phase, but more importantly in the growth phase. Also, joint-ventures with foreign investors could be supported. In the past, many Philippine-owned companies were started up but then sold out to foreign firms once they reached a medium size. Providing stimulation for firms in terms of facilitated access to credit and opportunities to grow could help here.

The second policy area where government could reconsider its existing policies is in the subsidies provided to the offshore service sector. The Philippine government has been very supportive of the growth of the offshore service sector and provides generous incentives through its SEZ schemes. The necessity of providing continuous financial subsidies to the sector should be re-evaluated, since firms achieve large cost reductions due to the relocation of service activities. Asian Development Bank economist Usui (2012) estimates that redundant incentives provided to foreign investors have caused revenue losses of over 1% of GDP per annum. Likewise, the financial support given to commercial real-estate developers and existing property owners, who are among the richest families in the country, seems an unnecessary drain on state resources and an example of continuing rent-seeking behaviour by oligarchic elites.
Third, investments in the education system should be made to provide opportunities for advanced education of management staff and the creation of specialised professional skills. The findings of this research have shown that a skilled labour force is an important factor for attracting investments and moving up the value chain. Currently, existing policies and the intervention of foreign investors privilege the creation of only generic, lower-end skills, the ones required for mainly voice-based service delivery.

The findings on the Philippine experience can inform other countries that aim at creating a ‘knowledge-based economy’ on the basis of attracting FDI in offshore services. Although many countries have drawn inspiration from the example of India’s successful development of offshore services, India might present an extreme or unique case, which cannot easily be replicated by other countries. Instead, the Philippines’ lower-end integration into service-delivering GPNs on the basis of foreign-investment attraction might present a more exemplifying\(^{45}\) case.

The Philippines participates primarily in low-end export-oriented service delivery so far, based on attracting FDI, with only limited successful upgrading. The extent to which this strategy can lead to the creation of a ‘knowledge-based economy’ remains unclear. Developing countries, which aim at integrating into GPNs in offshore services, could learn from the Philippine experience about the challenges of a lower-end route of BPO service delivery based on foreign investors alone.

### 8.4 Revisiting GPNs

What lessons can be drawn from this study for the GPN framework? The main aim of this research has been to adapt and transform the heuristic GPN framework into an approach for empirically studying the offshore service sector. Although the framework provided a valuable lens through which to study the offshore service sector in the Philippines, it has been a difficult process to operationalise the broad framework for an empirical study. This, by itself, is an important step in advancing GPN research, as Henderson et al. state: “The proof of success […] will depend on whether the GPN framework stimulates research that delivers analyses that are both empirically and theoretically richer than at present” (2002: 458).

In general, the GPN approach does not discriminate between manufacturing- or service-production networks and its analytical concepts can be employed for studying services. The GPN approach has been a useful tool to empirically investigate the processes of sector emergence and evolution. In order to operationalise the GPN framework, it has been expanded with other literatures and concepts, sometimes in an ‘eclectic’ fashion, as advocated by previous authors (Dawley, 2011; Parrilli et al., 2013). The adaptation has helped to increase the usefulness of the framework for understanding ‘globalised’ regional development. The three main analytical concepts of power, embeddedness, and value, and the notion of strategic

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\(^{45}\) I follow Bryman (2008) here, who uses the term ‘exemplifying’ case; Yin (2009) refers to this as a ‘representative’ or ‘typical’ case.
coupling, have been instrumental in tracing the rise and expansion of complex GPNs in services and the changing international division of labour in the Philippines.

The findings also point at the asymmetric power relations and the possible uneven integration into GPNs by developing countries, in some instances similar to branch-plant economies, thereby adding to recent debates about the ‘dark side’ of GPNs (Coe & Hess, 2011; MacKinnon, 2012). Of importance for analysing developmental outcomes is the issue of entrepreneurship and firm nationality. Yeung (2014) shows how East Asian firms have become disembodied from ‘developmental state’ structures and re-embedded into GPNs. This strategy, however, presupposes the existence of locally owned firms able to take up technology and learn from lead firms in networks. In the Philippines, these highly competitive national firms have been absent, reducing the opportunities for knowledge spillovers to local firms, thereby diminishing opportunities for local value-capture.

The role of firms originating from the Global South in GPNs requires more research. Often, GPNs are organised with a clear North-South dimension, especially if cost reductions are a rationale for integrating new places into a production network. In offshore services, we can see the growing significance of lead firms stemming from South Asia. The emergence is noted of South-South production networks coordinated by Indian multinational corporations, which follow global delivery models with clients based in the Global North. Several Indian offshore-service firms have started to set up subsidiaries in the Global North. It would be valuable to explore in more detail the enabling conditions for firms from the Global South to assume the position of lead firms in GPNs.

It is important to keep in mind that GPNs are non-static and involve dynamic processes of coupling, recoupling and decoupling (MacKinnon, 2012). First coined in 2002, the GPN framework is still in its infancy and is still evolving. New publications aim to advance GPN research through the integration of labour, finance, and by outlining more dynamic GPN analyses (Coe & Hess, 2013; Coe, Lai & Wojcik, 2014; Coe & Yeung, 2015). This study has attempted to contribute to this growing field of research.

Apart from adapting the framework and eclectically combining it with existing literature to make it more applicable to empirical research, this study has shown that, on a theoretical level, the GPN framework is stronger in studying networks and weaker in assessing territorial economic development. The rise of globalised enclaves in urban agglomerations in the Philippines confirms the importance to analyse development in places (Kelly, 2013). GPNs, though inclusive of many different types of actors, have a blurred vision beyond the boundaries of the network. Actors that are not part of the actual networks, but crucial for their functioning and for issues of local value capture, may fall out of a GPN analysis. Recent endeavours have sought to include the financial sector in GPN analysis (Coe et al., 2014); the real-estate sector in the Philippines can function as another example.

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46 For example in the Netherlands and the US (Beerepoot, Roodheuvel & Jacob, 2014; The Economist, 2011).

47 As I write this conclusion, a new GPN research centre is being inaugurated at the National University of Singapore (see http://gpn.nus.edu.sg/). The centre’s aim is to advance scholarship on GPNs also in the future.
This research has shown that deeper-lying social and institutional structures significantly affect the outcomes of economic development. A powerful and deeply entrenched elite in the Philippines is able to engage in rent-seeking, even in relation to a rather new economic activity. Although the GPN framework affirms that the socio-spatial context influences the nature and articulation of GPNs (e.g. Coe et al., 2008: 289), the social embeddedness in long-standing (local) power structures remains under-theorised in current formulations of the framework. Path-dependent institutions and regional business systems48 are important factors for the nature and articulation of GPN integration and remain vital for explaining regional outcomes of development. The actor-centric analysis may benefit from a combination with political economy approaches investigating institutional structures, to arrive at a more realistic understanding of places in global networks.

8.5 Agenda for future research

The relatively recent phenomenon of the offshoring of services still requires more empirical research, including case studies on different sectors and the outcomes in different countries. Important questions not comprehensively addressed in this study focus on the experience of Indian and Filipino workers in the BPO sector. How inclusive is economic growth and who gets access to the new employment opportunities?

Researchers are currently probing deeper into the dynamics of inclusion and exclusion of the BPO sector in India and the Philippines. Are employment opportunities in the sector open to different groups of people or are they reserved for existing middle classes (Sandhya Krishnan)? Do graduates from different castes and minority groups in India get access to BPO employment (Al James, Fiona McConnell and Philippa Williams)? How can work in the BPO sector strengthen the employability of workers in internal- and external labour markets (Leian Marasigan)? And what indirect employment and business opportunities are created in support services for BPO firms, in the fields of security, facilities management and transportation (Randhir Kumar)? Outcomes of these research projects will give more insights into inclusive growth as a result of services offshoring.

8.5.1 Equality and growth

Despite high GDP growth in the Philippines over the past years, unemployment remains problematically high. Some 28% of the population lives below the poverty line, a figure that has remained stable since 2006 (NSCB, 2013). In a survey conducted in December 2013, 55% of Filipinos found their quality of life had decreased over the past year (Philippine Daily Inquirer, 2014). Although the BPO sector primarily employs workers with tertiary education, a ‘trickle-down’ of workers’ salaries towards other sectors may be envisioned to benefit other segments of society. According to BSP data, the average monthly BPO

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48 A discussion of regional business systems in the Philippines is offered by Van Helvoirt (2009).
salary in Metro Manila in 2012 was $737 in 2012, sparking high consumption growth in the Philippines (Chan, 2014). The young workforce spends a considerable share of its income on consumption in the local economy, supporting the residential property market, as well as food and beverage industries, transport, tourism, communications and retail (Tajon & Leynes, 2012), thereby increasing the overall size of the service economy (Mitra, 2013). Most of these sectors are dominated by large Philippine-owned conglomerates. More research can be done consumption expenditures of BPO workers in the Philippines, in conjunction with Sandhya Krishnan’s ongoing research on the spending patterns ‘new middle classes’ of offshore service workers in Mumbai.

More research is needed on the indirect effects of the BPO sector. Mitra (2011) reports an estimated ‘multiplier effect’ of 2.5 indirect jobs created per FTE in the BPO sector in the Philippines. The types of jobs and conditions of employment created require further analysis. Do we witness employment growth in a ‘services underclass’ of low-paid restaurant workers, drivers, security guards, cigarette vendors, and others, who form the counterpart to the relatively high-paid ‘cognitive-cultural’ or professional service workers, not unlike service sector patterns observed in metropolitan areas of the US (Scott, 2012)?

8.5.2 Real-estate and enclave-based economic growth in the Philippines

Based on the empirical findings from the Philippines, I identify two directions for further research to assess new forms of service-based economic development, which are interrelated with offshore service delivery in the Philippines. First, I argue that the rise of enclave spaces as topographies of economic development requires a better understanding. Second, the nexus between real-estate and the offshore service sector identified in this study leads to questions on the role of the real estate sector’s role as a driver of economic growth.

Future research is recommended to delve further into economic development strategies based on the creation of globalised enclave spaces, which proliferate in the Philippines in the form of gated communities, SEZs, international hospitals and residences for health- and retirement tourism, all-inclusive tourism enclaves, and casinos. These enclave spaces, primarily urban phenomena, are not only increasing the pre-existing urban-rural economic divides but also presenting sharp new boundaries around global capital and the local economy within cities. Understanding the different forms of economic enclaves in the Philippines, existing also in the tertiary sector, is important for analysing the uneven outcomes and both ‘dark’ and ‘bright’ sides of participation in GPNs. In general, more comparative research is needed into the different types of contemporary enclaves characterising production in different industries, to understand the consequences and local outcomes of GPN integration (Phelps, Atienza & Arias, forthcoming). The role of the stakeholders involved in their creation, especially the real-estate sector building these environs, also requires more attention in the future.

Additional research would be helpful to further elucidate the role of real-estate as a driver of economic growth. The high GDP growth rates in the services component in the Philippines is not only derived from offshore service investment; current economic growth
rates in the Philippines are also influenced by a real-estate construction boom. Commercial property development is primarily driven by (expected) demand from foreign investors in the BPO sector, and BPO workers’ salaries (in addition to remittances received from overseas) are channelled into new residential real-estate projects (Colliers International, 2012). Overdevelopment of high-end commercial property and luxurious residential condominiums could lead to an overheating of the economy, and unregulated real-estate growth financed by high borrowing (which increased by 45% in 2013) and shadow banking could lead to a bubble (Colombo, 2013; World Bank, 2014). The dynamics in motion are not unlike the run-up to the Asian crisis and its boom-to-bust journey, which was fuelled by cheap credit and speculative real-estate investment, with disastrous economic consequences.

8.6 Final observations

‘Miracle’ economies, a favourite theme of economists studying Asia, seems to be a far-fetched description when observing the empirical process of the emergence of the offshore service sector on the ground. Traditional economic development ‘models’ have been in crisis for some time; import-substitution policies and attempts at autarky did not lead to rapid industrialisation; export-oriented manufacturing industries in many cases led to short-lived employment creation based on lower-cost labour alone. Services, as a new driver of export-oriented development, present opportunities for economic growth and employment creation. However, deep-rooted structures of inequality and rentier capitalism in the Philippines are hard to break, and it seems that the offshore service sector, despite lifting the international profile of the country and its investment rating, has not made a dent in these underlying structures.

Achieving economic development in a globalising world will depend increasingly on how to find niches in GPNs that are continuously evolving, both functionally and spatially. The opportunity to switch production volumes between different regions, and their workforces, through strategies of dual- or multiple sourcing is an example of how space is not only socially constructed, but how social processes are constructed over space (Massey, 1984: 56). The vertical disintegration of GPNs in service delivery and their expansion around the globe to include ever-new frontier spaces leads to profound changes in places that couple or decouple from (service) production processes.
References


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# Appendix

## List of interviews in the Philippines

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## Appendix

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## List of interviews in India

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<td>Chief People Officer (Head HR), former foreign-owned BPO (now Indian-owned)</td>
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Expanding Global Production Networks: The emergence, evolution and developmental impact of the offshore service sector in the Philippines

Contemporary globalisation is characterised by an expansion of global production networks in services. Developments in information and communications technology have enabled the relocation of services across national borders, or, the offshoring of services. This has had profound implications for where in the world services are produced and where service employment is generated. Scholars assume that a changing international division of service labour presents an important opportunity for developing countries to achieve economic development on the basis of exporting services, but empirically grounded studies from the perspective of developing countries are still scarce.

India is a well-known case of a country that achieved growth in the offshore service sector. This research examines the less-explored case of the Philippines, a country that employs close to one million workers in its business process outsourcing (BPO) sector. This study observed the integration of the Philippines into global networks of service delivery. It explored, how and why the offshore service sector in the Philippines has emerged, how it has evolved, and how it impacts economic development.

In addressing these questions, the global production network (GPN) approach is used as a theoretical framework. The framework was developed by economic geographers based in Manchester, as an advancement of the global value chain (GVC) and global commodity chain approaches to understand complex processes of contemporary globalisation and their regional outcomes on economic development. The heuristic GPN framework examines inter- and intra-firm relations and takes into consideration the role of non-firm actors in the Global North and the Global South. This dissertation contributes to a better understanding of contemporary processes of economic globalisation and expands economic geographical research on GPNs in services.

I argue that the GPN framework provides a valuable lens to analyse contemporary global production processes and regional development. However, it needs to be complemented with insights from other literatures in order to operationalise its concepts and make the framework more applicable to explaining contemporary processes of service delivery. This study expands the GPN framework from its earlier focus on industrial-production processes to services. Moreover, I combine and refine its three main analytical categories of power, embeddedness and value through a combination with concepts and insights from other literatures.

The empirical findings contribute to debates about economic development through the exporting of services. In this way, the findings can inform economic geographers, as well as international development- and urban-studies scholars, as the processes analysed are distinctly embedded in urban areas. Beyond academic debates, the findings are relevant to policy-makers situated in the Philippines and in other countries in the Global South who aim to attract offshore service sector investments and build a service-export sector.

The findings are primarily based on a qualitative case study of the offshore service sector in the Philippines. I conducted extensive fieldwork in Metro Manila and several second-
tier cities across the Philippines between 2011 and 2013. Data was collected through 106 in-depth open and semi-structured interviews, a survey among BPO firms, the analysis of secondary sources, and personal observations. In addition, I carried out several months of fieldwork in India, yielding 21 interviews in the cities of Mumbai and Pune. Understanding the workings of the sector in India provided a reference case and helped to place the findings from the Philippine case study in a broader perspective.

The dissertation follows an article-based format and is structured around six stand-alone empirical chapters, each using a key concept of the GPN framework in combination with other literature. Chapters two and three deal with the emergence of the offshore service sector and analyse the processes of ‘strategic coupling’ of regions and GPNs. Chapter four maps the position and functions of offshore service firms and branch offices in the Philippines and analyses the distribution of corporate power in global production networks. Chapters five and six discuss the evolution of the sector. Are firms becoming increasingly territorially embedded over time, or do they remain footloose? And are firms moving up the value chain into higher value-added services, or do they remain limited to delivering lower-end services? Finally, Chapter seven refocuses attention on urban changes as a result of the rise of the offshore service sector, relating back to questions of local value-capture and regional development. The findings of these chapters are summarised in the following.

Emergence: Foreign direct-investment attraction and strategic coupling

Chapter two: Why did India and the Philippines become integrated into GPNs of service delivery and what are crucial differences and similarities?

India is a forerunner of offshore service-delivery and became integrated into GPNs in services since the 1980s, whereas the experience of the Philippines is more recent. The GPN framework uses the concept of strategic coupling to explain the emergence of a particular sector through the result of linking a region’s assets with the needs of GPNs. Several important differences in regional assets precede the emergence of the offshore service sector in both countries and have set India and the Philippines on different trajectories. The offshore service sector depends, above all, on the availability of skilled labour; therefore, differences between the education systems and skill-sets of the labour force are important explanatory factors. In India, technical education has been prioritised, and firms are therefore able to deliver not only more standardised BPO services, but also information technology and knowledge-intensive services. In the Philippines, the country’s comparative advantage has mainly centred on its people’s English-language skills and ‘neutral’ accents. Thus, the predominant share of services are voice-based customer-service activities. Second, the BPO sector in the Philippines is largely based on exporting services through foreign-owned firms’ subsidiaries, whereas in India, large Indian-owned firms have been a driving force of the sector. In the Philippines, domestic entrepreneurs have been largely absent, or delegated to the lowest ranks of service delivery. Third, in contrast to the Philippines, many Indian entrepreneurs have benefited from diaspora networks and returnee migrants constitute an important link between clients’ markets and India-based offshore service firms.
Chapter three: What role have local institutional actors played in facilitating the strategic coupling of second-tier cities in the Philippines with offshore service sector investors?

As foreign investors explore new frontiers, they have expanded their reach to incorporate provincial cities into their GPNs. Chapter three analysed the role of local institutional actors in facilitating the strategic coupling of second-tier cities in the Philippines with offshore service sector investors through a contrasting case study of the cities of Baguio and Bacolod. In addition to regional assets, the agency of local coalitions for inward-investment attraction influences and co-shapes the integration of places into global service-delivery networks. Combining the concept of ‘strategic coupling’ with earlier literature on investment attraction, this chapter showed how local institutional actors are complicit in processes of globalisation and can play an important role in attracting investment in BPO, a first step to achieve economic development through the integration into GPNs. For assessing developmental outcomes, it is important to consider the position that firms and subsidiaries operating in the Philippines occupy within these networks.

Positioning firms and cities in global production networks

Chapter four: What (power) position occupy firms in Metro Manila and second-tier cities in the Philippines in GPNs in services?

Chapter four mapped existing offshore service-delivery networks from the perspective of actors in the Philippines to analyse power relations in these networks. The chapter combines the GPN framework with indicators from the older branch-plant literature to assess dependent or developmental outcomes. Findings from qualitative interviews with firms in Metro Manila and three second-tier cities show that branch-plant economies result. In particular, second-tier cities occupy low-end functions and are dependent on decisions taken elsewhere. The functional and spatial disintegration of value chains through outsourcing increases the number of actors involved in decision-making, with subsidiaries in the Philippines often remaining the lowest-ranking unit in power relations. As global outsourcing firms often operate as multinational corporations with office networks spanning the globe, the Philippine operations are just one of many locations within the GPNs of service delivery. Offshore service sector hubs are susceptible to global competition and ‘switching’ between subsidiaries can occur relatively easily, especially in low-end services production. Since GPNs are dynamic, firms may increase their embeddedness and upgrade into higher-end services to avoid these challenges.

Evolution: Increasing territorial embeddedness and upgrading into higher-end services?

Chapter five: How do foreign investors in offshore services gain access to skilled labour, what kind of industry-academe linkages are formed, and what are their implications for economic development?

The evolution of the offshore service sector in the Philippines is addressed in Chapters five and six. Increasing territorial embeddedness in offshore services is more difficult compared to manufacturing, because BPO firms require fewer relations with local firms for sourcing
their inputs. The most important local asset in the production process of offshore services is skilled labour. Securing access to labour is an avenue for foreign-owned BPO firms to become more territorially embedded. Chapter five investigates the development of linkages between BPO firms and universities. The findings show that many foreign investors have developed linkages with the education sector, thereby investing in longer-term relations in the host territory and increasing their embeddedness. Industry-academe collaboration are part of active-embedding strategies by foreign investors. The interventions, however, have been primarily aimed at securing the lower-end skill supply for their voice-based operations, thereby redirecting institutions to fulfil companies’ short-term needs. This ‘institutional capture’ of the education sector by foreign investors is a pitfall of increased embeddedness, potentially leading to dependent development-outcomes and presenting problems for a move into higher-skilled employment and upgrading into higher value-added services.

Chapter six: To what extent has upgrading into higher-end services in the offshore service sector been achieved in the Philippines and India?

Chapter six analysed to what extent upgrading efforts into higher-end services have been successful in the Philippines and India. The chapter distinguished between ‘product’ upgrading into higher-skilled and more knowledge-intensive functions and ‘functional’ upgrading into higher revenue-generating functions in the offshore service sector. It showed that limited upgrading has taken place into higher-skilled services, which has mainly been driven by foreign actors instead of Philippine-owned firms. Captive shared service centres, especially, have been able to move into more knowledge-intensive segments of business process outsourcing. However, firms in the Philippines have not changed their power position within GPNs. Functional upgrading into higher-revenue functions, as achieved by domestic-owned firms in the Indian offshore service sector, has not occurred. A comparison of the upgrading trajectories in India and the Philippines points towards emerging specialisations and an unfolding Indian-Philippine (South-South) division of labour.

Implications: Urban transformations and the rise of service-based special economic zones

Chapter seven: Which urban transformations occur as a result of offshore service sector attraction and who benefits locally from the rise of service-based special economic zones?

Chapter seven maps the location of offshore service investments on a national and regional level and traces the genesis of service-based special economic zones (SEZs), which combine functions of service delivery for global markets with increasingly globalised consumption patterns. These zones arise due to the location-choice factors of foreign investors in services offshoring, who require skilled labour and prefer modern and secure environments. Changing government policies on spatial zoning have facilitated the rise of these SEZs in central business districts in Metro Manila. Existing, powerful real-estate developers have not only enabled this development, but are also the primary local beneficiaries of the offshoring of services. This chapter argues that rise of the offshore service sector in the Philippines has led to the construction of ‘islands of globalisation,’ globalised enclaves as places for 24-hour
production and consumption, modelled according to the lifestyle and consumption pattern of foreign investors’ home countries. These urban transformations and spatial outcomes of the offshore service sector tend to be overlooked in traditional GPN analysis.

Expanding global production networks in services: A new ‘model’ of development?

To what extent is the emergence of the offshore service sector following a new model of economic development? Three similarities with earlier export-manufacturing development strategies can be found: 1) both are based on foreign direct investment, 2) in both cases ‘production’ takes place in special economic zones, and 3) labour arbitrage forms the core rationale behind offshoring. However, several differences are discernible. The offshoring of services generally employs high-educated labour, and is not only driven by cost competition, meaning that skills are an important location factor. The phenomenon is office-based instead of factory-based, and in general firms provide higher wages and better working conditions compared to industrial production. These advantages also make the sector less inclusive, unable to provide employment opportunities to excess agricultural labour, as higher education and especially English language are prerequisites. The geographies of service delivery have become more dynamic and the long-term growth prospects of the BPO sector in the Philippines are affected by rising competition from other developing countries, efforts of re-shoring services to home countries, and automation processes.

On the basis of this research, some tentative policy advice can be given. The absence of powerful Philippine-owned BPO firms decreases opportunities for value capture in the Philippines and simultaneously makes the Philippines more dependent upon decisions taken in faraway headquarter locations. Efforts to stimulate domestic entrepreneurship and support locally owned small and medium enterprises are therefore important. Investment in the education system should be made to provide opportunities for advanced education of management staff and the creation of specialised professional skills. The findings have shown that a skilled labour force is an important factor for attracting investments and moving up the value chain. Currently, existing policies and the intervention of foreign investors privilege the creation of generic lower-end skills required for voice-based service delivery.

The findings on the Philippine experience can inform other countries that aim at creating a ‘knowledge-based economy’ on the basis of attracting foreign direct investment in offshore services. Although many countries have drawn inspiration from the example of India's successful development of offshore services, India may present an extreme or unique case, which cannot easily be replicated by other countries. In fact, the Philippines lower-end integration into GPNs of service delivery on the basis of foreign investment might present a more exemplifying case.

On a theoretical level, this dissertation has contributed to expand the GPN framework by adapting and eclectically combining with existing literature to operationalise its analytical categories for empirical research on services. The analysis of asymmetric power relations and the possible uneven integration into GPNs by developing countries, in some instances similar to branch-plant economies, contributes to recent debates about the ‘dark side’ of GPNs. Moreover, this study has shown that the GPN framework is stronger in studying networks and
weaker in assessing territorial economic development. The rise of globalised enclaves in urban agglomerations in the Philippines confirms the importance to analyse development in places.

This research has demonstrated that deeper-lying social and institutional structures significantly affect the outcomes of economic development. Next to workers, the oligopolistic real-estate sector in the Philippines has been identified as one of the main local beneficiaries of the rise of the offshore service sector. This shows that a powerful and deeply entrenched elite is able to engage in rent-seeking, even in relation to a rather new economic activity. Although the GPN framework affirms that the socio-spatial context influencing the nature and articulation of GPNs, the social embeddedness into long-standing (local) power structures remains under-theorised in current formulations of the framework. Path-dependent institutions and regional business systems are important factors regarding the nature and articulation of GPN integration and therefore remain vital for explaining outcomes of development at regional level. The actor-centric analysis may benefit from a combination with political economy approaches investigating institutional structures, to arrive at a more realistic understanding of places in global production networks.
Nederlandse samenvatting

De uitbreiding van wereldwijde productienetwerken: De opkomst, ontwikkeling en invloed van de offshore dienstensector in de Filippijnen

De huidige mondialisering wordt gekenmerkt door een uitbreiding van wereldwijde productienettenwerken in de dienstensector. Ontwikkelingen in de informatie- en communicatietechnologie hebben een verplaatsing van diensten naar het buitenland mogelijk gemaakt. Dit heeft verregaande gevolgen gehad voor zowel de locatie waar diensten in de wereld geproduceerd werden, als voor de locatie waar werkgelegenheid in de dienstensector ontstaat. Wetenschappers gaan er tot nog toe van uit dat de internationale arbeidsverdeling in de dienstensector belangrijke mogelijkheden biedt voor ontwikkelingslanden om economische ontwikkeling te creëren op basis van het exporteren van diensten, maar empirisch gefundeerde studies vanuit het perspectief van die ontwikkelingslanden zijn nog steeds schaars.

India is een bekend voorbeeld van een land dat groei in de offshore dienstensector gerealiseerd heeft. Dit onderzoek richt zich op de minder bekende casus van de Filippijnen, een land dat nog weinig onderzocht is op het gebied van offshore dienstensector, terwijl het bijna een miljoen werknemers heeft in de business process outsourcing (BPO) sector. Dit proefschrift concentreert zich op de integratie van de Filippijnen in de wereldwijde productienetwerken van de dienstensector. Het onderzoek richt zich op de vraag waarom en hoe de offshore dienstensector in de Filippijnen is ontstaan, hoe het zich verder heeft ontwikkeld, en hoe dit de economische ontwikkelingen in de Filippijnen heeft beïnvloed.

Bij het aanpakken van deze vragen is het global production network, oftewel, het ‘wereldwijde productienetwerk’ (WPN), als raamwerk gebruikt voor het theoretisch kader. Dit kader werd ontwikkeld door economische geografen gevestigd in Manchester. Zij zochten een beter instrument dan de wereldwijde waardeketen (global value chains), om complexe processen van de hedendaagse globalisering en hun regionale uitkomsten op economische ontwikkeling te kunnen begrijpen. Het heuristische WPN-kader richt zich op relaties tussen en binnen bedrijven in het mondiale Noorden en het Zuiden, en houdt daarbij ook rekening met de rol van actoren buiten het directe productieproces. Met dit proefschrift wordt getracht meer grip te krijgen op de hedendaagse processen van economische globalisering en tevens het economisch-geografisch onderzoek naar de WPN’s in de dienstensector uit te breiden.

Ik betoog dat het kader van het ‘wereldwijde productienetwerk’ een nuttig middel is om zowel hedendaagse mondiale productieprocessen als regionale ontwikkeling te analyseren. Echter, dit kader moet worden uitgebreid met inzichten uit andere literatuur om concepten te operationaliseren en meer van toepassing te maken op het onderzoek naar fenomenen uit het dagelijkse leven. In deze studie wordt het WPN-kader uitgebreid, waarbij, in tegenstelling tot de eerdere focus op industriële productieprocessen, nu de aandacht uitgaat naar diensten. De drie belangrijkste analytische categorieën van het WPN (macht, inbedding en waarde), worden bestudeerd en uitgebreid door middel van een combinatie van inzichten en concepten uit andere literatuur.
De empirische bevindingen van deze studie dragen bij aan de discussies over economische ontwikkeling door middel van diensten-export en kunnen van belang zijn voor economisch geografen, ontwikkelingsstudies en experts op het gebied van urban studies, omdat de geanalyseerde processen duidelijk ingebed zijn in stedelijke gebieden. Behalve in academische debatten, zijn de bevindingen relevant voor beleidsmakers in de Filippijnen en andere ontwikkelingslanden die trachten investeringen aan te trekken en een offshore dienstensector op te bouwen.


De dissertatie is gebaseerd op artikelen en is gestructureerd rond zes afzonderlijke empirische hoofdstukken, die elk een sleutelbegrip van het WPN raamwerk uitwerken in combinatie met andere literatuur. Hoofdstukken 2 en 3 hebben betrekking op de opkomst van de offshore-dienstensector en analyseren de processen van strategische koppeling van regio’s met WPN. Hoofdstuk 4 brengt de positie van offshore dienstverlenende bedrijven en vestigingen in de Filippijnen in het netwerk in kaart en analyseert de machtsrelaties tussen bedrijven in het netwerk. Hoofdstuk 5 en 6 bespreken de ontwikkeling van de sector. Worden bedrijven door de tijd heen steeds meer territoriaal ingebed of blijven ze footloose? En klimmen bedrijven omhoog in de waardeketen tot diensten met hogere toegevoegde waarde of blijven ze beperkt tot het leveren van lagere diensten? Hoofdstuk 7, tot slot, richt de aandacht op de stedelijke veranderingen als gevolg van de opkomst van de offshore-dienstensector, met betrekking op wie er lokaal van de uitbreiding van WPN profiteert en wat dit betekent voor regionale ontwikkelingsdoeleinden. De bevindingen van deze hoofdstukken kunnen als volgt samengevat worden:

De opkomst: Directe buitenlandse investeringen en strategische koppeling
Hoofdstuk 2: Waarom zijn India en de Filippijnen geïntegreerd geraakt in wereldwijde productie-netwerken van dienstverlening en wat zijn de cruciale verschillen en overeenkomsten? India is een voorloper in de offshore dienstverlening en raakte sinds de jaren '80 van de vorige eeuw in WPN's van diensten betrokken. De ervaring van de Filippijnen op het gebied van deze sector is recent. Het concept van 'strategische koppeling' verwijs naar de koppeling van de plaats-specifieke voordelen van een regio met de behoeften van de bedrijven in het WPN. Een aantal belangrijke verschillen in deze locatiespecifieke voordelen in India en de Filippijnen hebben ervoor gezorgd dat de twee landen zich op verschillende trajecten richten. Belangrijke verschillen tussen de twee landen zijn de onderwijsystemen en de vaardigheden van de beroepsbevolking. Deze verklaren de verschillen in de beschikbaarheid
van een geschoolde beroepsbevolking, waar de offshore dienstensector voor een groot deel van afhankelijk is. In India heeft technisch onderwijs prioriteit gekregen en bedrijven zijn daardoor in staat om een mix van informatietechnologie, kennisintensieve diensten, en gestandaardiseerde business process outsourcing services te leveren. In de Filippijnen is het comparatieve voordeel van het land voornamelijk gebouwd op Engelstalige vaardigheden met ‘neutrale’ accenten. Daarom bestaat het overgrote merendeel van de diensten uit op taal gebaseerde customer service activiteiten. Ten tweede zijn binnenlandse ondernemers in de Filippijnen grotendeels afwezig geweest, of zijn gedelegeerd aan de laagste rangen van de dienstverlening. De BPO-sector in de Filippijnen is grotendeels gebaseerd op diensten-export via dochterondernemingen van buitenlandse bedrijven, in tegenstelling tot India waar grote Indiase bedrijven een drijvende kracht voor de sector zijn geweest. Ten derde, in tegenstelling tot de Filippijnen, hebben veel Indiase ondernemers geprofiteerd van diaspora netwerken en spelen teruggekeerde migranten een belangrijke rol als schakel tussen de markt van klanten en in India gevestigde offshore-dienstverlenende bedrijven.

Hoofdstuk 3: Welke rol hebben de lokale institutionele actoren gespeeld in de strategische koppeling van regionale steden in de Filippijnen met investeerders van de offshore-dienstensector?
Toen buitenlandse investeerders nieuwe grenzen verkenden, hebben ze hun werkterrein uitgebreid naar provinciale steden om deze op te nemen in hun WPN. In hoofdstuk drie wordt de rol geanalyseerd van lokale institutionele actoren in de strategische koppeling van regionale steden in de Filippijnen met investeerders van de offshore-dienstensector. Dat wordt gedaan door middel van een contrasterende case studie van de steden Baguio en Bacolod. In aanvulling op regionale locatie-specifieke voordelen, beïnvloeden lokale coalities het aantrekken van inkomende investeringen van de plaatsen in het WPN van dienstverlening. Door een combinatie van het WPN-concept van de ‘strategische koppeling’ met eerdere literatuur over het aantrekken van buitenlandse investeringen laat dit hoofdstuk zien hoe de lokale institutionele actoren bijdragen aan processen van globalisering en een belangrijke rol kunnen spelen in het mogelijk maken van BPO investeringen. Het aantrekken van buitenlandse investeringen en de opkomst van de BPO-sector kunnen gezien worden als een eerste stap in de verwezenlijking van economische ontwikkeling door middel van integratie in het WPN. Om de mogelijke implicaties van deze integratie voor economische ontwikkelingen te beoordelen, is het van groot belang om de positie van BPO-bedrijven in WPN te analyseren.

De positie van bedrijven en steden in wereldwijde productienetwerken
Hoofdstuk 4: Welke (machts)positie en functies bezetten de ondernemingen in Metro Manila en regionale steden in de Filippijnen in de wereldwijde productienetwerken van diensten?
Hoofdstuk vier brengt bestaande netwerken van dienstverlening vanuit het perspectief van actoren in de Filippijnen in kaart, om machtsverhoudingen in deze netwerken te analyseren. Het hoofdstuk combineert het WPN-raamwerk met indicatoren van de oudere ‘branch plant’ literatuur om de resultaten voor economische ontwikkeling te beoordelen. Bevindingen uit kwalitatieve interviews met bedrijven in Metro Manila en drie regionale
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steden laten zien dat in het bijzonder de kleinere steden aan het syndroom van 'branch-plant economieën' lijden, omdat zij afhankelijk zijn van beslissingen die elders genomen worden. De functionele en ruimtelijke desintegratie van de waardeketen door outsourcing verhoogt het aantal actoren dat betrokken is bij de besluitvorming. De Filippijnse operaties vormen vaak de laagste-ranking-eenheid in de machtsverhoudingen. Omdat wereldwijde outsourcing bedrijven vaak opereren als multinationals met netwerken van kantoren verspreid over de hele wereld, zijn de Filippijnse operaties slechts een van vele locaties binnen het WPN van dienstverlening. Offshore dienstensector hubs zijn gevoelig voor de wereldwijde concurrentie en 'schakelen' tussen dochterondernemingen kan relatief eenvoudig plaatsvinden, vooral in low-end services productie. Aangezien wereldwijde productienetwerken dynamisch zijn kunnen bedrijven hun lokale inbedding kunnen verhogen naar hogere diensten om deze uitdagingen het hoofd te bieden.

De ontwikkeling: Het verhogen van de territoriale inbedding en het upgraden naar meer kennisintensieve en hoogwaardige diensten?

Hoofdstuk 5: Hoe krijgen buitenlandse investeerders in de offshore dienstensector toegang tot geschoolde arbeidskrachten, wat voor soort verbanden worden er gevormd tussen BPO-bedrijven en onderwijsinstellingen, en wat zijn de gevolgen daarvan voor de economische ontwikkeling? De evolutie van de BPO-sector in de Filippijnen werd behandeld in hoofdstuk vijf en hoofdstuk zes. Toenemende territoriale inbedding is moeilijker te bereiken in de offshore dienstensector in vergelijking met de industriële productie, omdat BPO-bedrijven minder relaties met en input van lokale bedrijven vereisen. Het belangrijkste lokale voordeel in het productieproces van offshore diensten zijn geschoolde arbeidskrachten. Ervoor zorgen dat er voldoende toegang is een mogelijkheid om de territoriale inbedding van buitenlandse BPO-bedrijven te garanderen. Daarom wordt in hoofdstuk vijf dieper ingegaan op de ontwikkeling van verbanden tussen BPO-bedrijven en onderwijsinstellingen. De resultaten toonden aan dat veel buitenlandse investeerders banden hebben ontwikkeld met de onderwijssector, waardoor bedrijven investeren in lange termijn relaties en toenemende territoriale inbedding ontstaat.

Samenwerking tussen bedrijfsleven en onderwijsinstellingen zijn onderdeel van actieve inbeddingsstrategieën van buitenlandse investeerders. De interventies zijn vooral gericht op het veiligstellen van lager geschoolde vaardigheden voor hun callcenter diensten, waardoor bedrijven indirect hun behoeften op korte termijn kunnen voldoen. Deze ingreep in het onderwijs door buitenlandse investeerders is een valkuil van verhoogde inbedding, die kan leiden tot afhankelijke uitkomsten voor economische ontwikkelingen. Verder kan het probleem voortduren voor een overstap naar hoger gekwalificeerde arbeid en het upgraden naar diensten met hogere toegevoegde waarde.

Hoofdstuk 6: In hoeverre kan het upgraden naar hogere diensten in de offshore dienstensector bereikt worden in de Filippijnen en in India?

Hoofdstuk zes analyseert in hoeverre de opwaardering naar hoger geschoolde diensten en diensten met een hogere toegevoegde waarde succesvol is geweest in de offshore-dienstensector.
in de Filippijnen en in India. Het hoofdstuk maakt onderscheid tussen ‘product’ upgraden naar hoger geschoolde en meer kennisintensieve functies, en ‘functioneel’ upgraden naar hogere omzet-genererende functies in de BPO sector. Daaruit bleek dat er beperkte opwaardering heeft plaatsgevonden naar hoger geschoolden diensten, die voornamelijk werd gedreven door buitenlandse actoren in plaats van door Filippijnse bedrijven. Vooral dochterondernemingen in shared service centers zijn in staat geweest om meer kennisintensieve segmenten van de BPO sector te laten groeien. Echter, de ondernemingen in de Filippijnen zijn niet veranderd van machtspositie binnen het WPN. Functioneel upgraden naar functies met een hogere omzet, zoals dat is gerealiseerd door de Indiase bedrijven in de Indiase offshore-dienstensector, heeft niet plaatsgevonden in de Filippijnen. Een vergelijking van de upgradings trajecten in India en de Filippijnen wijst in de richting van opkomende specialisaties en het ontvouwen van een Indische-Filippijnse arbeidsverdeling.

De invloed: Stedelijke transformaties en de opkomst van de service-gebaseerde speciale economische zones

Hoofdstuk 7: Welke stedelijke transformaties treden op als gevolg van het aantrekken van de BPO-sector en wie profiteert ter plaatse van de opkomst van speciale economische zones voor diensten in steden?

Hoofdstuk zeven brengt de locatie van BPO investeringen op nationaal en regionaal niveau in kaart en schetst de ontstaansgeschiedenis van speciale economische zones (SEZ) voor diensten, die de functies van de dienstverlening voor de wereldwijde markten combineren met steeds meer geglobaliseerde consumptiepatronen. Deze SEZ voor diensten ontstaan als gevolg van factoren van locatiekeuze van buitenlandse BPO investeerders, die geschoolde arbeidskrachten nodig hebben en een voorkeur hebben voor moderne en beveiligde omgevingen. Het veranderen van het overheidsbeleid op de ruimtelijke zonering vergemakkelijkt de opkomst van deze speciale economische zones in zakencentra in Metro Manila. Bestaande machtige vastgoedontwikkelaars maken deze ontwikkeling niet alleen mogelijk, maar zijn ook de primaire lokale begunstigden van dit kenmerk van de hedendaagse globalisering. De opkomst van de offshore-dienstensector in de Filippijnen heeft geleid tot de bouw van de ‘eilanden van de globalisering’: geglobaliseerde enclaves voor 24-uurs productie en consumptie, gemodelleerd volgens thuislanden van de buitenlandse investeerders. Deze stedelijke transformaties en ruimtelijke uitkomsten van de offshore-dienstensector worden vaak over het hoofd gezien in een traditionele WPN analyse.

De uitbreiding van de wereldwijde productienetwerken in diensten: Een nieuw ‘model’ van ontwikkeling?

In hoeverre creëert de opkomst van de offshore-dienstensector een nieuw model van economische ontwikkeling?

Drie gelijkenissen met eerdere export-productie ontwikkelingsstrategieën kunnen worden aangemerkt: (1) beide zijn gebaseerd op directe buitenlandse investeringen, (2)
'productie' in beide gevallen vindt plaats in speciale economische zones en (3) loonkosten arbitrage vormt de grondgedachte achter verplaatsing. Echter, een aantal verschillen zijn waarneembaar. Diensten offshoring telt over het algemeen een hoger opgeleide beroepsbevolking, en wordt niet alleen gedreven door kosten-concurrentie, omdat ook vaardigheden en belangrijkevestigingsfactor zijn. Bedrijven gebruiken kantoren in plaats van fabrieken en verstrekken over het algemeen hogere lonen en betere arbeidsomstandigheden in vergelijking met de industriële/verwerkende productie. Deze voordelen maken ook de sector minder toegankelijk. Zij zijn niet in staat om werkgelegenheid te bieden aan voormalige landarbeiders, omdat hogere opgeleiden en er vooral Engels als voorwaarden voor arbeid zijn. De geografie van de dienstverlening is dynamischer geworden en de lange termijn vooruitzichten voor de BPO-sector in de Filippijnen worden beïnvloed door de stijgende concurrentie van andere ontwikkelingslanden, het terugverplaatsen, of reshoring, van diensten naar landen van herkomst, en automatiseringsprocessen.

Op basis van dit onderzoek kunnen een aantal voorzichtige beleidsadviezen gegeven worden. De afwezigheid van grote Filippijns BPO-bedrijven vermindert de mogelijkheid om waarde in de Filippijnen te genereren. Tegelijkertijd maakt het de Filippijnen meer afhankelijk van beslissingen die in de verre hoofdvestiging genomen worden. Inspanningen om het binnenlandse ondernemerschap te stimuleren en lokale kleine en middelgrote bedrijven te ondersteunen zijn daarom belangrijk. Investeren in het onderwijs moet mogelijkheden bieden voor gevaccineerde opleidingen voor leidinggevend personeel en de groei van gespecialiseerde professionele vaardigheden. De bevindingen hebben aangetoond dat geschoolde arbeidskrachten een belangrijke factor zijn voor het aantrekken van investeringen en het opwaarderen naar hogere functies van de waardeketen. Op dit moment begunstigen het bestaande beleid en de tussenkomst van buitenlandse investeerders het creëren van algemene lagere vaardigheden die nodig zijn voor de voice-gebaseerde dienstverlening.

De bevindingen over de Filippijns ervaringen kunnen andere landen informeren, die gericht zijn op het creëren van een ‘kennis-economie’ op basis van het aantrekken van directe buitenlandse investeringen in offshore dienstverlening. Hoewel veel landen inspiratie hebben gehaald uit het voorbeeld van de succesvolle ontwikkeling van offshore services in India, zou India een extreme of unieke case kunnen zijn, die niet gemakkelijk kan worden geproduceerd door andere landen. In plaats daarvan zou de Filippijns lagere integratie in het WPN van de dienstverlening op basis van het aantrekken van buitenlandse investeringen een meer typerend model kunnen vormen.

Op theoretisch niveau heeft dit proefschrift het WPN-raamwerk uitgebreid door het aan te passen en eclectisch te combineren met bestaande literatuur om analytische categorieën te operationaliseren voor empirisch onderzoek over diensten. De analyse van asymmetrische machtsverhoudingen en de mogelijke ongelijke integratie in WPN door ontwikkelingslanden, in sommige gevallen vergelijkbaar met branch plant economieën, draagt bij aan recente debatten over de ‘donkere kant’ van WPN’s. Bovendien heeft deze studie aangetoond dat het WPN-kader goed bruikbaar is in het bestuderen van netwerken en zwakker in de beoordeling van de territoriale economische ontwikkeling. De opkomst
van de geglobaliseerde enclaves in stedelijke agglomeraties in de Filippijnen bevestigt het belang om de ontwikkeling in plaatsen te analyseren.

Dit onderzoek heeft aangetoond dat dieper liggende sociale en institutionele structuren grote invloed hebben op de uitkomsten voor economische ontwikkeling. Naast werknemers, is de door de elite gedomineerde vastgoedsector geïdentificeerd als een van de belangrijkste lokale begunstigden van de opkomst van de offshore-dienstensector. Dit toont aan dat een krachtige en diepgewortelde elite in de Filippijnen in staat is deel te nemen aan ‘rent-seeking’, zelfs met betrekking tot een vrij nieuwe economische activiteit. Hoewel het WPN-kader bevestigt dat de sociaal-ruimtelijke context van invloed is op de aard en de uiting van het WPN, blijft de sociale inbedding in de al lang bestaande (lokale) machtsstructuren onder-theoretiseerd in de huidige formuleringen van het kader. Padafhankelijke instellingen en de regionale zakelijke systemen zijn belangrijke factoren voor de aard en de uiting van WPN-integratie en blijven van vitaal belang voor het verklaren van de regionale uitkomsten van ontwikkeling. De actoren-centrische analyse zou baat kunnen hebben bij een combinatie met politiek-economisch onderlegde onderzoeken naar institutionele structuren, om te komen tot een meer realistisch begrip van plaatsen in de wereldwijde productienetwerken.
Contemporary globalisation and the relocation, or offshoring, of services have created new opportunities for economic development in the Global South. Over the past decade, one million workers have found employment in the offshore service sector in the Philippines, primarily in Metro Manila’s call centres. This study investigates the emergence, evolution and the impact of the changing spatial division of service labour from the perspective of firms and subsidiaries located ‘offshore’ in the Philippines. It empirically examines expanding global production networks in services. Theoretically, this work expands the global production network framework by combining its analytical concepts of power, embeddedness and value with existing literatures from economic geography and development studies to understand to what extent services offshoring constitutes a new ‘model’ of economic development.