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

Kleibert, J.M.

Publication date
2015

Document Version
Final published version


CONVERGYS
JOB
CARAVAN
Davao City
Apo View Hotel
April 18 to 20, 2013
10am - 4pm
Hiring for Makati
Relocation assistance
awaits all successful hires.

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 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:

> [W]hile 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

Dimension	Dependent	Developmental
Ownership	Foreign-owned, outsourced or captive	Domestic-owned, outsourced
Nature of activities	Low-end	High-end
Network position	Peripheral position	Nodal position
Decision-making and control	Foreign, external	Local, internal
Job quality	Unskilled work	Skilled work
Local linkages	Limited	Extensive
(Fixed) investments	Low	High
Ease of relocation	High	Low

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

4

Figure 4.1: Map of the Philippines, indicating field-study locations

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].

[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).

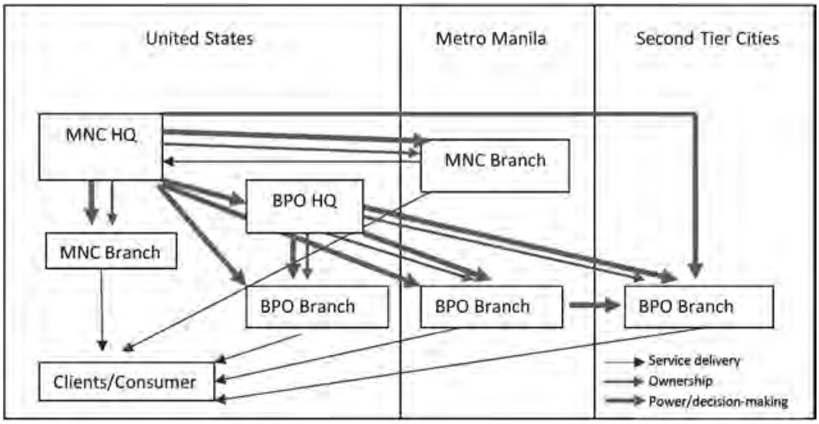
Comparing contact centres in the NCR and second-tier cities, two differences are noteworthy. First, second-tier cities' offshore service branch offices have fewer accounts or clients. One subsidiary of a large call centre in Baguio only services one single client, for which all its employees work, whereas 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

Figure 4.2: Position of Philippine branches and power relations in offshore service GPNs



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.

Table 4.2: Classification of findings in dependency-development taxonomy

	Second-Tier Cities (Baguio, Bacolod, Davao)	Primary City (Metro Manila)
Ownership	Foreign-owned, all outsourced	Foreign-owned, both outsourced and captive
Nature of activities	Low value-added, routine operations	Low to medium value-added, mostly routine operations
Network position	Weakest unit in the network	National/regional operational headquarters
Decision-making and control	Externally by clients and/or headquarters abroad or higher management in Manila, limiting local decision-making	Externally by clients and/or headquarters abroad, operational issues decided locally
Job quality	Medium-skilled	Medium to high-skilled
Local linkages	Limited	Limited, few domestic clients and outsourcing relationships
Fixed investments	Low	Low
Ease of relocation	Potential contract discontinuation by individual clients high	More protected due to captive operations and more clients

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.