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


JPMorgan Chase & Co.
Deutsche Bank

CHAPTER 6

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).

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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].

[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[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

[32] Product here signifies the end-product, please note that in services the final outcome could also be a service.

Table 6.1: Classification of low- to high-skilled offshore services

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

(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 sub-contractor 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 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 in 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 function[33]. 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[34]. 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

[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

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

(Source: Interviews, reports by NASSCOM and BPAP)

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

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

(Source: NASSCOM and BPAP data for 2012)

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 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)

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

(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-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.