

The Business Process Outsourcing Sector in the Philippines: A Defiant Trend

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Abstract

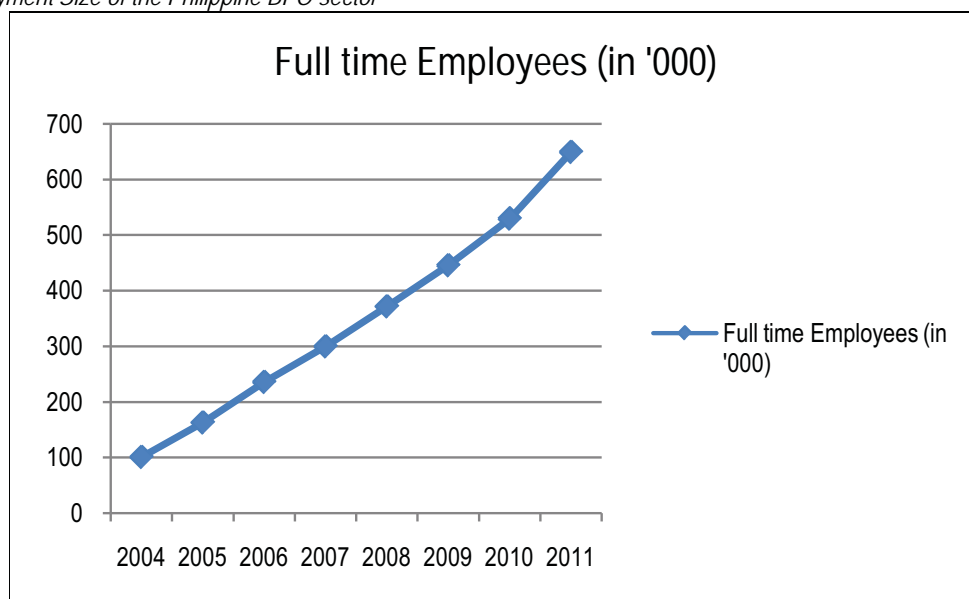
In recent years, Business Process Outsourcing (BPO) sector has become the pillar of the Philippine Economy because of its contribution in terms of employment and financial returns. This study aims to understand why the sector has a strong international competitiveness, even though the lack of competitiveness is generally admitted as the main hindrance for the nation to achieve its economic development. Therefore, the paper sheds light on the main sources of the sector, which foster its international competitiveness, by employing Porter's Diamond model to the sector. The findings of the study are vastly supportive of Porter's hypothesis in diamond model. The paper concludes that the sector may keep its high competitiveness at international level with some structural changes.

1. Introduction

In general, lack of competitiveness is admitted as the major obstacle to economic development in the Philippines as the country's import substitution policy hampered, for years, the emergence of a culture of world-class competitiveness among entrepreneurs. Nonetheless, the Philippine business process outsourcing (BPO hereafter) sector has become an exception in terms of the country's global competitiveness. In 2010, the Philippines posted almost US\$5.70 billion of pure voice-based (call-center) revenues, which make the country rank globally number one in this category; however, India—its biggest competitor in the sector—continues to be the leader in the global BPO industry mainly with its strong presence and capacity in the information technology (IT) (NEDA, 2011:67).

The size of BPO sector, which has around 650,000 jobs in the Philippines, is an indicator of strong human capital in the country (NEDA, 2011). It also shows the significance of the sector for the Philippine economy (see figure 1 for its growing employment size).

Figure1. *Employment Size of the Philippine BPO sector*



Source: Based on NEDA, (2011).

That's why, this paper examines the BPO sector in the Philippines. The paper, first, gives definitions related to the sector. Then, it explains the analytical framework—Porter's Diamond—and it assesses the sector's competitiveness with a relevant historical background and current sectoral data through this framework. The study applies secondary analysis of available data. One of the biggest advantages of secondary analysis is its capacity to reproduce studies from a different perspective and within a distinct theoretical framework. In general, the massive variety of topics makes them well suited to dealing with debates about foremost political, social and economic change, but the social and political context in the relevant country should be taken into account (Burton, 2000). On the other hand, if the issue of context may be well addressed, secondary analysis of early data is likely to engender crucial new perspectives to lead into wider theoretical and sociological debates (Gillies&Edwards, 2005).

2. BPO and Its Subsets

BPO is the process of leasing another company to handle some business activities. It is the outsourcing of a particular business process undertaking, and generally categorized as back office outsourcing, which includes internal business functions (e.g. billing and purchasing), and front office outsourcing (e.g. marketing or tech support). Information technology outsourcing (ITO) concentrates principally on hiring a different company or service provider to do Information Technology related activities (e.g. application development, or testing and quality assurance). ITO, therefore, is a division of business process outsourcing. ITO portrays a process, whereby an organization chooses to contract out or trade the firm's IT assets, people and/or activities to a third party supplier, who, in exchange, provides and manages these assets and services for an agreed fee over an precise time period (Saitta & Fjermestad, 2005: 9).

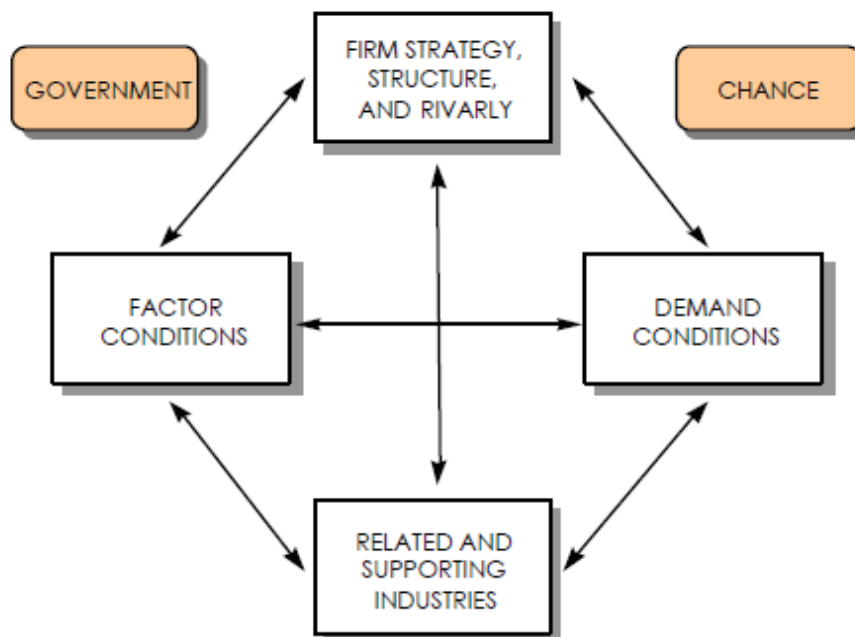
Another offshoot of BPO is knowledge process outsourcing (KPO). Briefly, KPO is outsourcing of knowledge intensive business processes, which require specialized field expertise. The strong point of KPO is not the cost-saving but the added-value. It offers a sustainable competitive advantage for customers in all knowledge intensive industries by supplying data and statistical analysis, market and industry research competitive analysis, and support in legal and administration processes (Mireau, 2007). Unlike voice-based BPO (call-centers), which is primarily based on cost advantage, and relatively quickly trainable labour pool, KPO depends on a more limited resource of highly-skilled, educated employees, and it focuses on delivering value-added services to the clients (Balda, 2010). Its prime objective is to provide clients with useful insights that may assist them in their strategic decision making process (IBEF, 2008). Acquiring the necessary skill sets, attracting talent, protecting intellectual property and dealing with conflicting interest is likely to be the major challenges of KPO industry over the next years (KPMG, 2008). However, organizations with vast experience in BPO sector are supposed to have a shorter learning process in the KPO.

3. Porter's Diamond for National Competitiveness

This paper applies Porter's Diamond model to the Philippine BPO sector. According to traditional economic theory, land, location, natural resources, labour and population size are five factors to determine the comparative advantage of a nation as they may hardly be influenced. Therefore, national economic opportunity is believed to be inherited, and it is supposedly difficult to create new economic opportunities since abovementioned economic factors may not be easily changed. On the other hand, Michael Porter (1990) maintains that sustained industrial growth has barely ever been built on said factors. Briefly, basic factors like raw materials, water resources, and unskilled labour necessitate little or no new investment to be utilised in the production process. Moreover, Porter (1990) argues that large quantity of these factors may even weaken the competitive advantage; hence, he brings in a concept called "clusters" of interconnected suppliers, industries, and institutions, which develop in certain locations.

For Porter (1990), competitive advantage of nations is the result of four inter-connected advanced factors in and between companies. He claims that a nation may generate new advanced factors like advanced technology, skilled labour and culture; hence, he uses a diamond shaped figure as a starting point to show the imperatives of national advantage (see Figure 2). These advanced factors may practically be affected by two external determinants—government and chance, and they are developed through reinvestment and innovation (Smit, 2010: 115).

Figure 2. Porter's Diamond Model



Source: Porter (1990)

As it may be seen in figure 2, there four points of Porter's diamond:

1. **Factor Conditions:** A nation generates its own vital factors such as technology or skilled labour. These factors are improved and employed in time to answer the growing demand. Domestic shortcomings and weaknesses compel to make innovations. Thus, comparative advantage is achieved with new methods–innovations. All the countries have their own specific set of factor conditions. So, industries in different countries develop in different set of factor conditions, and they grow faster in countries, where those factor conditions are optimal. This explains the existence of so-called agricultural countries–large countries with fertile soil–or the start-up culture in the United States–venture capital market. Porter (1990) points out that these factors are not inevitably inherited.¹ For Kuah and Day (2005: 8-9), the Singaporean financial services sector is one of the remarkable examples. Even though Singapore is a country with little endowed factor condition, it has been successful as an offshore banking centre since the formation of Asian Dollar market, and relevant technological and socio-cultural changes. Although it has a land area of 685.4 square kilometres and population less than five million, Singapore has attracted many foreign banks and institutions to set up operations over the last three decades.
2. **Demand Conditions:** A growing demand within the country leads to national advantage as a stronger local market makes it easier for local firms to predict global trends. According to Porter (1990), home demand is influenced by three key features: the mix of customers' needs and wants, their scope and growth rate, and the mechanisms that convey domestic preferences to foreign markets. A country may reveal its national advantages in an industry, when domestic market gives clear indications of demand trends to local suppliers.
3. **Related and Supporting Industries:** Domestic competition brings cost effectiveness as well as innovation since local suppliers are forced to improve their products and methods. In addition, related industries are crucial as they can use and manage specific activities, or manufacture complementary products such as software.
4. **Firm Strategy, Structure and Rivalry:** Local conditions influence firm strategy, and competition in the market compels companies to move beyond simple advantages. Culture in different nations is significant to influence factors such as working ethics. On the other hand, structure of ownership also affects relation patterns with workforce (e.g. family businesses have different patterns).

¹ For example, socio-cultural changes or technological progress can have an impact on national factor conditions.

Finally, although not illustrated as one of the four factors in the Diamond model, Porter (1990) acknowledges the role of governmental forces and chance for the national competitive advantage. Governments' expected duty in the Diamond Model is principally to assist in creating growth for industries, and to give confidence. Furthermore, for him, national governments should establish policies to breed national advantages for industries in the country to develop a strong competitive position at global scale.

For Wickham (2005), one of the major problems regarding the implementation of Porter's model by policy makers is the replication of successful models such as Silicon Valley without examining the context. Likewise, some research projects underscore the necessity for amendments in the model to better evaluate the distinct circumstances.²

On the other hand, Moon et al. (1998) argue that governments' role is the most crucial factor, especially for smaller economies, to determine the competitiveness in a given industry. In addition, there are views considering the role of government as a fifth determinant in the diamond model (Oz, 2002; Wickham, 2005). Porter's model, however, provides no reliable guide for governments with respect to appropriate policies to engage in. Especially, developing countries are given extensive encouragement to pursue policies which may actually be detrimental (Wickham, 2005; Davies and Ellis, 2000; Jackson, 2006). The role of the Multinationals is allegedly overlooked in Porter's model as well (Kim and Wicks, 2010; Oz, 2002; Moon et al, 1998). In the face of these critics, Porter's model has continued to attract interest and it was further developed by a number of economists under various names such as the Generalized Double Diamond to include human factor (Moon et al, 1995, 1998), or the Nine-Factor Model to add the role of Multinationals (Cho 1994; Cho and Moon, 2000, 2005).

4. Assessing the Competitiveness of the BPO sector in the Philippines

4.1 Factor Conditions

First element of Porter's diamond model is factor conditions. According to the hypothesis of Porter (1990), more advanced factor conditions create stronger international competitiveness in a given sector, and pertinent factors are knowledge resources, capital resources, physical resources, human resources and infrastructure.

Currently, voice-based outsourcing is the Philippine's strongest business outsourcing activity, and its strength is deeply related to recent infrastructural developments. In 2002-2003, the Philippines had significant telecom advantages over other countries (e.g. available international direct dial services, lower prices, and diversity in the number of major or trunk lines). Later, a significant part of the wiring became comprised of fibre optics. A standard E1 (high bandwidth) telephone line was about two to three times cheaper in the Philippines than in India—its major competitor. These infrastructural advantages were the reasons behind the boost in the voice-based BPO (Tschang, 2005).

In terms of human resources, because of its relatively higher labour costs, the country lost its comparative advantage in unskilled labour-intensive production to the countries such as China. Nonetheless, it still has a comparative advantage in semi-skilled recruitment thanks to its English language based educational system (Abinales & Amoroso, 2005: 247). This is the main reason in the strength of the nation in voice-based BPO. In recent years, its success attracted interest in other countries as well (e.g. for researches to emulate the Philippine model on Bangladesh, see Carana Corporation, 2002).

On the other hand, for a successful shift from a voice-based BPO sector to stronger ITO and KTO for a sustainable growth, the Philippines should solve its two main problems (i.e. human resources and capital).³ In the Philippines, about 400,000 students graduate from colleges per year, and more than 20 per cent are in Engineering and IT departments. In addition, Western based curriculum and high literacy rate are all promising for the sector (NSO, 2012). Nonetheless, the quality of education in the relevant departments should be increased with more financial support and cooperation of the firms as software development firms are concerned about the competency of labour pool in dealing with software processes.

4.2 Demand conditions

Demand Conditions are related to domestic interest and demand for the products or service of a firm, and they are connected with both the quantity and the quality of consumers. Hence, the population characteristics and economic development level of a given country are significant determinants. Simply, if there is no current home demand for any

² See Magdalena and Federico (2011) for a discussion on the necessity of amendment in the model.

³ For example, Filipino software development has some disadvantages, whereas several Indian firms are already of a noteworthy size and capability, and firms in other countries such as China are also in search of entering the software services market.

specific service or products, and there is not any prospect for future demand, it is impossible for an industry to achieve international competition advantage (Porter, 1990).

Drawing on the hypothesis of Porter about demand conditions (i.e. more demanding homeland customers create stronger international competitiveness), we should first analyse the population of the country. According to the demographic indicators of the United Nations Population Fund (2010), total population of the Philippines was 93.6 millions in 2010, and it is projected that the population will reach 146.2 million by 2050; thus, the Philippines is likely to remain as the second most populated country of the South-Eastern Asia region after Indonesia. According to a report of National Statistics of Office (2012), the ratio of elderly people in the country in 2007 was only 4.1 per cent. In addition, the projections regarding the population of the country made by United Nations Population Fund (UNFPA) (2007; 2010) the state of world population reports confirm that the Philippines is expected to keep its young population in the future. Nonetheless, in terms of GDP growing and GDP per capita indicators, the country lagged behind its neighbours due to its boom-and-bust cycle economy which made it classified among low-middle level income countries (Aldaba, 2000; Gonzales and Manasan, 2002; Virola et al, 2010).

On the other hand, naturally, the size of population and per capita income are not adequate to gauge home demand. Apart from said macro indicators, key indicators concerning a sector to determine home demand for its service or products are interest and affinity of the people. However, home demand is the most intriguing issue in applying the Porter's Diamond for the BPO sector as the chief rationale of the sector is to gain offshore cost advantages. Therefore, in this sense, it is difficult to talk about a strong home market, but rather we may link the issue with successful internationalization of the home market with cultural affinity as mentioned by Porter (1990). In the BPO sector, strong cultural affinity of the Philippine people with English speaking nations thanks to similar educational syllabus and life-style in the big cities makes the country a preferable BPO destination abroad. Thus, we may argue that keeping and enforcing cultural similarities act the part of strong local market for the application of Porter's diamond into the BPO sector.⁴

4.3 Related and Supporting Industries

Third constituent of Porter's diamond is related and supporting industries. Especially, behind any industrial development path—whether it is about manufacturing, software, or services—there is a particular supportive economic mechanism including supplier networks, industrial or agglomerative clusters, resource pools, and institutions (neoIT, 2005). Development of competitive economy takes time as efforts to transform the economic base give positive results in the long term. On the other hand, industry clustering has eventually become more popular among economic development professionals all over the world since it is largely believed in our day that the competitiveness of a nation stands on the industrial ability to form networks, which sustain geographic concentrations of institutions, customers and firms. Whereas a sector may be identical with a cluster in some cases, a cluster is broader than a single sector. Clusters are industries that are connected by the flow of goods and services (Smith, 2003). On the other hand, the firms in a cluster may be both cooperative and competitive. They may be in direct competition with other members in the cluster; they may purchase inputs from other cluster members, or rely on the services of other firms in the operation of their business. A cluster also differs from a trade association, which generally has a more limited membership and focus. A trade association in general includes the members of a single industry and focus overwhelmingly on lobbying (UMES, 1999). Nevertheless, as the BPO is a service industry, it does not need supply chains like those of the manufacturing sector. BPO firms do not automatically have the same kinds of linkages that some clusters have between industries and universities, or between firms.

In the BPO sector, a different way to increase opportunities is to provide business opportunities to domestic firms. In the Philippines, some multinationals in the sector such as Accenture and RCG have started to develop relations or to use the work force of the smaller local software firms, which have capability in technical areas to complement the larger firms' ability. Similarly, e-commerce firm ABM Global-Bayan Trade has been developing the auction market for local suppliers and buyers to transact with each other. By doing so, it assists local industries become more efficient. On the other hand, local industry associations are important in promoting the potential of an industry.⁵ In the Philippines, Business Process Association of the Philippines (BPAP), which represents entire BPO industry including call centers and ITO firms, try to play a significant role (Tschang, 2005). The BPO Services Association Unlimited (BSA/U), and Contact Center Association of the Philippines (CCAP) are another important associations in the sector to unite the collective

⁴ Here, we should take account of the limitation of the study. This issue, as expected, should be widely discussed in connection with the Philippine local cultures and its other potential implications.

⁵ For example, India's software association—NASSCOM—plays a pivotal role for the Indian software industry to promote it abroad, and to assist in preparing useful industrial solutions.

interests of the BPO firms. Nonetheless, the Philippines, in general, is still lagging behind its competitors in building strong institutions to help its industries.

4.4 Firm strategy, Structure and Rivalry

Firm strategy, structure and rivalry are the fourth element in the Porter's model. Growth strategies are linked with higher competitiveness as the growth is highly related to overall business health. Greater competition in an industry paves the way for a firm to reach a higher level of competitiveness in comparison with its global competitors. However, in the Philippines, there is a need for structural change to achieve sustainable growth. The main problem of the country has hitherto been the inefficient or ailing institutions. During Marcos presidency, with the declaration of Martial law in 1972, existing legislative, executive and judiciary institutions were weakened. Marcos regime ended aftermath of EDSA uprising in 1986 with the help of some political elites, who were once close to him. The assistance of these elites including some high ranked Army officers prevented succeeding Corazon Aquino administration from establishing new institutions as well. The main objective of Ferdinand Marcos was to thwart oligarchs by supporting his cronies, and to establish a technocratic system to provide economic growth; hence, he appointed western educated economists, who had no political motivations. As a result, he kept good relations with international finance institutions—mainly with IMF and World Bank—and said institutions provided large amount of loans to the country. Nonetheless, the Philippines invested in wrong areas—capital intensive industries—instead of using its comparative labour advantage; therefore, its economy grew less than its neighbours (Root, 1996: 114-138).

On the other hand, main reasons to outsource to the Philippines are Filipinos' cultural affinity to the West, highly motivated labour pool, and the work ethics of Filipino agents causing relatively lower labour problems compared to western countries. Besides, English is the basic communication medium in business, government and schools. These advantages have made the Philippines a major call center destination.⁶ In addition, the sector expects to continue posting double digit growth, mostly owing to diversification and expansion of major clients abroad (BOI, 2011). Nonetheless, there is a growing tendency among industry leaders for a change from call center intensified employment and focus to higher value-added employment and businesses like outsourced animation and IT services.

In the Philippines, although there are extensive efforts to develop new outsourcing destinations in different cities, metro Manila is, by far, the most popular outsourcing destination. The biggest advantage of the city as a global centre of outsourcing is its huge skilful workforce pool with English language proficiency, cultural affinity with the English-speaking nations, good telecommunication infrastructure, and an attractive cost structure offering big savings for both outsourcing firms and their customers. Nevertheless, overall talent pool of its major rivals such as China and India are greater than the Philippines. Therefore, there is a need for a profound structural change, and a shift of priority in BPO subsectors (i.e. from voice-based to ITO and KPO). For now, KPO seems to be the new trend of global outsourcing market. Especially, India is in pursuit of producing policies to benefit more from the global market in this emerging sector. In the Philippines, although a remarkable growth in KPO⁷ with more than two-fold growth in revenues from US\$400 million to US\$830 million between 2007 and 2008, there are some disadvantages of the country in talent pool availability, and cost arbitrage (NEDA, 2011).

4.5 Government Policies and Chance

Along with the aforementioned four main components of Porter's diamond, Government policies and chance also play an essential role in developing the competitiveness of the nation.

Currently, the BPO industry has the full support of the incumbent Benigno S. Aquino III administration, which plans to generate additional jobs for nearly 1.3 million Filipinos in the BPO centres, and to increase total revenues to around \$25 billion by 2016. These plans came amid a backlash in the United States against the outsourcing by large corporations of back office work to cheaper locations like the Philippines and India in the midst of the high unemployment rate in the US mainland. However, it is not yet obvious whether this sentiment is translated into a lower degree of outsourcing through legislations or voluntary withdrawal from outsourcing. Therefore, the Philippine officials are still optimistic about the prospects for long-run growth of the sector thanks to high amount of English-speaking college graduates in the country, who are paid much lesser than their counterparts in the US and somewhere else for getting the same output. It is evident that advanced countries have better business infrastructures. In general, the Philippine government is quite supportive and it makes necessary amendments and official regulations to boost its local industries.

⁶ In 2010, over 60 percent of the total BPO workforce of 530,000 was employed in call center facilities (NEDA, 2011).

⁷ Mainly in research, analytics and legal services.

However, enforcement of laws is still problematic, and it should be one of the priorities of the national government in the coming years. Cost of doing business, time to start a business, or copyright and patent arrangements play a vital role in thriving of businesses. In recent years, the Philippine governments made several amendments, but there is still need for further improvements (e.g., time to start a business is 52 days in the Philippines, three days in Singapore, and six days in Hong Kong see NEDA, 2011).

On the other hand, The Philippine government has plans to develop alternative, smaller cities to sustain the growth in the BPO sector. Therefore, initially, eight cities were identified as the most favourable alternate destinations. These cities are Davao, Cebu, Clark, Cagayan de Oro, Iloilo, Baguio, Bacalod and Dumaguete, and they are called as second-tier emerging Filipino cities. Local governments in the aforementioned cities diligently promote their cities as an alternate outsourcing destination of the country as well. Although metro Manila is likely to keep its primary destination status in coming years, these cities have significant advantages compared with metro Manila especially in terms of cost of living and cost of real estate. Increasing cost of doing business mainly because of rising price of class A prime properties in Manila in comparison with relatively untapped outsourcing markets offering lower operational costs in the said smaller cities pave the way for emerging cities to boost their BPO industry (NeoIT, 2005; NEDA, 2011).

For Porter (1990), chance factor consists of positive or negative impacts of several external incidents such as war, or policy changes in other countries. For the BPO sector, a prospect policy change of the US administration to bring the offshore jobs back to the country may have a negative impact as the US firms are the leading client of the Philippine BPO industry. On the other hand, the Philippines is in a relatively more business friendly and stable region, which gives any thriving sector in the Philippines to find market for its services or products outside home market. However, chance alone is not enough to boost any industry and it should be wisely used by the firms in the sector as well as governments.

5. Concluding Remarks

This paper has discussed the Philippine BPO sector, which is currently one of the most vital sectors for the Philippine economy, and it has applied Porter's diamond model for the sector. When Porter's diamond model was applied to the Philippine BPO sector, it was observed that the industry's competitive advantage lies more in human factor. Drawing on the findings, this study suggests a structural change in the sector, enforcement of related laws and regulations, and better planned education policy by the government to sustain the growth in the sector. In the short term, a shift from voice based sector to KPO may be beneficial for the continuity of growth in the BPO sector.

Even if, as mentioned earlier, there are some critics of the model for its insufficient analysis on the role of multinationals or human factor, the results of the study, which are highly supportive of Porter's diamond model, may encourage the applicability of the framework to uncompetitive industries by designing relevant policies to boost their competitiveness at international level. To sum up, the BPO industry in the Philippines may keep its competitiveness with successful strategies on the basis of restructuring as discussed in this study.

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