EXECUTIVE SUMMARY

A. THE CEBU IT SECTOR

Cebu was declared as an Information Technology (IT) hub in December last year. It is currently being positioned to become the country's IT hub outside of Manila particularly for software and e-services. The following are the 4 dominant subsectors: a) software; b) IT-enabled services; c) internet café; and d) hardware. To date, number of Filipino-owned IT companies is less than 100. The internet café subsector has the highest population estimated at 500 enterprises consisting primarily of micro enterprises. There is limited synergy between the different subsectors except for the hardware industry, which provides the computer and other peripherals to Filipino-owned companies. The software companies are sometimes tapped by hardware companies to set-up the systems for their clients.

ESTIMATED NUMBER OF IT COMPANIES IN CEBU			
Industry Group	**Filipino Owned Companies**	**Multinationals / Joint Venture**	**Informal Businesses**
Software	25	6	50+
IT-enabled services	5 to 10	15 to 20	Warp zone outsourcers
Hardware	30	2	100+
Internet Cafe	500		

To date, statistics on employment of IT companies remain hazy. Basic problem is the lack of a comprehensive list of IT companies in Cebu.

53 companies covered in the Cebu Educational Development Foundation for Information Technology (CEDF-IT) survey reported employing a total 842 workers. 70% of the 842 are employed in 10 companies. The range in number of employees is wide --- from 2 to as many as 238 or an average of 16 per company. Direct employment of Cebu IT locators in the Philippine Economic Zone Authority (PEZA) is at 950 as of July 2004.

DIRECT EMPLOYMENT OF CEBU IT LOCATORS IN PEZA	
Period	**Average Direct Employment**
January to December 2003	307
January to July 2004	950
	Source: PEZA, 2004

A 19% increase in IT manpower is projected over the next two years --- with the 10 known biggest employers planning to increase by an average of 18%, and all the others by some 22%.

Main problem of the industry is the lack or shrinking pool of qualified manpower. Surveys including the recently conducted human resource (HR) survey by CEDF-IT indicate that number of graduates of IT and allied courses is on an increasing trend. However, the problem that cuts across all subsectors is that many of the graduates do not have the necessary qualifications required by the industry.

EMPLOYMENT FORECAST IN CEBU IT SECTOR						
Categories	2003	2004	2005	2006	2007	2008
	Base	20%	30%	40%	50%	50%
Software Development	1,000	1,200	1,560	2,184	3,276	4,914
Engineering Design Services	800	960	1,248	1,747	2,621	3,931
Other e-Services	8,000	9,600	12,480	17,472	26,208	39,312
Source: CEDF-IT ICT HR Survey						

B. POLICY AND RELATED ISSUES

The regulatory environment does impact the ability of local entrepreneurs to establish companies and compete in the IT market. Likewise, policies also affect the region's ability to attract investors. Rated by the highest number of participants during the validation workshop to be the most important intervention is the review and enhancement of policies related to accessing capital. Among the policy measures being suggested to improve access to capital are the following:

1. Improving the listing conditions of the Philippine Stock Exchange (PSE) and extending trading hours.

2. Strict implementation of the Initial Public Offering (IPO) requirement for Board of Investment (BOI) registered IT initiatives.

3. Improving the venture capital (VC) and angel environment by developing an incubator network and providing incentives for VCs, such as Regional Headquarters incentives or government counterpart funds.

4. Create a special window for IT companies in government financial institutions

POLICY AND RELATED ISSUES	
Menu of Proposed Interventions: Policy and Related Issues	Number of Votes 'Most Relevant'
Improving access to capital via improved policy measures	**7**
Attracting new capital: incentives for investors	2
Intellectual property rights	
Data protection and network security vendor/supplier concern	
Validity and enforceability of electronic transactions	

C. SOFTWARE SUBSECTOR

Per DTI records, there are 25 registered Filipino-owned software companies and of which 16 are members of the recently formed software association. These companies are usually family-owned enterprises. Majority of the local software houses are micro and small-scale enterprises. The multinational companies (MNCs), mostly US/Japan subsidiaries, are primarily off-shore development centers for their parent companies.

The freelance programmers usually operate individually and would have 2 to 3 long term clients (maintenance). There is a high level of informality in this particular level, since entry barriers are very weak, either by the technological side or by the investment requirements.

Vertical linkages and trust relationships in the subsector are quite strong especially between client and software houses. However, horizontal linkages are almost non-existent. Local companies rarely work with freelance programmers. Likewise, it is very rare for a multinational to subcontract part of the work to a local company.

Three of the Filipino owned companies are moving into own brand "productized services" (products that are sold as services). Products are concentrated on business solutions and information/application software systems. Majority of the Filipino owned companies and freelance entities are concentrating on offering software customization and installation services.

Only 2 out of the 25 Filipino owned companies cater to the export market. These are also the same companies who have set-up offices in Metro Manila and have clients in key cities in Mindanao and the Visayas. The remaining 23 companies are serving mainly the Cebu market.

Local companies generally generate clients through direct marketing and referral. Cebu has yet to strengthen its image in the international market. Current thrust of the government promotion program is to invite foreign software companies to set-up in the Philippines.
Some initiatives have also been made in promoting Cebu-based software companies in the international market via trade fair participation and selling missions. Export marketing initiatives at the company level include the following: a) quarterly visits to their main export market to establish and consolidate their presence as well as generate new client; b) strategic alliance/joint venture arrangement with 1st and 2nd tier distributors; c) trade fair participation; and d) website promotion. Industry players and analysts believe that the best way for companies to establish their presence in the international market is to set-up a marketing office in the target market itself.

The following are the main constraints of the subsector:

1. High cost to implement and acquire internationally recognized process and quality certification such as the Capability Maturity Model (CMM) and International Organization for Standardization (ISO).

2. Lack of enabling environment for start-up companies --- nurturing of technology ideas into commercial successes

3. Lack of cooperation culture among companies/ potential for work sharing not fully developed

4. Lack of entrepreneurial and management skills

5. Lack of awareness in local market on use and benefits of ICT (Price vis-à-vis perceived values - low willingness to invest)

6. Need for onshore presence to facilitate marketing

7. Lack of export market info/product-market knowledge

8. Lack of properly and technically equipped software professionals

9. Low supply of higher-level managers, e.g. project managers

10. Difficulties to retain employees/ problems on poaching

11. High cost involved in getting professional certification

12. Lack of venture capital/ Lack of access to low-cost capital

The following are the menu of proposed BDS/DDTVET interventions for the software sector:

SOFTWARE SUBSECTOR	
Menu of Proposed BDS/DDTVET Interventions	**Number of Votes 'Most Relevant'**
Venture capital linkage services	3
Market development services	8
Subcontractors and suppliers accreditation system	
Competency-based skills training via technical schools and other training providers	**14**
Enterprise-based training	
Organizational development	
Incubator facility/Research and Development (R&D) Facility	
Capability Maturity Model Integration (CMMI) certification	5
BDS/DDTVET awareness campaign	3

Competency based skills training via technical schools was voted or selected by the highest number of participants during the Validation Workshop to be most relevant and responsive to their needs. This was followed by market development services, CMMI certification, TVET/BDS awareness campaign, and venture capital linkage services. Given that there are ongoing programs aimed at addressing the gaps in the TVET IT supply, further analysis would have to be made on specific intervention niches for the program. Possible areas of intervention would be on: a) stimulation and strengthening of demand and purchase of vocational training through focused marketing campaigns; b) product development and/or revitalization with a focus on matching market requirements and standards; and c) development of delivery, payment, and financial sustainability schemes.

D. IT-ENABLED SERVICES

IT-enabled services (ITES) involve a business modality that is entirely dependent on the Internet and other information technologies for conducting the business, but which only requires basic knowledge about information technology itself. In other words, employees have to know how to use computers, but need not have an in-depth understanding on how they work.

The number of call centers operating in Cebu has grown from zero in September 2003 to nine as of June 2004. Almost all of the multinational call centers located in Manila have either set up or are already in the process of setting up shop in Cebu. Some of them have even bypassed Manila entirely and have established operations in Cebu directly.

Multinationals and foreign-owned companies dominate the Cebu ITES industry. There are only about 5 to 10 registered Filipino owned companies. There are also quite a big number of freelance and informal enterprises doing some business process outsourcing work, multimedia design, animation, etc. To date, there are no data available on the informal sector and it is quite difficult to track them.

The structure for ITES is characterized by the following models:

a. Informal sector ⇔ Small foreign company client. These are usually home-based operators who have set up a few workstations in their homes and discreetly processing payroll and some accounting functions for some small companies in Japan or doing some medical transcription for a clinic in the United States. They keep a low profile; maintain lean and mean operations with very minimal overhead costs. To date, there are no statistical data about this group. They are not registered and they do not pay taxes. Business transactions are made directly with the foreign client.

b. Multinationals/Foreign Companies ⇔ Brokers/Marketing subsidiary/Parent Company. Players in the Cebu ITES are mainly multinationals/foreign-owned companies with majority in the contact center business. These companies either have their mother companies in the US or wherever they seek business and/or are operating several marketing offices.

c. Filipino-owned registered companies ⇔ Broker/Agent. It is estimated that there are about 5 Filipino owned companies in Cebu with all of them in the medical transcription business. 2 are in the medium scale while the rest are micro enterprises. For Filipino companies and new entrants, the cost of maintaining an independent network of offices is typically not an option. This has given birth to an alternative outsourcing model - the third party broker. These "eServices solution providers" typically establish relationships with multiple offshore providers, and then channel work to these firms as they acquire business. These solution providers tend to have a deep knowledge of the outsourcing business, as well as extensive business networks that they utilize to secure new contracts. This model represents the most common ways in which Filipino owned ITES companies in Cebu entered into their outsourcing relationship.

d. Cebu-based Business Process Outsourcing (BPO) company ⇔ client. This represents the purest form of outsourcing in that the contractual relationship is between the foreign client and the provider with no intervening offices or third party firms. The outsourcing costs of this model are generally lower. However, this only happens for small transactions (between an informal enterprise and small foreign company) and among established multinationals. This is not a viable model for new entrants into the outsourcing field because of the element of trust as well as the remoteness of the providers from the markets. Most US companies enter into their outsourcing relationships through a US-based company.

The following are the constraints identified by the industry players particularly the contact centers and medical transcription companies:

1. Informal operations of a large number of players

2. Need for onshore presence to facilitate marketing

3. Lack of export market info/product-market knowledge

4. Shortage of English proficient workforce (both oral and written)

5. Only limited number of participants to training courses due to perceived high costs

Participants during the validation workshop indicated that strengthening of current training programs and review/enhancement of school curricula are the priority interventions needed by the industry in the short and medium-term perspectives. Below is the menu of proposed interventions:

IT ENABLED SERVICES	
Menu of proposed BDS / DDTVET interventions	**Number of Votes 'Most Relevant'**
Awareness campaign on BPO job opportunities	
Strengthening of current training program initiatives	6
School Curriculum Review and Re-Alignment	6
Market development BDS	

E. INTERNET CAFÉS

There are about 500 internet café operators in Cebu and of which 240 are members of the Internet Café Association of Cebu. It is estimated that there are about 300,000 internet café users in Cebu. About 80% to 90% of the clientele are students. As such, many of the internet cafes are located near the schools.

When Internet cafés first started sprouting in 1996, the business was very successful and lucrative. But now, with so many cafes in existence in Cebu, about three Internet cafés close down every month. Demographically, Cebu has more Internet cafes than any other city by density. Compared to Metro Manila, it is littered far more with cyber-cafes per 100 people. Fierce competition, however, is working against the internet café business as the situation continues to bring prices down. Thus, the tension in the market is creating a culture of commercial anxiety as stores lining the city's boulevards and alleys are always on guard —– worried that customers might switch to the neighboring shop at the slightest price drop. This, in effect, is making customer loyalty an alien term in Cebu. Internet café users are only loyal to the shop that offers the lowest price. Competition is primarily based on price and location.

A typical internet café would have 10 to 15 computers with one or two attendants. Majority of the internet cafes are micro scale. Similar to other micro enterprises, the owner handles most of the tasks and is assisted by one or two attendants. Many of the internet café operators had no previous computer and enterprise management background. Daily gross income ranges from PhP 1,500 to 3,000.

Many of the so-called neighbourhood Internet cafes are mainly game centers, where majority of the computers are not Internet-connected but dedicated to running games. Internet cafes near the schools also offer desktop services such as printing and scanning. On the side, they also sell pre-paid phone and Internet cards. Others have expanded into selling of food and school supplies. Other internet cafes are also into the assembly of hardware and computer maintenance services. A few have offered simple training courses in collaboration with the government.

Main constraints of the industry are the following:

1. The need to upgrade management skills as well as operations system efficiency

2. Lack of product differentiation

3. Difficulties to move up vertically/value-added services

4. The need to build a wider client base

5. Unfair competition from unregistered internet café — lower overhead costs/no taxes

6. Lack of technical skills for maintenance and troubleshooting tasks, network installation – high maintenance costs

7. High cost of components and licensed software/ online games

The industry also sees the opportunity to increase their income if they would be allowed to offer voice over internet protocol (VOIP) based services.

Product development was voted to be the most important intervention for the internet café group. This was followed by market development services. Below is the menu of proposed BDS/DDTVET interventions:

Menu of Proposed BDS/DDTVET Interventions	Number of Votes 'Most Relevant'
Organizational development	1
Technical and entrepreneurial capability buildup	1
Product development	**5**
Market development	2

F. HARDWARE

Computer hardware comprises: data processing equipment (computers), peripherals and networking products. It must be noted here that *"manufacture,"* in the context of the Cebu computer hardware industry, refers primarily to the following:

- Assembly of computers with imported components by Filipino owned companies and freelance technicians/assemblers
- Manufacture of peripherals by MNCs

The personal computer (PC) segment primarily consists of the following:

- Multinational brands (Dell, Compaq, Toshiba, etc.)
- Branded assemblers (Filipino companies)
- Unbranded assemblers (Informal sector; micro shops)
- Surplus computers from Korea and Japan

PCs sold to local clients are mainly assembled locally. There are about 30 Filipino companies in Cebu who are engaged in the assembly of computers. Almost all of them have their own retail outlets. Components are sourced out mainly from Manila-based importers. Horizontal linkages between MNCs and Filipino assemblers and retailers are almost non-existent. Likewise, locators in the Asiatown IT Park source their computers outside of Cebu.

Distributors of HP, Epson, Intel, and other similar products provide marketing support to retailers such as: a) collateral materials; b) promotional activities; c) incentives for every unit sold (e.g., Intel) which retailer-assembler can use for own promotional activities of his/her choice. From time to time, distributors also conduct marketing seminars.

Among the Filipino-owned companies, the major problem faced is the low profit margins from PCs and peripherals. Given that prices are fairly standardized, the only way for companies to improve profit margins is to avoid waste and/or reduce costs. Towards this end, the following are the proposed interventions:

Menu of Proposed BDS/DDTVET Interventions	Number of Votes 'Most Relevant'
Continuous productivity and quality improvement (CPQI)	2
Technical and technological competence build-up	