



A BASELINE SECTOR ANALYSIS OF THE BUSINESS PROCESS OUTSOURCING INDUSTRY OF SRI LANKA

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Learning Initiatives on Reforms for Network Economies

Information and Communication Technology Agency (ICTA) of Sri Lanka

The Information and Communication Technology Agency of Sri Lanka (ICTA), which became operational in July 2003 under the Information and Communication Technology Act, is the implementing organization for 'e-Sri Lanka'. To fulfil its mandate, ICTA will implement programmes in: 1) ICT policy, leadership, and institutional development, 2) building ICT infrastructure, 3) Re-engineering government ICT, 4) Human resource capacity building, 5) ICT investment and private sector development and 6) e-Society. Through the implementation of 'e-Sri Lanka', an enabling environment will be created where partnerships will be developed between public sector, private sector, and civil society to: 'take the dividends of ICT to every village, to every citizen, to every business and to transform the way government thinks and works'.

In lieu of the dearth of quantitative and qualitative data on the Business Process Outsourcing (BPO) sector in the country, ICTA partnered with LIRNE*asia* to conduct a baseline sector analysis of the BPO industry in Sri Lanka.

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LIRNEasia is the Asian affiliate of LIRNE.NET. It is a regional ICT [information and communication technologies] policy and regulation capacity building organization, incorporated as a non-profit organization under section 21 of the Companies Act, No. 17 of 1982 of Sri Lanka in 2004 and funded at present by the IDRC and infoDev, a unit of the World Bank. Its primary functions are research, training and informed intervention in policy and regulatory processes. Its current projects include research in South as well as South East Asia.

LIRNEasia aims to improve the lives the people of Asia – by making it easier to make use of information and communication technologies by facilitating the changing of laws, policies and regulations to enable those uses; by building Asia-based human capacity through research, training, consulting and by advocacy.

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1.0 Introduction

The current potential global Business Process Outsourcing industry (BPO) market of USD 11.5 billion is expected to grow ten-fold to around USD 120-150 billion in the near future¹. However, Sri Lanka only recently started emerging as a potential destination for outsourced work. The baseline sector analysis of the BPO industry in Sri Lanka was conducted to fill the knowledge gaps regarding this emerging service sector. The study identifies factors that attract BPO-related investments into Sri Lanka and also potential constraints to such investment growth. Although not designed to be a policy document but a nuts-and-bolts study of an emerging industry, the findings are useful to understand the broad requirements of BPO service providers and facilities necessary to create an enabling environment for further growth of the sector.

Specific objectives of the study include:

- Obtaining information on the range of BPO services offered in Sri Lanka
- Identifying factors that have made BPO companies locate in Sri Lanka
- Identifying the requirements and constraints posed by infrastructure and human resources to expand business prospects
- Identifying direct and indirect impacts on employment generation in Sri Lanka
- Identifying potential legislative and regulatory changes that are needed to promote the sector.

1.1 Definition of a BPO receiver

For the purpose of this study BPO is defined as the act of outsourcing to a third party the responsibility of running a business process that would otherwise be conducted

¹ The Nasscom-McKinsey Study (2005), *Extending India's leadership of the global IT and BPO industries*, National Association of Software and Services Companies, New Delhi

internally. The receiver of the outsourced process administers the process based on a defined and measurable performance matrix. The receiver is also an independent legal entity maintaining its own accounting systems. For this study, outsourced services are limited to the category of Information Technology Enables Services (ITES).

In this study BPO receiving companies are broadly classified as falling under one or more of the following segments:

An offshore BPO: When a business process or processes are outsourced to a company in Sri Lanka by a company located in another country.

An onshore BPO: When a company located in Sri Lanka outsources a business process or processes, to another company that is also located in Sri Lanka.

A captive BPO: The parent company that is outsourcing the business process owns the company that is set up to receive the outsourced work and the receiving company services only the parent company.

A non-captive BPO: An independent, third party receiver of outsourced business processes. These companies take on outsourced work from any other company including parent companies.

1.2 Survey Methodology

The study was conducted through a series of in-depth interviews with senior management of BPO receiving companies in Sri Lanka based on a semi-structured questionnaire.

The questionnaire developed for the study aimed to capture information necessary to reach the specific objectives outlined above. The questions covered general information about the firm: availability, quality and cost of infrastructure; labour market conditions;

marketing and sales methods; extent of industry cooperation; business-government relations and growth prospects.

1.2.1 Selection of study sample

The total number of companies that came within the definition of BPOs, as set by this study, was 25. All the identified companies were contacted instead of using a sample. The companies were selected from three sources: the members' list of the Information Technology Enabled Services Association (ITESA), a list of BPO service providers from the Board of Investment (BOI) of Sri Lanka and a list of companies from the Information Communication Technology Agency (ICTA) of Sri Lanka.

Software exporting companies and IT service providers were excluded, as they did not come within the definition of a BPO receiving company set by this study.

The 25 companies identified as BPO receivers comprised a mix of onshore, offshore, captive and non-captive operators. The attempt to conduct a census yielded an industry participation of 84% with 21 out of 25 identified companies taking part.

1.2.2 Administration of the interviews

To maintain confidentiality and impartiality, the services of market research firm, AC Nielsen Lanka (Pvt.) Ltd, was obtained to conduct the interviews. Pilot studies were conducted to fine-tune the questionnaire during the first week of March 2006. The interviews targeting top managers of BPO facilities in Sri Lanka, based on the finalised questionnaire, were conducted over a 5 week period from May to June 2006.

2.0 Summary of Findings

Although the first BPO unit, an offshore US operation, was set up in Sri Lanka in 1983, the findings indicate that the BPO sector started emerging only from year-2000. BPO investments gained momentum in 2004 with the establishment of 5 companies. Growth continued in 2005 with 8 additional new entrants. By mid 2006 one more BPO receiving facility had initiated operations and more were pending commercial operations.²

Salient points that emerged from the baseline study

BPO industry

- The BPO sector captured by the study comprised of more offshore companies (52%) than onshore companies (38%). Those that are both offshore and onshore were 10%.
- The industry is split equally between non-captive operators (48%) and captive BPO operators (48%).
- A majority of the companies (86%) are established under the Board of Investment of Sri Lanka.
- Sri Lanka's primary attractions for BPOs are low labour and operating costs.
- The main export markets for Sri Lankan based BPOs are the US and the UK

Employment at BPOs

- Employment numbers are higher among offshore BPOs (average of 265 employees) than onshore units (average of 78 employees). Total employment in the surveyed companies is 3,700³.

² Anecdotal evidence suggests that as of August 2006, six additional applications to set up BPO operations were pending BOI approval.

³ Including companies that didn't participate in the survey, anecdotal evidence suggests that total sector employment may be slightly higher than 4,000.

- Employment at non-captive BPOs is lower (average of 134) than at captive BPOs (average of 228 employees).
- Average yearly turnover of employees is 6%. Turnover is higher at non-captive units than at captive BPOs.
- A majority of BPO operators (95%) plan to increase employment in the near future.

Growth plans and constraints

- Most companies (76%) are planning expansion, including physical expansion and market development.
- Civil and political instability is considered the leading threat to the industry (67%).
- The mass transport service is considered the leading infrastructure bottleneck to BPO operations and growth (57%).
- Telecommunications facilities⁴ is the second most frequently cited infrastructure constraint (48%) and 38% expressed dissatisfaction with broadband facilities.
- Electricity is for the most part not considered an obstacle to growth as a majority of BPOs (86%) have invested in generators.

⁴ Telecommunication facilities include basic telephone facilities as well as broadband (primarily leased lines) facilities. The latter is essential for delivery of IT enabled BPO services.

2.1 Investments

The total investment of the 21 surveyed companies is slightly over USD 13.2 million.⁵ These investments are mostly under the Board of Investment of Sri Lanka (BOI). The total offshore investment is USD 4.3 million compared to the USD 7.8 million worth of onshore investments.

Table 1a: BPO investments with BOI status

Type of BPO investment	In millions (USD)
BOI investments	11.8
Non -BOI investments	1.4
Total investment in the sector	13.2

Table 1b: Offshore/ onshore BPO investments

Type of BPO investment	In millions (USD)
Offshore investments	4.3
Onshore investments	7.8
BPOs that are both onshore and offshore	1.1
Total investment in the sector	13.2

2.2 Service Offerings

Accounting services is the most popular type of work undertaken in Sri Lanka with 43% of the surveyed companies listing this as one of their main service offerings, followed by call centre services (19%) and medical insurance processing (14%).

⁵ Investment data is limited to survey participants.

2.3 Labour

The total workforce of the 21 surveyed companies is 3,700 persons.⁶ Employment is expected to increase by over 30% during 2006-2007 due to expansion plans of existing companies and new entrants.

Over half (59%) the persons engaged in providing BPO services in Sri Lanka are between the ages of 18-24 and the growth in employment can be expected primarily in this age demographic. Fifty one percent of BPO workers have an Advanced Level certificate as their main qualification. However, 15% of the BPO workforce comprises graduates and BPO companies cited 'fresh graduates' as an industry requirement.

The leading skill requirement in the BPO labour market is for English language skills. Almost all BPOs (95%), including companies that are engaged in providing services other than call centre services, considered the ability to communicate in English as the most important skill requirement for their work.

Although employment prospects are opening up in the BPO sector, the survey findings indicate that BPOs are experiencing difficulties finding suitable personnel. Nearly half the BPO employers (43%) expressed dissatisfaction with the supply of skilled personnel and 38% expressed dissatisfaction with the quality of available persons. However, nearly all BPOs (95%) invest in compulsory and/or non-compulsory training of employees to meet skill and quality shortfalls.

⁶ Including companies that didn't participate in the survey, anecdotal evidence suggests that overall employment may be slightly over 4,000

2.4 Major obstacles to growth

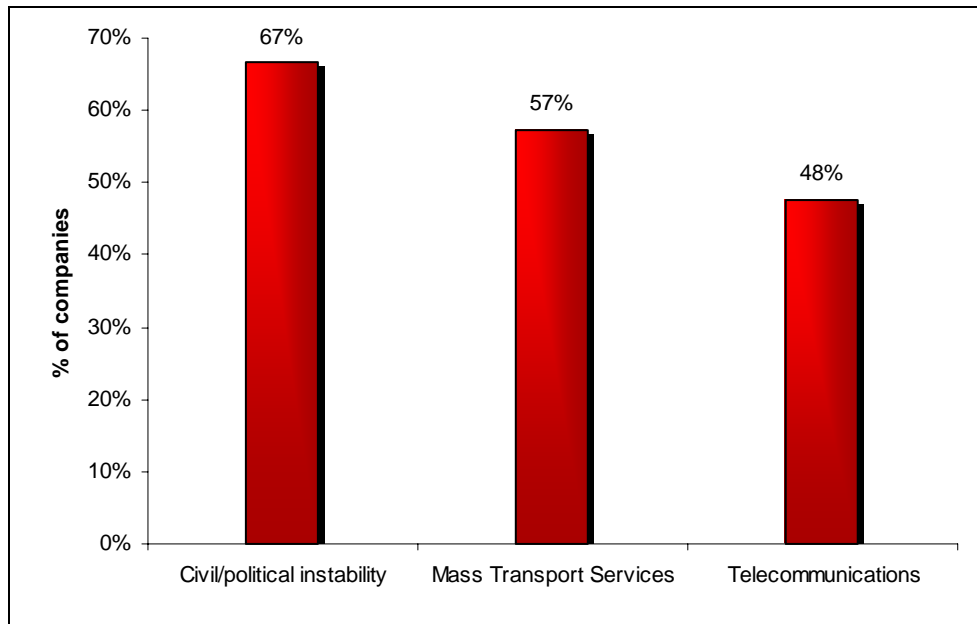


Figure 1: Leading obstacles to BPO sector growth

2.4.1 Domestic stability

The overwhelming concern of the BPO sector is with regard to domestic civil and political stability. The most frequently cited threat to successful operations and growth is domestic instability (67%). This could be due to the fact that BPOs mostly service foreign clients and the industry could be impacted by external perceptions of domestic instability. BPOs may also be concerned that domestic instability could disrupt their ability to deliver uninterrupted services. However, the emphasis on the subject could also be a result of the timing of the survey when domestic security concerns were re-emerging strongly and wide international media coverage was focused on the peace process and ceasefire violations.

2.4.2 *Transport*

After domestic instability the second most frequently cited industry impediment is Sri Lanka's mass transport service. Over half the respondents (57%) considered commuter services an 'obstacle' to routine operations and to growth.

2.4.3 *Telecommunications*

Telecommunications facilities (includes basic telephone facilities and more importantly for BPOs- broadband/leased line facilities), although an essential component in the provision of IT enabled BPO services, are perceived as a growth constraint. Nearly half the respondents (48%) maintained that telecommunications services are an 'obstacle' to operations and growth. This perception could be due to factors related to broadband access as a significant number (38%) of respondents are not satisfied (i.e. consider it as 'unreliable') with the quality of leased line services. Only 29% classified leased line services as reliable.

2.5 *Expansion*

Despite the various difficulties faced by BPO service providers the sector is set to expand in the near future, which would lead to growth in employment in the sector and increased BPO service exports. Most of the BPO companies (76%) mentioned expansion plans including physical expansion and market expansion.

3.0 An overview of Sri Lanka's BPO sector

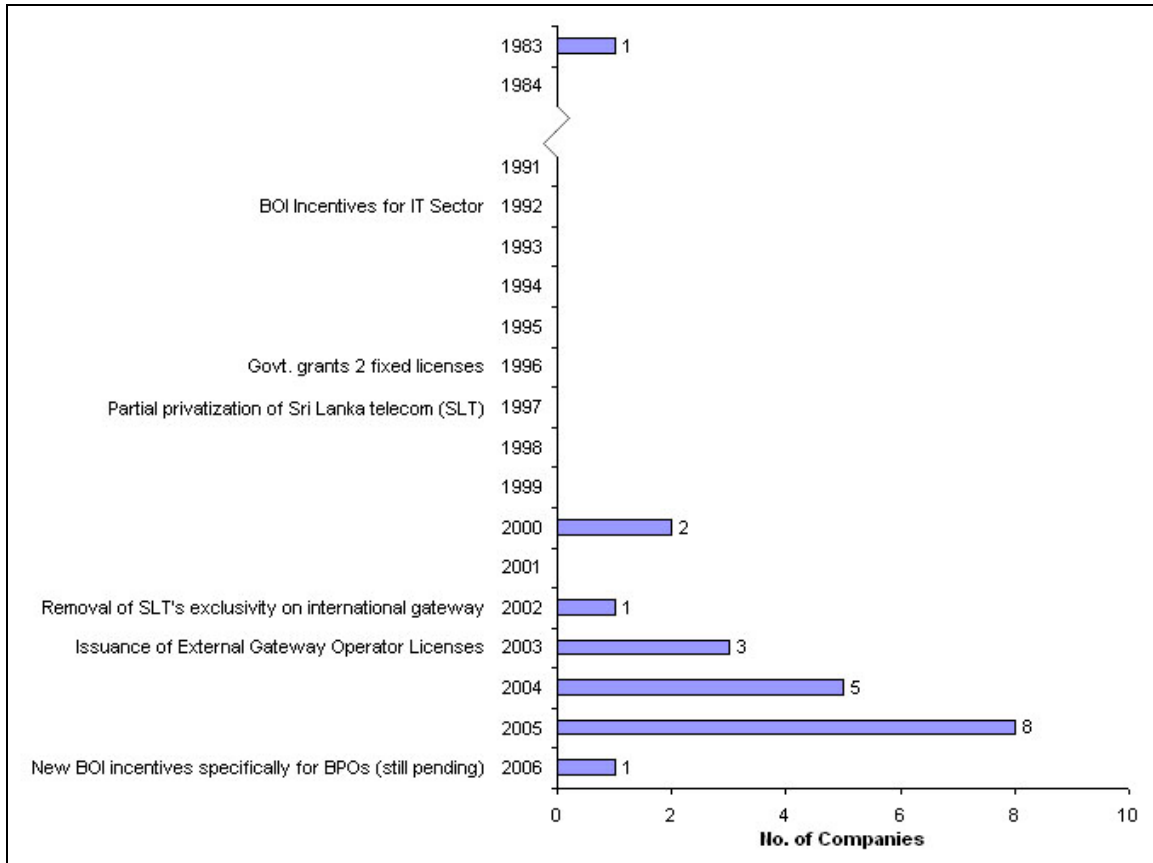


Figure 2: BPO entry by year

The baseline survey captured data on 21 out of the 25 companies identified as IT enabled providers of outsourced business process services. The findings indicate that the formation of Sri Lanka's BPO sector began in year 2000 with the regular emergence of BPO units. Year 2004 experienced a spurt of BPO activity despite the prevalent political uncertainty with no less than five new companies starting operations. This momentum was sustained in 2005 with eight additional new entrants. As of mid 2006 one more company had started operations.⁷

⁷ Anecdotal evidence suggests that as of August 2006, six additional applications to set up BPO operations were pending BOI approval.

Given the high dependency of BPO establishments on telecommunications infrastructure, developments in the local telecommunications landscape could have had a direct bearing on the growth of the BPO sector. Of these recent changes, the most significant is the ending of Sri Lanka Telecom's exclusivity on international connectivity in August 2002 and the subsequent issuance of External Gateway Operator (EGO) Licenses from March 2003 onwards. A prominent BPO obtaining access to seamless connectivity through an undersea cable in February 2004 based on these liberalisations was a significant landmark. It is understood that the bandwidth utilised since then has grown by many fold.⁸

In addition to the telecommunications liberalisations, tax incentives introduced in the early '90s to pull in IT related investments, may have also had spill over effects on the BPO sector.

3.1 Sector composition

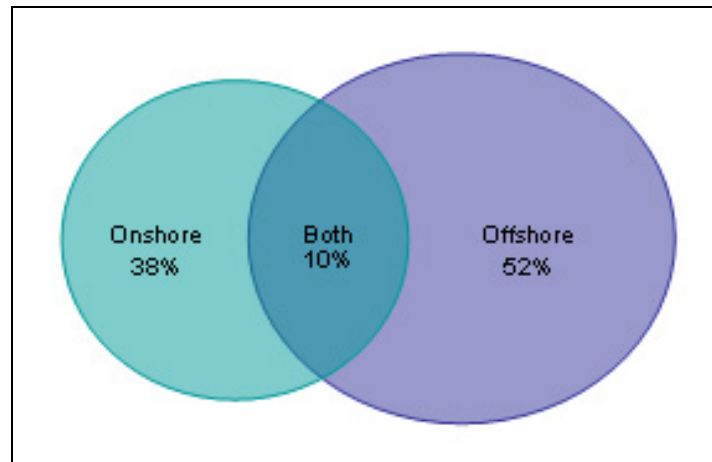


Figure 3: Composition of Sri Lanka's BPO industry

⁸ Precise figures on the bandwidth utilisation were unavailable

The study sample of Sri Lanka’s BPO sector comprised offshore BPOs (52%), onshore BPOs (38%) and those that classified themselves as both onshore and offshore operations (10%). The largest number of offshore investments is from the US with four BPO units in Sri Lanka set up by principals in the US.

The marketplace is also evenly divided between captive (48%) and non-captive (48%) operators. Two out of the four companies that are off shored from the US are non-captive operations and a majority of the companies that are headquartered in Sri Lanka (63%) are also non-captive units.

Table 2: Headquarters of BPO companies

Location of Headquarters⁹	No. of BPO companies	% of companies
Sri Lanka	11	52.4%
USA	4	19.0%
UK	2	9.5%
Sweden	2	9.5%
Singapore	1	4.8%
Hong Kong	1	4.8%
Total	21	100.0%

Most BPO companies (67%) are standalone operations that do not have branches in other countries. Only one third (33%) of the companies cited branches abroad. These companies reported branches in India, Philippines, Indonesia, China, Poland, UK, Germany, USA, Switzerland, Finland, Singapore and Costa Rica.

⁹ BPO companies do not consider offshore/onshore categorisation based on location of headquarters. Two companies headquartered in Sri Lanka categorised themselves as offshore companies and one company headquartered in Hong Kong, listed under onshore.

Only three out of 21 companies mentioned branches within Sri Lanka. These operations are located in Nugegoda, Kandy, Wattala, Colpetty, Wellawatte, Galle, Matara, Nuwara Eliya, Ratnapura, Chilaw, Badulla and Kaduruwela.¹⁰

3.2 Reasons for locating in Sri Lanka

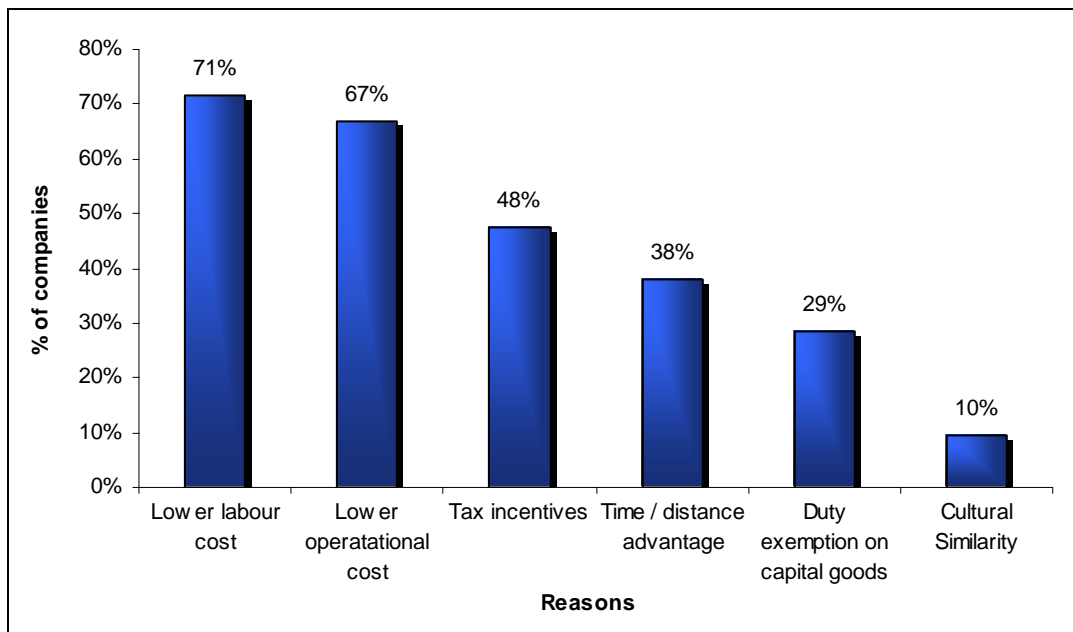


Figure 4: Reasons for locating in Sri Lanka

Sri Lanka’s main attraction for the BPO business is low labour and low operating costs. A majority of the surveyed companies (71%) cited lower labour costs as an important deciding factor. This included 73% of offshore BPOs and 63% of onshore BPOs. The finding is in line with a recent World Bank report on off shoring to Sri Lanka (henceforth referred to as the “World Bank report”), which suggests that Sri Lanka’s labour costs are among the lowest when compared to other global BPO outsourcing destinations.¹¹ The

¹⁰ However, it is not clear what roles these branches play in delivering the BPO services of the company

¹¹ Radwan, I. & Fernando, G. (2006). *Offshore to Sri Lanka; Finding Sri Lanka’s Offshoring Niche*. Washington: World Bank.

World Bank report cites that labour cost, per hour, in Sri Lanka (at less than USD 0.60), is lower than in Mexico (USD 1.60 - USD 2.10), Thailand (USD 1.10 - USD 1.60), China, Philippines and India (USD 0.60 - USD 1.10).

The second most frequently cited reason for selecting Sri Lanka to set up a BPO unit is the lower costs of conducting operations. This was mentioned by 67% of the respondents (73% of offshore BPOs and 50% of onshore BPOs).

Tax incentives is the third most common reason for locating BPOs in Sri Lanka (48%) indicating that government incentives are successful in attracting BPO investments, particularly foreign investments. Almost two thirds (64%) of offshore companies cited tax incentives as important, compared to the 25% of onshore companies.

Over one third of the companies (38%) cited the time/distance advantage due to Sri Lanka's geographic situation as a deciding factor. This is of importance mainly to offshore operators. Over half (55%) the offshore companies cited time and distance as a deciding factor compared to only 13% of onshore companies.

A little over one fourth (29%) of the companies cited duty exemptions on capital goods (another government incentive), as significant when deciding to locate a BPO operation in Sri Lanka. This included 27% of offshore companies and 25% of onshore companies.

Most BPO operators (90%) did not think cultural similarity is a significant factor.

3.3 BPO investments in Sri Lanka

Investment flows into Sri Lanka's BPO sector is relatively regular since year-2000. The inflow is in all three forms: foreign investments, local investments and joint ventures. Foreign investments in joint ventures ranged from 30% to 95%. Most BPO investments (86%) are under the Board of Investment of Sri Lanka.

The total investment value of the surveyed companies established during 2000 to 2006 is about USD 13.2 million. The value of individual BPO investments ranged from USD 15,000 to USD 3.5 million. The survey results also indicate that investments by offshore BPOs (USD 4.3 million) are lower than onshore investments (USD 7.8 million). This could be due to less international recognition of Sri Lanka as an off shoring destination and also due to lower capacities to cater to large-scale offshore ventures. However, these findings may not be comprehensive, as the survey data is limited to participants.

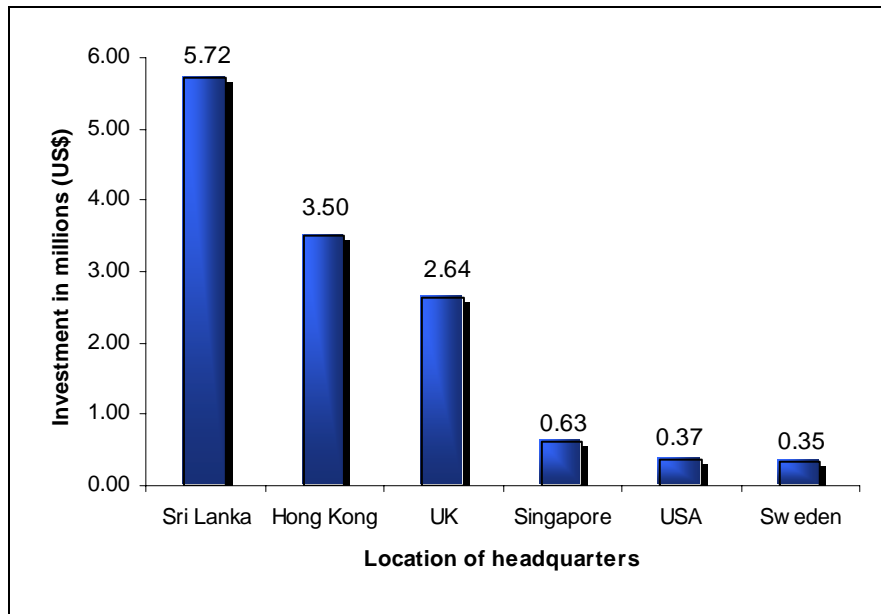


Figure 5: Investment by location of headquarters

Available data suggests that companies headquartered in Sri Lanka are the largest investors in the domestic BPO sector. However, four out of 11 such companies have foreign investment components ranging from 30% to 100%. While the US has the largest number of off shored BPOs in Sri Lanka, (four companies), the value of these off shored investments are relatively small.

3.4 Services

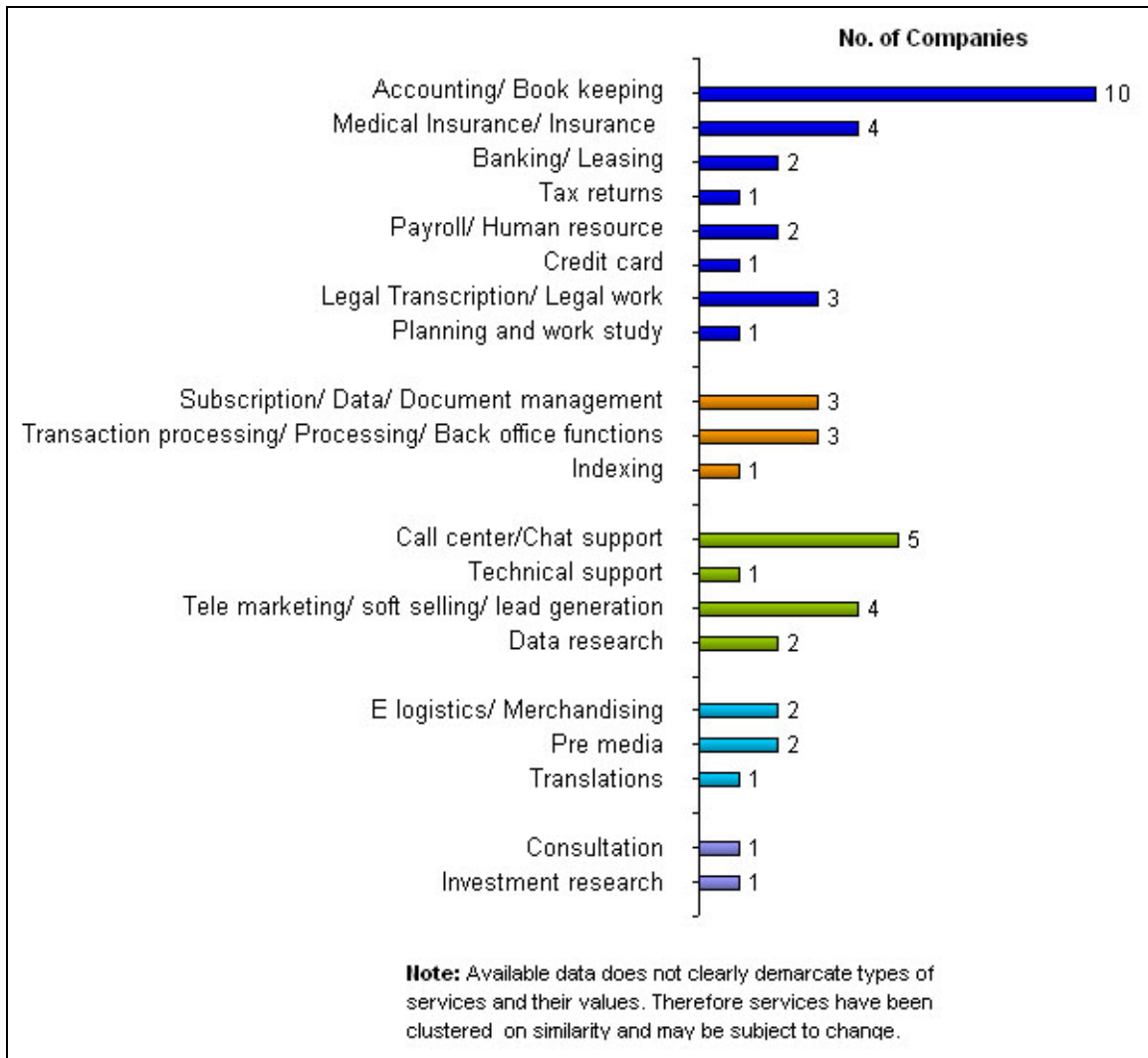


Figure 6: BPO service offerings

Accounting services is the most popular product offering in Sri Lanka with 43% of the companies listing it as a main service. Call centre services and medical insurance processing are the next most popular with 19% and 14% of the companies offering these services. Most BPOs offer more than one type of work and in general, are geared to undertake at least two different types of services. Non-captive operators appear to provide a greater variation than captives, with the number of services offered averaging to 3.5, compared to the average of 1.4 services offered by captive BPOs. In addition, more onshore (6 companies) than offshore (3 companies) provide accounting services,

indicating that local companies are tapping into the opportunities presented by the large pool of young, qualified accountants in Sri Lanka.

3.5 Export Markets

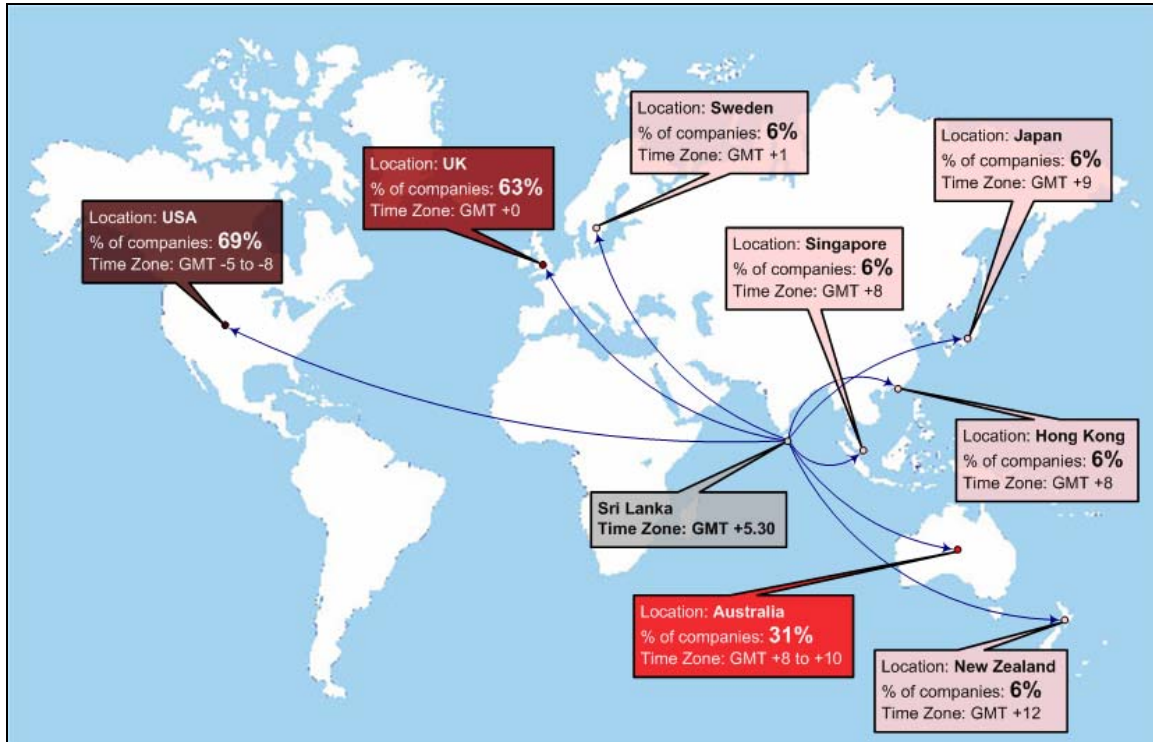


Figure 7: Main export markets

The industry is predominantly export oriented with 71% of the companies exporting 100% of their services. The leading consumer of Sri Lankan BPO services is the US, which is catered to by over half the BPOs (69%). The UK is targeted by 63% of BPO companies and 31% are exporting to Australia. Other export markets are Sweden, New Zealand, Hong Kong, Singapore and Japan.

3.6 Marketing Sri Lanka's as a BPO destination

Nearly half the BPO companies (48%) identified their operations as non-captive, indicating that they do not have a constant stream of regular work from parent companies and must compete for work in the open market. Sales and marketing activities indicate that the proportion of companies without access to captive streams of work could be much higher. Thirty eight percent of the companies mentioned conducting independent marketing exercises to attract clients. Another 28% stated that parent companies, based in other countries, establish contact with customers and direct outsourced work into Sri Lanka. In both cases, work does not stem from a single source and must be obtained on a competitive basis. Only 28% of the companies said they receive fixed volumes of work from either a client, a joint venture partner or a sub-contractor.

The above situation could explain the high degree of concern evinced by BPOs on maintaining Sri Lanka's image internationally and the emphasis on domestic civil and political stability. Given that outsourced work must be attracted into Sri Lanka BPOs may be concerned that external perceptions of domestic instability could reduce inflows of outsourced work. A majority of companies, 67%, identified civil and political instability as the leading threat to the industry while 57% expressed dissatisfaction with government efficiency at maintaining Sri Lanka's image abroad.

3.7 BPO operating costs

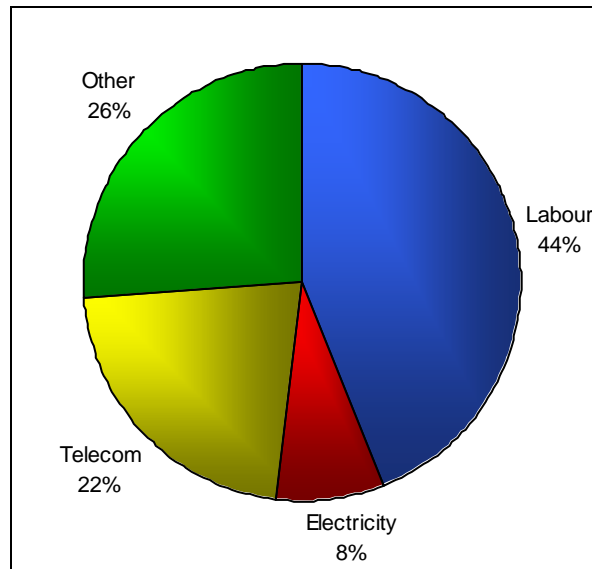


Figure 8: Operating costs of BPOs

The total operating costs for a BPO unit averages to around LKR 4.9 million per month (approximately USD 48,000). Due to the high labour intensive nature of BPO services, labour costs account for the largest share of overheads averaging to about 44% of total operating costs. On average, labour costs at an offshore BPO unit is about 51% of total costs as compared to 35% at an onshore BPO.

Training and development, on average, account for about 8% of the total operating expenditure of a BPO. The survey findings also indicate that offshore BPOs spend more on training and labour than onshore units. This could be due to the fact that both average employment numbers as well as average salaries are higher at offshore BPOs than onshore BPOs.¹² However, the price of labour is not considered a cause for concern by most BPO establishments and only 14% of the companies cited labour costs as a potential industry constraint.

¹² Refer to Section 5.2 and Section 5.4 which respectively analyses employment and salary characteristics of the BPO industry.

After human resources, the second highest expense faced by a BPO is for telecommunications, with costs averaging to around 22% of total monthly costs. The electricity expense is a much lower 8% of operating costs on average.

In terms of office space, the World Bank report found that rents in Colombo on average, are lower than in other major Asian cities.¹³ The average monthly cost per square metre is estimated at around USD 11.60 in Colombo compared to USD 15.45 to USD 26.15 in New Delhi while the price of office space in Shanghai, is nearly three times the cost in Colombo.

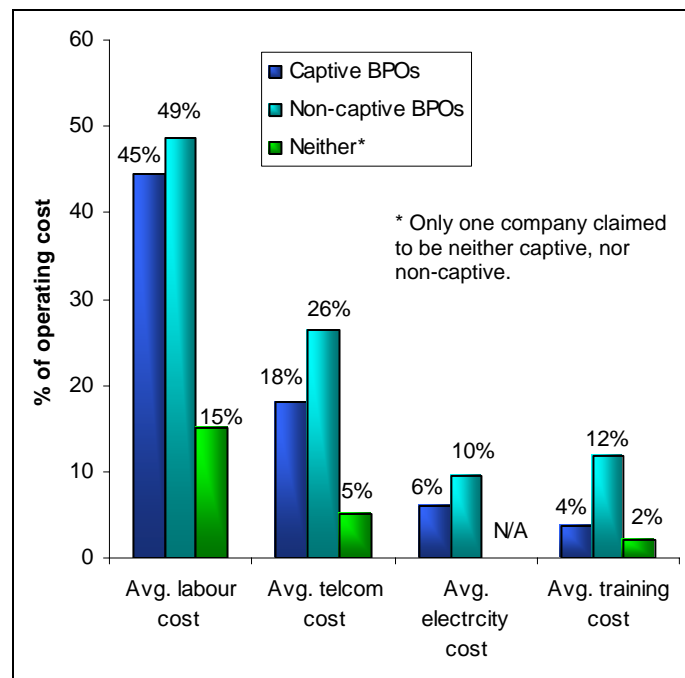


Figure 9: Operating costs of captive & non-captive BPOs

Costs of infrastructure and labour are somewhat higher for non-captive BPOs than for captives as illustrated in Figure 9. Average expenses on labour, training, electricity and telecommunications at non-captive BPO operations, are all above the rates mentioned by captive counterparts. Higher training expenditure could be explained by the need to re-

¹³ Radwan, I. & Fernando, G. (2006). *Offshore to Sri Lanka; Finding Sri Lanka's Offshoring Niche*. Washington: World Bank.

train workers for new jobs/projects and the increased expenditure on training may explain the marginally higher labour costs. However, reasons for non-captive BPOs registering greater telecommunications and electricity costs compared to captive BPOs are not apparent, although this could be due to lower abilities to leverage economies of scale resulting from comparatively smaller size. Non-captive BPOs in general seem to maintain smaller operations with workforces averaging to 134 workers compared to an average workforce of 228 at captive establishments. Despite the higher cost components non-captive BPOs are under greater pressure to contain their overheads, as they are required to compete for work, as opposed to captive units that receive regular workflows from parent companies.

4.0 Impacts of domestic infrastructure on the BPO sector

Transport, telecommunications and electricity are the three facilities primarily examined through the baseline study to gain an understanding of the infrastructure support systems available for BPO activities in Sri Lanka. Mass transport services were examined mainly due to impacts on labour mobility, given that many BPOs operate during unconventional working hours to provide real time services to different time zones. Reliable and cost-effective telecommunications and electricity services on the other hand, are prerequisites for operational efficiency of BPOs.

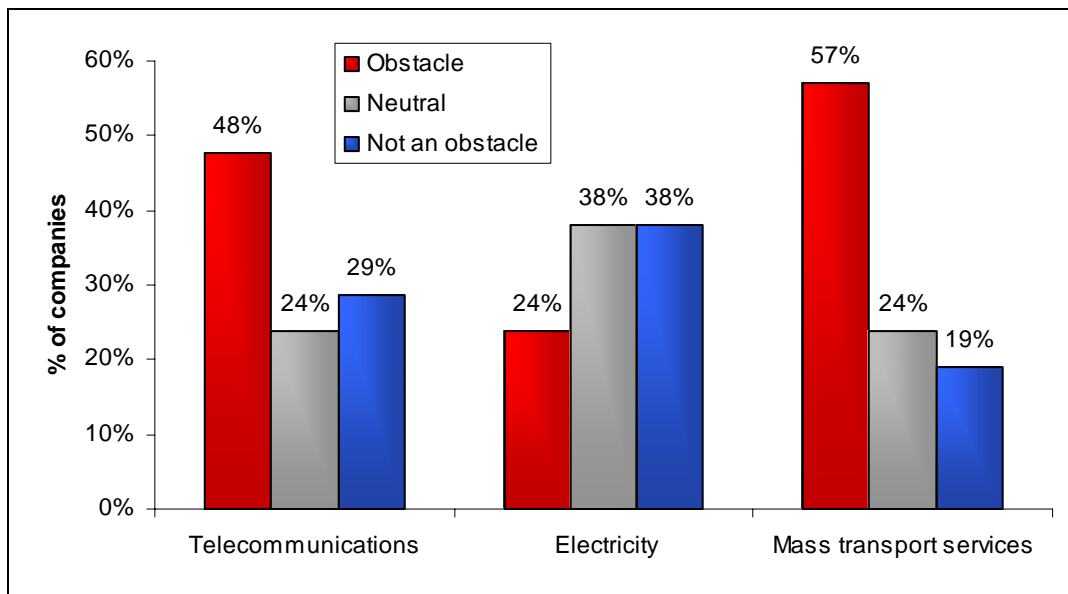


Figure 10: Impacts of domestic infrastructure on the BPO sector

4.1 Transport

BPO companies considered mass transport services as the most inefficient of all the services, with 71% of the companies classifying them as 'inefficient' or 'highly inefficient'. Further more (as seen in Figure 10), BPO companies consider mass transport

services as the greatest infrastructure related bottleneck to BPO activities, with 57% of the companies citing mass transportation services as an 'obstacle' to operations.

Most BPO service providers (61%) work in shifts and an even larger proportion (81%), provide transport for employees. However, transport facilities provided by BPO companies for employees is mainly one-way transport during non-traditional work times or when employees are required to work late after normal work hours. Out of the companies that provide transport, 83% mentioned that employees are transported 'from office when they work late' and 11% stated that transport is provided for employees when 'they have to come early to work.' A few companies (6%) provide transport facilities when public transport is not available.

4.2 Telecommunications

BPOs depend on telecommunication services for their functioning. This primarily includes broadband (mainly leased line) facilities, which are essential for the delivery of their services, but also includes basic telephone services.

On average, BPOs spend about 22% of their operational costs on telecommunication services. Among essential infrastructure facilities, telecommunications services are the second most frequently cited obstacle to growth and operations. Nearly half the companies (48%) cited telecommunications services as an 'obstacle' to operations and growth.

All of the BPO companies use common amenities such as telephones, email and Internet, and some have also invested in VoIP and other types of facilities¹⁴. Over a third of the companies (38%) are using VoIP and another 9% use other unspecified services.

¹⁴ Companies did not specify what these "other" telecommunication facilities were.

A majority of BPO service providers (71%) are satisfied with the reliability of basic telephone services in Sri Lanka rating them as ‘very reliable’ or ‘reliable’.

For broadband access BPOs utilise ADSL facilities, shared and dedicated leased lines, VSAT and other facilities with bandwidths ranging from 256 Kilobits per second (Kbps) to 4 Megabits per second (Mbps). A majority of the companies (67%) use dedicated leased lines for their business with bandwidths ranging from 45 Kbps to 2 Mbps.

Table 3: Types of broadband facilities used by BPOs

Type of connection ¹⁵	Bandwidth (Kbps)	Percentage of companies
ADSL	256 - 2048	24%
Shared leased line	256 -4096	19%
Dedicated leased line	45 - 2560	67%
VSAT	72 - 512	10%
Other	Not mentioned	5%

Despite leased lines being the most common mode of broadband access, BPOs are not as satisfied with the quality of leased lines as they are with telephone services. Only 29% felt that leased line connections were dependable and 38% classified them as ‘unreliable’.

¹⁵ Companies used one or more of the listed facilities.

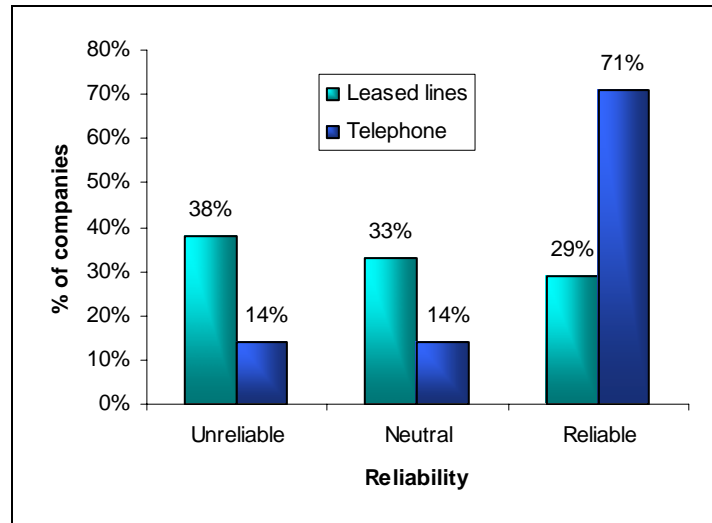


Figure 11: Reliability of leased lines and telephones

The bandwidth, reliability and costs associated with leased line facilities impact the ability of BPOs to deliver their services in a dependable, timely and cost-effective manner. However, cost data obtained by the study is inconclusive to gauge expenses incurred by BPO operators on leased line facilities. An independent study on regional domestic leased line costs on the other hand, suggests that costs in Sri Lanka are considerably higher compared to other countries of the region like India and Pakistan.¹⁶ Sri Lanka’s Domestic Private Leased Circuit (DPLC) prices for 2 Mbit/s is around USD 6,518 for a 2 km distance and around USD 7,901 for a 100 km distance.¹⁷ Comparative DPLC costs in India are USD 376 and USD 3,899 and in Pakistan the prices are USD 1,598 and USD 6,948.

The high costs and low penetration of leased line services could adversely impact expansion of BPO activity. Given that leased line penetration is low outside of the

¹⁶ The leased line costs incurred by a company is related to costs associated with the international portion of the leased line (i.e. an International Private Leased Circuit which connects the foreign client or branch to the landing station of the IPLC in Sri Lanka) plus the domestic portion of the leased line (i.e. DPLC which connects the company to the landing station for the IPLC). IPLC costs for Sri Lanka were unavailable.

¹⁷ Lokanathan, S. (2005). *A Preliminary Methodology for the Comparative Analysis of Domestic Leased Lines Tariffs in the South Asian region*. Available at <http://www.lirneasia.net/2005/08/comparative-analysis-of-leased-line-tariffs/>

greater Colombo area, BPO businesses are restricted in their ability to expand service centres outside Colombo and thus leverage potentially lower labour costs. Only two of the surveyed companies reported branches outside the greater Colombo area. One of the companies reported branches in Kandy while the other reported branches in Kandy, Galle, Matara, Nuwara Eliya, Ratnapura, Chilaw, Badulla and Kaduruwela.¹⁸

4.3 Electricity

Electricity costs as compared to telecommunications and labour costs represent a smaller share of operating expenditure (8%) and most BPOs do not consider electricity an obstacle to daily operations and future growth. Only 24% of the surveyed companies viewed electricity as an obstacle to sector growth. There were also no reports of frequent power outages as most BPO companies (86%) have invested in generators. This could explain why 48% of the companies considered electricity supply as either 'reliable' or 'very reliable.'

However, a comparable number of BPO operators (48%) expressed dissatisfaction with electricity prices. Sri Lanka's electricity tariffs at around USD 0.08 per kilowatt-hour are noted as among the highest in the world for business operations due to cross subsidisation of domestic consumers.¹⁹ Businesses in Sri Lanka pay more for electricity than companies located in many East Asian countries and companies in the US. Indonesia, India and the US charge electricity rates below USD 0.06 per kilowatt-hour while electricity tariffs are below USD 0.07 in Thailand.²⁰

¹⁸ As noted earlier, it is not clear what roles these branches play in delivering the BPO services of the company

¹⁹ Radwan, I. & Fernando, G. (2006). *Offshore to Sri Lanka; Finding Sri Lanka's Offshoring Niche*. Washington: World Bank.

²⁰ *Ibid.*

4.4 Losses due to infrastructure failure

Nearly half the surveyed companies (48%) stated that they have not experienced any losses due to infrastructure failure. Only four companies (19%) reported losses ranging from LKR 120,000 to LKR 1 million per year. However, 33% percent of surveyed companies did not respond to the question. It is not clear whether the damages reported by some of the surveyed companies are due to electricity or telecommunications failures but the low frequency of reporting such incidents and the investments in back up systems suggest that companies rarely experience large-scale losses due to infrastructure failure.

5.0 BPO sector management and workers

Sri Lanka's BPO sector only recently acquired critical mass to gain recognition as an export oriented service distinct from the island's IT and software export industries. As such, the sector is much smaller in size and the total workforce of the 21 companies that participated in the survey amounted to 3,700. Inclusive of those few companies that did not participate in the survey, the total BPO workforce is currently estimated to be slightly over 4,000. However, the sector is expanding, offering new opportunities for young Sri Lankans.

5.1 BPO top management

The survey found that 43% of the top managers have no prior experience in the BPO business. However, 57% of top managers reported previous work experience in BPO, either in a domestic company or in a foreign firm. Out of these experienced company heads, 42% reported experience of 10 years and above while the balance reported two to six years of prior experience. Half the company heads (50%) with prior BPO work experience, reported working with foreign BPO firms from two to 10 years.

Slightly over half (52%) of the top managers have a post-graduate qualification, while 19% have either professional qualifications or undergraduate degrees.

5.2 Sector employment

Employment numbers in BPO companies vary greatly, from just 3 employees in one to 1,700 employees in another. Half the companies employ less than or equal to 62 workers (the median). Twenty-five percent maintain less than 25 employees and 25% have at

least 120 employees. The large deviation is a result of the much higher employment numbers reported by the two largest employers.

Employment also varies according to the type of BPO operation. Employment is higher amongst offshore operations than among onshore BPOs. The average workforce at offshore BPOs is about 265 employees while average workforce is about 78 persons at onshore units and at BPOs that are both onshore and offshore operations. In addition, captive BPOs displayed higher average employment numbers (228) than non-captive operations (134).

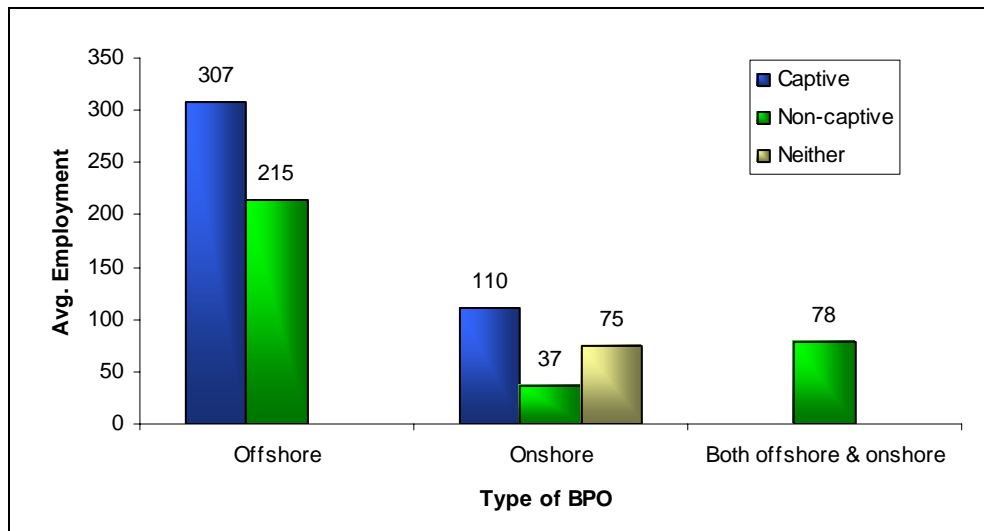


Figure 12: Average employment in BPOs

The BPO sector is not unionised and 95% of the managers did not think trade union formation in the sector is likely. Despite a relatively young workforce, part time work is still extremely rare in the sector. Most of the companies (90%) stated that all their employees work full time and only 10% reported having a few part time employees.

5.3 Workforce characteristics

The following analysis excludes employment data from the largest BPO employer, as this company is an outlier in terms of the overall sector numbers (and represents nearly half the total number of employees in the sector). Inclusion of their data would have significantly skewed the results of the analysis. Therefore, an analysis of this largest employer is presented separately.

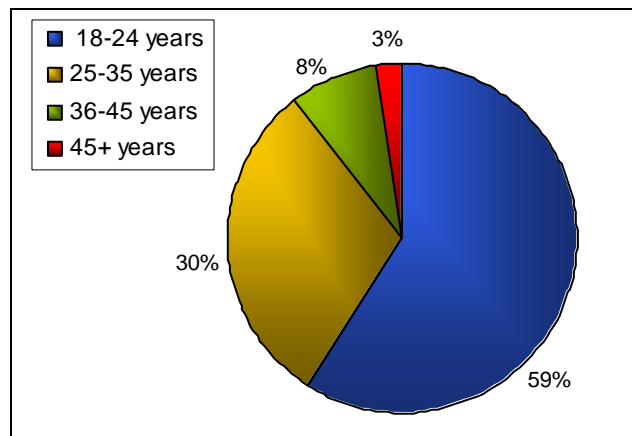


Figure 13: Age distribution amongst BPO workers (excluding largest BPO)

Excluding the largest surveyed BPO, the average workforce per company is about 100. The employees are predominantly young with 59% of all employees in the 18-24 age group and another 30% in the 25-35 age bracket. The average age of a BPO employee is around 25 years.

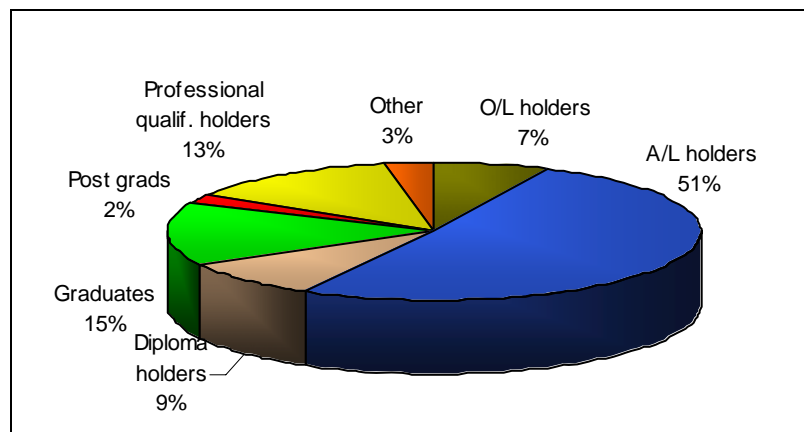
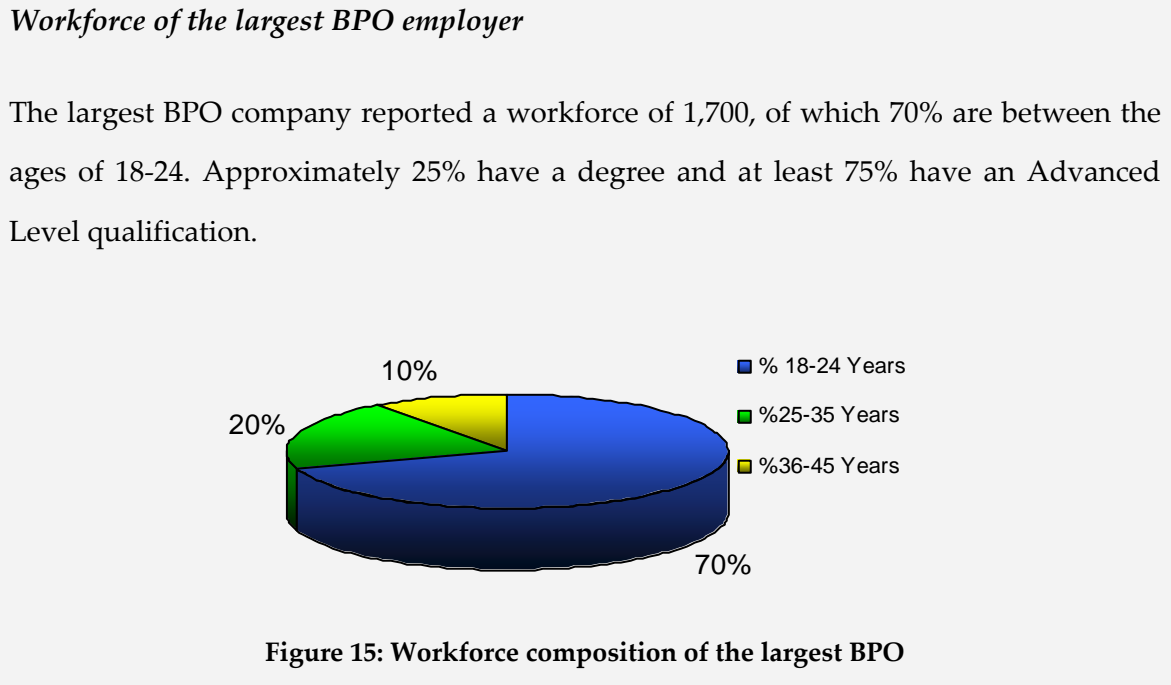


Figure 14: BPO employees by educational qualification (excluding largest BPO)

Half the BPO employees (51%) have the GCE Advanced Level as their highest qualification, 15% are graduates, 9% are diploma holders and 7% have an Ordinary Level qualification. Despite the trend towards a large intake of Advanced Level holders BPO companies cited 'fresh graduates' as an industry requirement.



5.4 Salaries and incentives

The average monthly salary of a BPO worker is around USD 270, inclusive of bonuses and commissions. However, remuneration packages ranged from USD 114 to USD 1,000 per month. Salaries for services like investment research are about USD 1,000 per month while payments for accounting services are around USD 176. Offshore operations displayed marginally higher average monthly salaries (USD 304) than onshore BPOs (USD 226). The survey results do not permit further analysis of the salaries (especially disaggregated analysis of management versus regular employee) or work conditions.

The surveyed companies reported a range of employee incentives from project based salary add-ons to seasonal incentives. Non-financial incentives are for the most part provided in the form of transport and food during non-traditional hours of work, and medical insurance coverage. Most BPOs (61%), work in shifts and 81% provide transport for employees, mostly during night and early morning shifts. Many companies 76% provide medical and/or other types of insurance for workers. Roughly 30% provide food and beverage at work, possibly for those on duty during the night shifts and a few (19%), have welfare and worker compensation provisions. Very few (5%) reported providing internal loan facilities for employees.

Companies also listed conveniences like club membership, professional subscriptions, overseas trips and cars but most likely some of these incentives (e.g. cars) are geared towards management.

Most BPOs do not consider labour costs in Sri Lanka as a problem that would affect future growth prospects or current operations. Nearly half the companies (43%) claimed that the cost of labour is not an obstacle to company growth and another 43% were neutral. Only 14% of the companies felt labour costs to be an obstacle to growth and operations.

5.5 Employee turnover and recruitment

5.5.1 Turnover

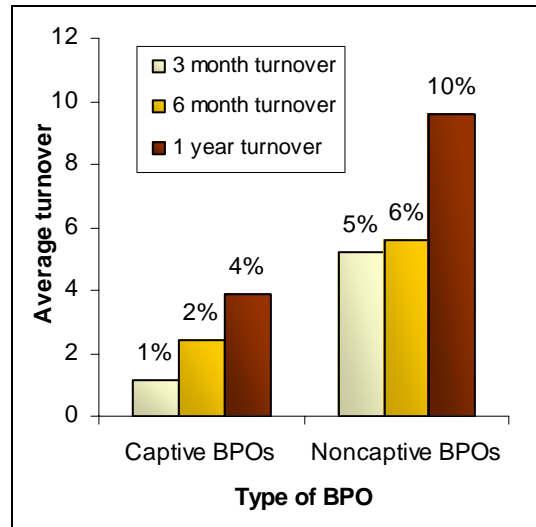


Figure 16: Turnover in 3, 6 and 12 months

The average employee turnover for the industry is 6% per year. The average turnovers for six and three months are 4% and 3% respectively. However, turnovers show wide variation, with some companies reporting high employee turnovers while some reporting zero turnovers. Average turnover at captive BPOs is lower than at non-captive BPOs. The average non-captive turnover could be a result of the project/contract based nature of the operations rather than due to attrition (i.e. employees quitting and/or being fired). However, available data does not allow specific conclusions.

5.5.2 Recruitment

BPOs compete for talent in the labour pool through most of the regular recruitment channels. The most popular method of hiring employees is conventional advertisements in newspapers with 71% of the companies utilising this method. Although Internet usage in Sri Lanka is increasing, only 5% of the companies claimed to use this medium to recruit new employees. Informal channels, such as 'head-hunting' and the 'grapevine'

are more popular than Internet usage. Almost half the companies (48%) reported using references and a further 19% reported using 'word of mouth' in their recruitment activities.

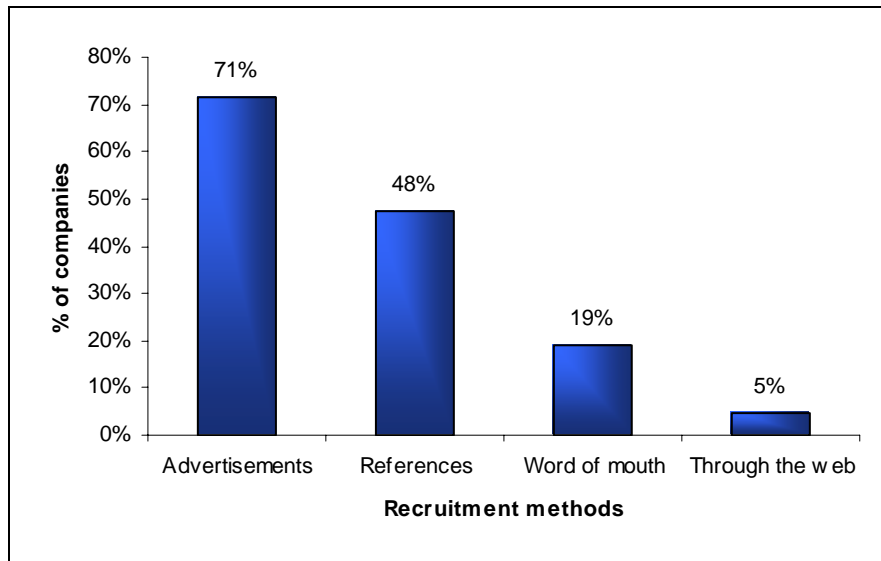


Figure 17: BPO recruitment methods

5.6 Skills in demand

In recruiting potential employees, BPOs look for both domain skills in their offered service areas as well as personality attributes. The primary set of domain skills in demand is language and communication skills (57%), accounting knowledge (19%) and technical knowledge (5%)²¹.

The leading skill requirement in the BPO labour market is for English language skills. Almost all the managers participating in the survey (95%), regardless of the type of services provided by the company, considered the ability to speak in English an

²¹ Language, speech and communication skills requirements are primarily in relation to English. Companies however did not specify what types of technical skills are required. Personality attributes like attitude and professionalism are listed as 'other skills'.

important requirement for BPO work. English writing is considered important by about 66% of the companies. Speaking and writing skills in Sinhala and Tamil are considered 'not important' by a majority (over 60%) of BPO managers, which is not surprising as the sector is primarily export oriented.

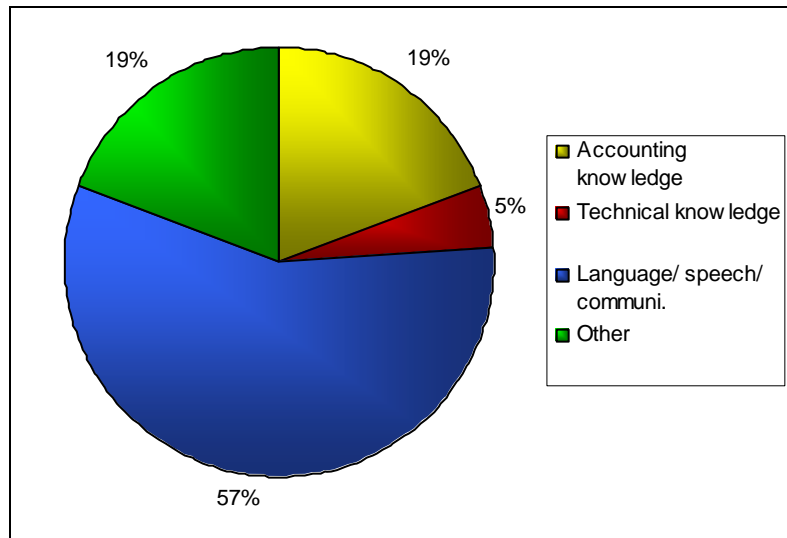


Figure 18: No 1 set of skills demanded by BPOs

Just under half the companies (43%), are not satisfied with the availability of personnel in the primary skill areas of accounting knowledge, technical subjects and language skills.

While supply shortfalls of qualified personnel in some of these primary skills may occur, it would be surprising if this were the case where accounting skills are concerned as Sri Lanka is noted for its large and qualified pool of accountants. It is possible that supply limitations of qualified personnel for BPOs may arise out of societal attitudes, where non-traditional working hours especially "grave-yard" shifts may be perceived unfavourably. Such concerns may be even more pronounced amongst females and, coupled with poor mass transport facilities after dark, may discourage women from applying for BPO work. In addition, low public awareness about the nature of BPO workplace, salaries and career opportunities may also limit the number of potential candidates applying for BPO jobs.

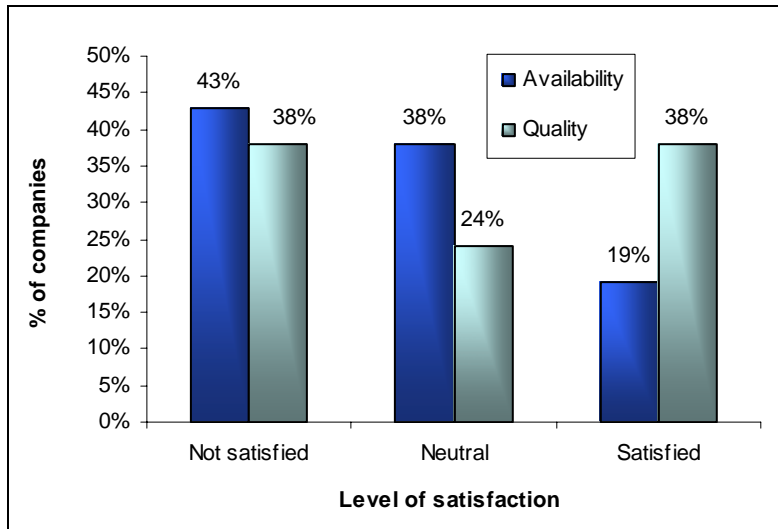


Figure 19: Satisfaction on availability & quality of personnel

The quality of available personnel for the above primary skills is not as much a concern as their supply. However, 38% of the companies are not satisfied with quality of available candidates, but an equal proportion (38%) are satisfied with the quality of available talent.

In addition, BPOs also require proficiencies outside of those identified as domain skills. Managers expressed the need for persons qualified and proficient in areas such as marketing, management and law. Computer literacy is also in demand.

However, one third (33%) of the companies stated that overall skills and education of available employees, are an obstacle to operations and growth. Companies also did not view the public education system very favourably. Nearly half the companies (48%) maintained that education services are 'inefficient' or 'highly inefficient.' Nearly a quarter of the companies (24%) cited improving the supply of skilled personnel as a priority area that requires immediate attention for the development of the sector.

The available pool of talent may be adequate at present to meet the requirements of the relatively small number of BPO companies currently in operation in the country. However the findings do indicate quality and supply constraints which may negatively impact the long-term competitiveness and growth of the sector.

5.7 Skills development and training

Almost all the surveyed BPO establishments (95%) provide compulsory and non-compulsory training for employees. The cost of such training programmes on average is about 8% of total monthly operating costs and training duration ranges from a few days up to six months based on the type of training.

Although the most commonly offered service by Sri Lankan BPOs is accounting services, the most frequently reported employee training is speech training with half (50%) the companies investing in this. This highlights the importance BPOs place on communication skills, whatever the type of services being exported. Many companies (40%) stated they provide training in soft skills but did not specify what these are.

5.8 Employment growth

Almost all the surveyed companies (95%) plan to increase their workforce in the short term. The survey results suggest that sector employment should grow by 30% during 2006 - 2007. In the case of many BPO companies however, expansion in employment will take place over a fairly low base. As explained previously half the companies maintain up to 62 employees and 25% have less than 25 employees.

6.0 Government relations and industry bodies

Sri Lanka's BPO sector has strong links with the state, with almost the entire trade coming under the purview of the Board of Investment of Sri Lanka (BOI). Eighty six percent of surveyed BPOs are registered under the BOI and are recipients of various BOI incentives. The BOI's current (2006) plans to provide BPO-specific incentives for the first time clearly indicate the importance that the government is placing on the sector.²²

Most BPO companies were able to make a relatively smooth entry into commercial operations. Nearly three quarters (71%) of the surveyed companies reported no delays in starting their business. However, the remaining 29% reported procedural delays ranging from three weeks to eight months. These include offshore and on shore BPOs and also companies that are both offshore and onshore operations. All the companies that reported delays are BOI companies. One third of the BOI companies (33%) experienced delays in starting commercial operations while non-BOI companies (although a much smaller pool, representing only 14% of the entire surveyed sample) did not report such delays.

Table 4: Reported procedural delays

% of BPOs that experienced delays	29%
Reported delays (in days)	21, 60, 90, 99, 210, 240
Reasons for delays	<ul style="list-style-type: none">• Regulation payments• Company incorporation and BOI procedures• Registration procedures• Formalities

²² Incentives targeting BPO specific investments were not finalised at the time of this study.

6.1 Regulations and taxes

Once operational, companies spend a considerable amount of management time dealing with various government administrative procedures. These include tax and customs related procedures, labour regulations, licensing and registrations, dealings with government officials and completing forms. On average 12% of management time per year, is spent on dealing with such government-related requirements.

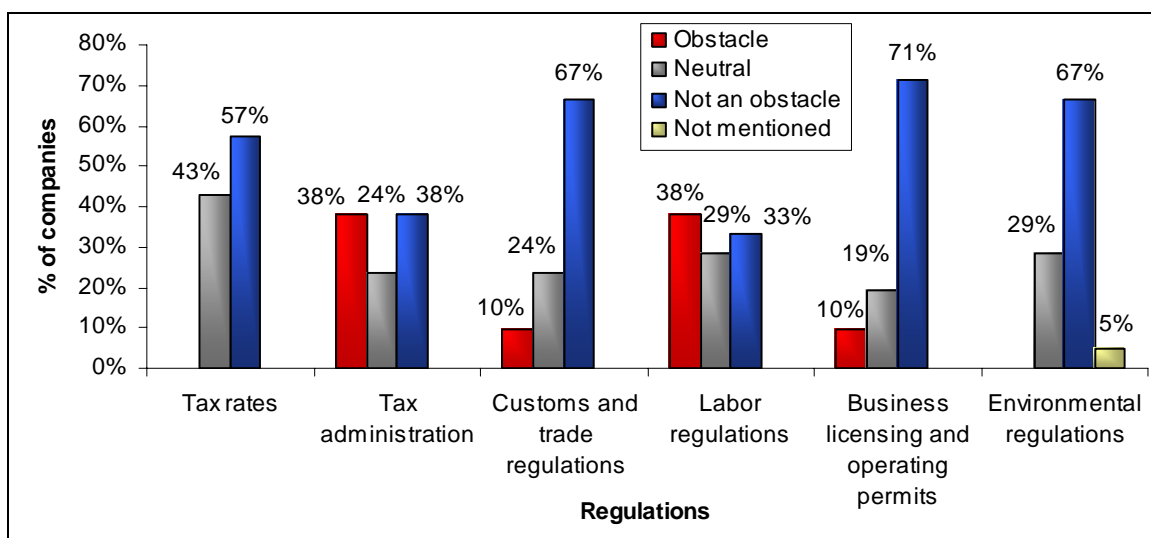


Figure 20: Industry perceptions of Government regulations

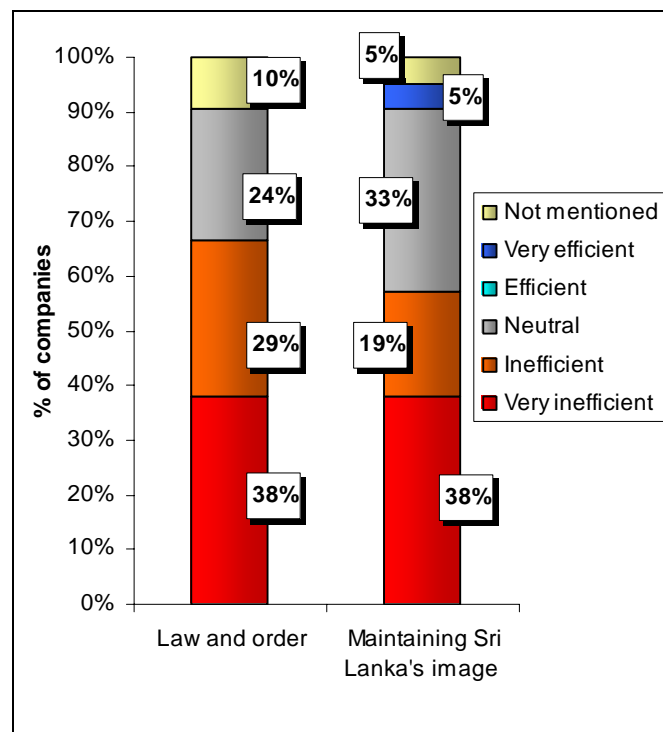
Payment of taxes is not considered a hindrance to growth and operations by 57% of the companies. This is most likely due to the fact that over half the BPO companies are still enjoying tax holidays under the prevailing BOI incentive schemes. Tax administration on the other hand is considered an obstacle by 38% of the companies.

Customs, trade, environmental regulations and business licensing and operating permits are in general not considered problematic. Over half the companies (67%) did not consider customs and trade regulations a difficulty and only 10% cited these procedures as a 'major obstacle.' None of the BPO operators considered environmental regulations a hindrance to operations and only 10% stated that business licences and permits caused difficulties.

Over one third of surveyed companies (38%) stated that labour laws are an ‘obstacle’ to growth and operations. As the World Bank report suggests, the cost and procedures associated with termination of employment could be the most serious barrier.²³ However, almost an equal proportion (33%), did not consider labour laws an obstacle to their operations.

6.2 Stability of operating environment

One third (33%) of the BPOs did not agree with the statement that ‘Interpretations of regulations affecting my establishment are consistent and predictable’. An equal proportion (33%) was non-committal and only 29% agreed that regulations were consistent and predictable.



²³ Radwan, I. & Fernando, G. (2006). *Offshore to Sri Lanka; Finding Sri Lanka's Offshoring Niche*. Washington: World Bank.

Figure 21: Perception of government services

Over half the surveyed companies (57%) are not satisfied with government's efforts at upholding Sri Lanka's national image among the rest of the world. An even larger proportion (67%) expressed concerns about the state of law and order²⁴ and ranked maintenance of law and order as either 'inefficient' or 'very inefficient'.

6.3 Government incentives

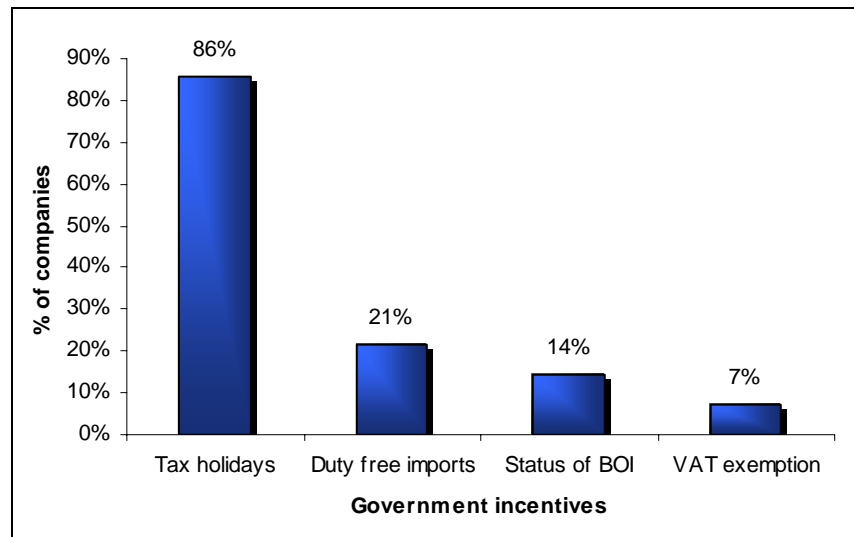


Figure 22: Government incentives used by BPOs

Over half the surveyed companies (67%), enjoy various government incentives. Out of these companies 86% enjoy tax holidays and 7% have VAT exemptions while 21% utilise duty free import facilities. BPOs could also be using tax concessions to supplement price competition against large, established, low cost BPO service destinations like India. This would also explain why a majority of BPO investments come under the BOI despite the reported delays caused by time consuming procedures.

²⁴ "Law and order" is different from "Civil and political stability/unstability". The former is associated with the laws within the criminal justice system and the enforcement of such laws. The latter is related to issues (if any) in the government and the political process as a whole.

6.4 Sector representation

Despite its small size and relative youth, over half the BPO sector is already organised within private-sector trade bodies. Sixty six percent of the companies belong to a directly BPO related business association or a general trade chamber. The findings indicate that BPO companies are utilising these trade affiliations in different ways but the extent of benefits and ability to influence national policy, are unclear.

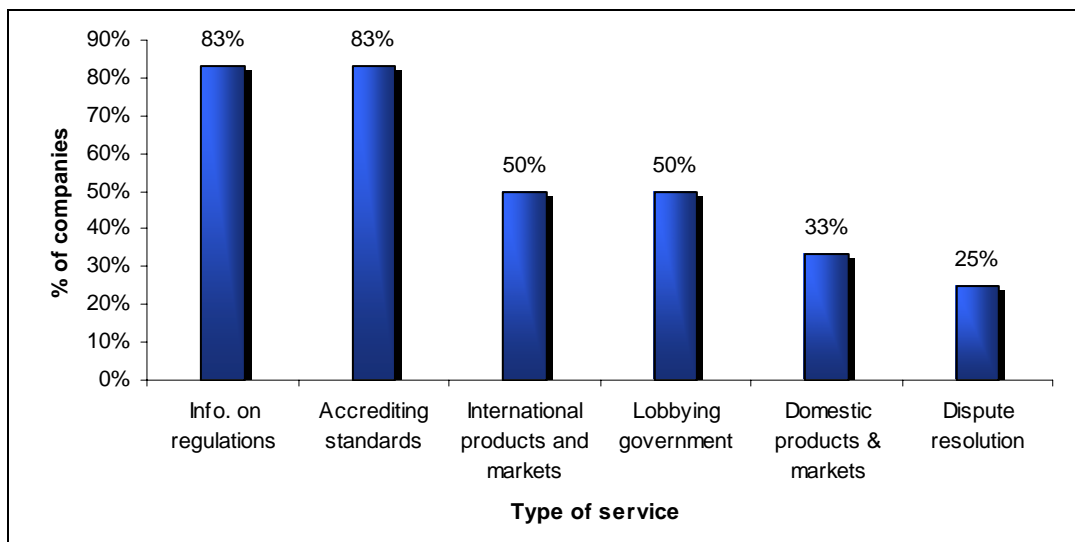


Figure 23: Value of services offered by trade chambers

Out of the BPO companies that belong to a trade body, a majority (83%) cited that information on government regulations and information on accrediting standards are two of the most valuable services provided by trade chambers. Information and contracts on international products and input markets, and lobbying government, are also mentioned as valuable activities of trade bodies by 50% of the companies. Thirty three percent cited information on domestic products and input markets, as helpful. Dispute resolution is considered useful, although not to the extent of other activities, and only 25% said this was a valuable service.

7.0 Growth prospects of the BPO sector

A majority (76%) of Sri Lanka's BPOs, both offshore and onshore, are gearing to expand their activities.

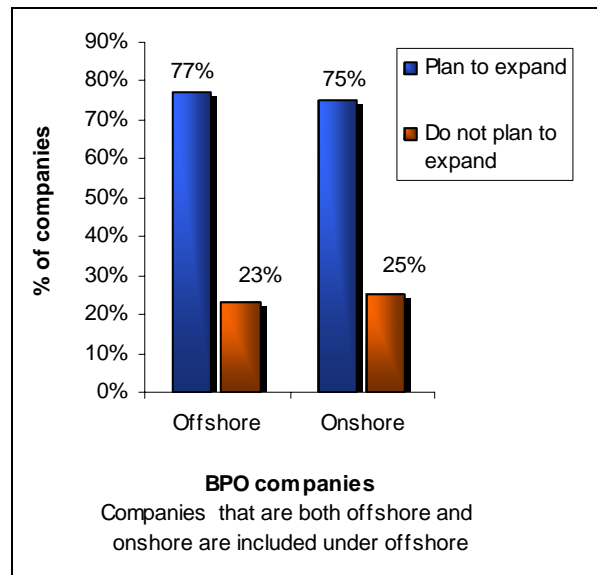


Figure 24: BPO sector growth plans

Most companies considered corruption and operational stability a greater concern than raising capital for expansion. Seventy one percent of the companies claimed that obtaining funding for expansion was not a difficulty and 62% said the cost of funds was also not a problem. Only 14% stated that financing aspects could pose difficulties for expansion. However, 33% of the companies cited corruption as an obstacle while another 29% cited macroeconomic instability, and crime and disorder as potential bottlenecks to growth.

Out of the companies that plan on expanding, 50% are considering physical expansion with possible investments in bigger work premises and/or new branches. However, one fourth (24%) of the companies stated that access to suitable land and office space was a growth constraint. BPO managers also suggested infrastructure improvements and allocation of space for BPO activities. This could refer to a dedicated zone for IT enabled

service providers with land and infrastructure specifically structured to cater to industry needs.

About 13% of the BPOs that stated expansion plans are considering market expansion in the Asia-Pacific region. Another 6% are considering expansion through the formation of new partnerships that would lead to overall growth. However, companies were reluctant to divulge details on expansion strategies and new ventures.

Almost half the BPO companies (42%) that participated in the survey intend to make changes to their existing sales and marketing strategies. These companies stated various tactics such as increasing marketing activities, targeting clients directly instead of through third parties and changing the corporate brand or modifying the current service package.

BPO companies also expressed the opinion that national and international marketing and promotional activities to position Sri Lanka as an outsourcing destination, should be augmented to support individual and industry level efforts.

8.0 Conclusions

Following accelerated telecommunications liberalisations in 2002-03, Sri Lanka's BPO sector is expanding both in terms of increased activities of existing players, as well as new entrants. This growth of BPO activity has so far been fuelled through low labour and low operating costs. Government incentives too, seem to have been successful in encouraging BPO investments. However, Sri Lanka needs to address capacity constraints in the three areas of English language skills, mass transport, and, telecommunications infrastructure (specifically improvement of broadband facilities) for any significant expansion of BPO activity to occur.

8.1 Capacity constraints

The survey reveals that Sri Lanka requires further investments in education, particularly in English language skills. Irrespective of a company's services, English language is a requirement across the board. Therefore, improving English language skills is a blanket requirement for BPO sector growth. Measures to improve English education and other types of skills should primarily target the youth, as the BPO sector is an emerging opportunity for this demographic.

While the irregular work hours and company-funded transport provided by BPO establishments may help to somewhat alleviate the effects of the poor mass transportation services, surveyed companies clearly conveyed the need for further improvements.

Telecommunications liberalisations, especially the opening of the international gateway to competition in 2002, may have stimulated BPO sector growth. However, the higher costs associated with leased lines, their relative unreliability and the low penetration of broadband facilities outside of Colombo must be addressed for BPO sector expansion,

In lieu of the sector's emerging potential, the government should assess the feasibility of setting up a dedicated BPO zone with enhanced transport facilities and telecommunications infrastructure.

8.2 Regulatory and procedural constraints

Complex regulatory procedures not only lead to delays in realising investments but also add to operating costs. Over one fourth (29%) of the companies experienced start up delays due to government procedures and once operational on average, 12% of management time per year, is spent on dealing with government-related requirements. In addition, one third of the BPO operators (33%) felt that the applicable regulatory environment was inconsistent. These findings indicate the need to streamline regulations that govern the industry to facilitate the process of setting up and conducting BPO operations.

Given the limitations of the baseline survey, this report does not make recommendations on changes to specific laws and procedures. It is noteworthy however, that labour laws are viewed unfavourably by over one third (38%) of the BPO operators. As the government is already in the process of addressing restrictions on working times of women employees, the labour laws are probably considered problematic due to costs and procedures associated with employment terminations. However a more in-depth study is required to gauge impacts of labour and industry related legislation on BPO activity.

8.3 Marketing and sector promotion

Successfully leveraging Sri Lanka competitive advantages of lower labour and operating costs requires strong promotional and branding exercises that would benefit from

greater government participation. Over half the respondents (57%) expressed concerns about maintaining Sri Lanka's image abroad, suggesting that more needs to be done to promote Sri Lanka as a viable outsourcing destination. Therefore national promotional campaigns could attract further offshore investments and also encourage non-captive operators by attracting outsourced workflows. However, other domestic factors need to be addressed in parallel, for promotional campaigns to show adequate results. Although large, captive, offshore BPOs tend to be more cost effective, generate higher employment and may also provide greater employment stability, promotional activities to draw such investments must be accompanied by measures to address capacity constraints to successfully supply operational needs of BPOs.

Other factors such as civil and political stability, and law and order, also seem to directly impact BPO activity. Over half the surveyed companies stressed the need to uphold national image and maintain law and order. These factors are of particular importance for non-captive operators as external perceptions of domestic instability could adversely impact inflow of outsourced work. Perceptions of domestic instability and security concerns could also discourage further offshore investments.

Overall, greater attention and facilitation by national decision makers is necessary to nurture and realise the potential of the BPO sector at this nascent stage.