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Sector Workshop



Creating employment and
economic wealth through
developing the South African
BPO&O sector

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Creating employment and economic wealth through developing the South African BPO&O sector

Business process outsourcing and offshoring (BPO&O) is a major global trend, with a significant positive impact in developing countries that have the required skills, cost advantage and infrastructure. Over the next 4-5 years, a window of opportunity exists for South Africa to realize significant value by developing this sector. South Africa has a good starting position with a large and growing domestic BPO market, and strong capabilities in the highest growth sectors (e.g., financial services and insurance) to exploit the international opportunity. Early estimates suggest that a concerted effort could create between 65 000 and 100 000 jobs (15000-25000 direct, 45000-75000 indirect), attract between \$90-175m in cumulative foreign direct investment up to 2008 (in real terms), and result in a GDP contribution of between 0.3-0.5%.

However, to date South Africa has not been able to attract large BPO&O projects, and initiatives aimed at attracting European and US multinationals have been fragmented and largely unsuccessful. This is in marked contrast to the rapid development of the BPO&O industry and the experience of successful players such as India and Philippines, who have rapidly growing business process outsourcing industries, significantly stimulating growth and employment. For example, India is forecasting the creation of approximately 1 million direct jobs from this sector by 2008.

This memorandum outlines our core beliefs around the size and nature of the opportunity, the key success factors based on the experience of winners in this sector, and provides a perspective on the key obstacles to be addressed in order to make it happen for South Africa. The memo is structured around five sections:

- ¶ Global and domestic sector market and trends
- ¶ Assessment of South Africa's offering given current situation and policies
- ¶ Constraints and challenges
- ¶ Value proposition and opportunities
- ¶ Required Initiatives

GLOBAL AND DOMESTIC SECTOR MARKET AND TRENDS

South Africa has a significant opportunity to grow its BPO&O market in the next 4-5 years. This opportunity arises in the context of massive global growth in the traditional (English-speaking US and UK) market, coinciding with increasing supply constraints on the part of the major incumbents such as India and China. Although not currently competitive against these 'tier 1' players, South

Africa is increasingly becoming more attractive as a 'tier 2' destination. With strong industry leadership and government support, this position can be strengthened significantly.

- ¶ The global traditional BPO&O market is expected to grow from approximately \$10bn today, to between \$50bn and \$60bn by 2008, driven by increasing levels of offshoring among early movers, as well as an increase in the number of companies willing to offshore processes in the next 3-4 years. Between 40% and 50% of the opportunity will be in the financial services and insurance verticals. In addition to growth in the UK and US markets, additional growth of \$8-9m is forecast in continental Europe, however, this is less certain.
- ¶ This dramatic market growth will create an additional 3 million direct jobs worldwide by 2008. While 1 million jobs are likely to remain 'near shore' to the countries generating demand (primarily US and UK), the remaining 2 million will be relocated based on the price performance (a combination of cost and quality) of location.
- ¶ Today, the top locations meeting this demand are the likes of India, Philippines and China. However, due to anticipated supply side bottlenecks such as talent and infrastructure availability, performance issues, and an increasing requirement for companies to develop globally diversified offshoring footprints, a significant portion of demand will be *unmet* by these established centres over the next 4-5 years. It is this 'surplus demand pool' (expected to range in size between 200 000 and 500 000 jobs) that offers an exciting opportunity for SA to pursue – along (and in competition with) with a range of other emerging 'tier 2' players such as Thailand, Dubai, Singapore and Mauritius.

Although a small BPO&O market today (~3500-4500 direct employees), SA is steadily improving its candidature as a destination for offshoring investments, with a number of exciting reference cases emerging, spurred on by government initiatives such as the deregulation of the telecom industry. South Africa also has fundamental advantages in high growth industry verticals such as financial services and insurance.

ASSESSMENT OF SOUTH AFRICA'S OFFERING, GIVEN CURRENT SITUATION AND POLICIES

An assessment of SA's current performance against the key criteria used by companies to choose offshoring locations reveals significant gaps and important areas to address. Given that a number of other tier 2 countries have already announced aggressive growth intentions in this market, SA will need to move fast to take advantage of this window of opportunity. When companies consider offshoring locations, they assess potential locations against a scorecard that covers three broad categories:

- ¶ **Does the country have the core intrinsics of a successful BPO&O centre?** On this dimension, SA fares reasonably well on the availability of basic ITES (IT-enabled services) infrastructure, the availability of social and business infrastructure, and the quality of operations, however, substantial gaps exist on the dimensions of cost competitiveness, talent availability and perceived risk of operations:

- *Cost*: SA is about \$7-8 hour/FTE (almost 100%) costlier than lowest cost centers, (e.g., India, Philippines) today. The key drivers to high costs are labour rates and telecom costs. While telecom cost reduction and increased scale of operation are expected to reduce costs by 17%, this will not be sufficient to close the gap.
- *Talent*: Significant gaps are already apparent in the availability of managerial level talent today. While agent level talent supply issues not in evidence today, it will become a barrier in 2-3 years if aggressive growth is pursued – especially as the local outsourcing and call centre industry requires talent to fuel its growth of 15% per annum.
- *Risk of operations*: Although South Africa is perceived to be economically and politically stable relative to other offshoring locations, significant perception issues exist around personnel security and crime rates in SA.

¶ **Does market maturity exist in the local BPO&O industry?** Given that BPO&O is an emerging industry in South Africa, it is not surprising that market maturity is a big issue for the country to address in its bid to attract offshoring from major MNCs and third party vendors:

- *Set-up assistance*: SA is significantly behind other locations on the effectiveness of setup assistance provided to BPO&O companies and time required to complete set up requirements and company registration
- *Regulations and incentives*: Concerns have been raised by companies regarding the flexibility of the labour regulations (particularly with regard to overtime work) and the risk of unionization in the industry. SA is also significantly behind other locations on the provision of financial and non-financial incentives to investors
- *Third party vendor landscape*: Only 3-5 scale players with experience of migrating international business are available in SA today, compared to 30-40 in the Philippines and over 250 in India

¶ **Does the market undertake proactive marketing efforts to attract investments?** When compared to the target marketing efforts conducted in other countries, those currently being conducted at a country and provincial level in SA are not of similar scale and sophistication. Duplication and fragmentation of efforts tend to result in ineffectiveness of interaction with and even confusion on the part of investors.

KEY CONSTRAINTS AND CHALLENGES

Based on the assessment outlined above, the major real and potential obstacles standing in the way of realising the BPO&O opportunity therefore includes:

- ¶ Lack of cost competitiveness vis-a-vis preferred locations such as India and China
- ¶ Talent shortages at both managerial and agent level (this is expected to become a real growth barrier in 2-3 years)

- ¶ Perceptions of an unfavourable labour regulatory framework, including risk of union resistance (e.g. potential de-legitimation of the outsourcing industry in reports regarding atypical forms of employment) and labour constraints vis-à-vis 24x7 work requirements (e.g. overtime pay)
- ¶ Industry fragmentation and the lack of a strong industry body to partner with government
- ¶ Lack of distinctive support to prospective investors, such and transparent and accessible financial and non-financial incentives, and ease of set-up
- ¶ Ineffective marketing efforts, including lack of target marketing activities at appropriate scale and sophistication, and failure to address negative foreign perceptions around personal security risk, crime and HIV

Therefore, a number of critical success factors will need to be met in order to avoid these elements turning into constraints and challenges:

- ¶ **Government Championship:** Leadership and support from government at the highest level, manifested through recognition of BPO&O as a priority sector, is key. Within this, the following commitments will be critical:
 - Willingness to take bold regulatory steps where required (e.g. labour flexibility, unionization). For example, in the Indian situation, the BPO&O industry was declared an ‘essential services’ industry, precluding unionized activity, in the case of the Philippines, foreign ownership requirements were relaxed
 - Ensuring successful telecom deregulation as a symbol of its commitment – this is a high profile and visible element being followed closely by the outside world
 - Creating an attractive and supportive environment for investors through commitment to ensuring ease of set-up and providing incentives
- ¶ **Industry leadership and collaboration:** A high performing, credible and representative industry body (e.g. NASSCOM in India) is a pre-requisite for rapid mobilization within the industry. This means that:
 - Industry must take the lead in developing the sector, ensuring that government and industry shares the same vision, speaks with one voice to the outside world, and ought to draw on and involve government on critical initiatives
 - For such initiatives, the establishment of effective public-private partnerships with government around key initiatives (e.g. talent development and skill building) will be critical.
- ¶ **Effective marketing strategy and execution:** A coherent and consistent message, targeted at and tailored to priority audiences and backed up by an ability to deliver on promises made are the essential elements of effective marketing. Lessons learnt suggest the following:
 - Develop a powerful message, that distinguishes SA from other tier 2 players on the basis of, for example, focus industry themes (e.g. financial services and insurance).

Position SA as the ‘supplier of choice’ for services across the value chain within these industries.

- Prioritise going after 3-4 MNCs and 3-4 top global third party vendors, and attract them to South Africa through tailored incentive and support packages – these high profile players act as powerful champions of the industry, as proven by the experience of India through HSBC and GE.
- Capitalise on existing relationships, such as multi-nationals with strong presence in the country and on the African continent, who have decentralized back-office operations.

OPPORTUNITY AND VALUE PROPOSITION

The degree to which SA could share in the growth of the global BPO&O industry depends on a number of variables – some within and some outside of the country’s control. The key variables at play are the degree of demand surplus available to tier 2 players, South Africa’s relative cost competitiveness, and the extent to which SA can capitalize on offering a distinctive proposition for offshoring and outsourcing in its two best-positioned industries (financial services and insurance). On the basis of these variables, three potential scenarios have been created (detailed in the attached exhibit 1):

Assuming an end game that emerges falls somewhere between the base case and best case, an aspirational vision for South African to pursue for 2008 would be to create a \$0.8bn industry, generating total incremental employment of up to 100 000 new jobs and attracting cumulative FDI of up to \$175m. Distribution of this newly created wealth would contribute to government’s objectives of employment equity and poverty alleviation, based on existing evidence that through training, currently unemployed and destitute talent pools can achieve high levels of performance in, for example, the contact centre industry. Also, through focused education and skill-building efforts on the part of a credible industry body, the stimulation of small and medium enterprises alongside scale third party vendors would be enabled.

Practically, achieving these levels of economic impact would require SA to attract 5-7 MNC captives of 1000-2000 people each, 5-7 third party vendors of similar size, between 20 and 30 smaller investments, and expansion of existing players by 150-200%. Achieving these targets will require a significant, dedicated effort, with prioritized initiatives as outlined in the following section.

In pursuing this opportunity, SA will need to provide an attractive value proposition, built on a combination of current strengths and the commitment to address the most critical identified gaps. In our view, SA should seek to deliver a value proposition based on three pillars, supported by unequivocal underlying commitment and support from government to facilitate easy set-up and industry prioritization. These pillars are:

- ¶ **Pillar 1 – A solid foundation that earns the ‘right to play’:** South Africa is already on most prospective investors’ radar screens when considering offshore locations. Its core strengths include reliable and sophisticated business infrastructure, attractive social/living environment and efficient international connectivity – all recognized as

important criteria considered by customers when considering locations for BPO&O. In addition, despite not being able to lay claim to ‘lowest cost’ status at present, SA meets the gating criteria in terms of cost competitiveness of 30-40% cost reduction relative to UK and US costs.

- ¶ **Pillar 2 – Clear commitment to cost improvement:** However, to be a truly attractive alternative to the current locations of choice and other emerging ‘tier 2’ locations, SA will need to improve its attractiveness on the cost dimension through for example telecom deregulation and broadening access to lower cost high quality talent pools. At the same time SA will have to provide attractive economic incentives to players, in order to off-set some of the operational cost disadvantages in the short to medium term.
- ¶ **Pillar 3 – Structural elements of distinctiveness:** The uniqueness of SA’s value proposition could come from a set of emerging areas of distinctiveness around quality and specialist service provision – anchored in some structural characteristics. SA has an emerging record of high quality service provision, under-pinned by strong cultural and language affinity to the key demand centres (US and UK). It also has sophisticated industry expertise and infrastructure in two of the highest growth sectors (financial services and insurance), opening up the opportunity to offer distinctive propositions on high-end specialist services in focus sectors.

REQUIRED INITIATIVES

By prioritizing and investing in the BPO&O sector, and partnering with industry to mobilize a set of key initiatives to build and deliver a distinctive SA value proposition, government can create significant economic wealth over the next 4-5 years. To kick-start this effort, a set of 5 priority initiatives will need to be launched in the immediate term. Specifically:

- ¶ **Comprehensive lower cost, high quality talent development:** SA needs to launch a 3-pronged talent development program focused on training, certification and promotion for the BPO&O industry. This program should specifically focus on developing an available agent talent pool of 40-60 K p.a. (including broadened access to alternative and lower cost labour pools) and a middle management pool.
- ¶ **Distinctive investor support, incl. incentive schemes and set-up assistance:** SA needs to develop a comprehensive BPO&O policy focused on providing incentives for companies that can reduce the cost of operation by 20 to 30% from the present levels (~\$17-18/FTE/hour). Additionally, development agencies should be allowed to offer special incentives for major players on a case to case basis. SA would also need to develop an effective model to provide distinctive set-up assistance for investing companies.
- ¶ **Favourable regulatory framework for the industry:** SA would need to ensure a favourable regulatory environment through targeted initiatives in especially the areas of telecom and labour. SA will need to think creatively about ways to signal its commitment to this industry to the outside world.

- ¶ **Target marketing initiatives:** SA should launch a focused marketing program for 30-40 targets clients in 3 categories (top captives in India, top global third party vendors, and regional players) with the intent to attract, at a minimum, 3-4 top vendors and 3-4 MNCs to act as champions for the region. It is critical that the dti follows a transparent approach to allocating opportunities to various regions, and co-operates closely with the provincial agencies.
- ¶ **Stakeholder mobilization initiatives:** SA needs to develop a vibrant industry association to take the leadership role in developing this industry – the success of India was in large measure owed to the drive and influence of NASSCOM. The industry should also ensure close co-operation with government - ultimately, strongly felt support from the top political leaders will be critical for the success of the industry, especially when it comes to attracting the first MNCs and top vendors.

In pursuit of the aspiration for 2008 outlined above, one thing is clear: ‘Business as usual’ will *not* deliver these results. Success will depend on the execution of an integrated programme, covering distinct projects to deliver on the five initiatives outlined above, supported by top-notch programme management and leadership at the highest levels of industry and government.

In summary – significant employment and wealth creation potential can be unleashed through focused investment in the BPO&O industry. A concerted effort on the part of both industry and government will no doubt be essential to tap into this opportunity, but the size and nature of the value-creation potential strongly indicates that such an effort will pay great dividends for South Africa’s economic growth.

November 5, 2004