

CHAPTER 24

INDUSTRIAL STRATEGY, OFFSHORING, AND EMPLOYMENT PROMOTION IN SOUTH AFRICA

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ABBREVIATIONS

BFSI	banking, financial services, and insurance
BPA/P	Business Processing Association of the Philippines
BPeSA	Business Process Enabling South Africa
BPO	business process outsourcing
BPO&O	business process outsourcing and offshoring
DTI	Department of Trade and Industry, South Africa
FAO	finance and accounting outsourcing
FDI	foreign direct investment
GAS	Government Assistance and Support program, South Africa
GDP	gross domestic product
HRO	human resources outsourcing
ICT	information communication technologies
IPAP	Industrial Policy Action Plan, South Africa
ITES	information technology-enabled services
IT/ITO	information technology/information technology outsourcing
KPO	knowledge process outsourcing
MNC	multinational corporation
NASSCOM	National Association of Software Services Companies, India
O&O	offshoring and outsourcing
R&D	research and development
SACCCOM	South African Contact Centre Community
SETA	Sector Education and Training Authority

1 INTRODUCTION

South Africa has an extremely high rate of unemployment, in a middle-income country with substantial capability in service industries. Business process outsourcing and offshoring (BPO&O) presents as one of the few rapidly expanding global opportunities in which South Africa might generate large numbers of jobs in traded activities. BPO&O is essentially a new activity, enabled by the diffusion of broadband and internet services over the 2000s. Yet, to date, India and the Philippines are the only developing countries to have positioned effectively to the result of generating large employment numbers.

This chapter reviews the global positioning of South Africa for BPO&O industrial expansion. BPO&O is first defined and a review of global context considered. Since India and the Philippines are the market leaders, explanations for their success are presented. The chapter then considers the experience of one emergent entrant to BPO&O, namely South Africa, and its attempts to gain a greater share of this market.

2 PATTERNS OF BUSINESS PROCESS OUTSOURCING AND OFFSHORING

2.1 Definitions and classifications

Historically, business services would have been undertaken mostly within firms or in face-to-face interactions with others. The increased penetration of broadband internet has enabled the emergence of extended relationships outside firms and across borders. This explains the rapid expansion and growing sophistication of business process outsourcing (BPO) over the past decade.

Understanding and measuring BPO and BPO&O activity are challenges. Data are poor on ITES offshoring and outsourcing (Gereffi and Fernandez-Stark 2010a, 2010b; Kierkegaard 2008). As the industry expands, existing statistical classifications are proving inadequate for measuring relevant trends (Sako 2005). While offshored services are captured through foreign direct investment (FDI) data (inward FDI flows) and through trade-in-services data, the data are neither consistent nor complete. There is no standard industrial classification that captures BPO&O activity statistically. The representation of trends often relies on nonscientific measures offered by business associations, sector-based consulting firms, or the press. This makes scrutiny of data near impossible. Moreover, reports may mix definitions, so it is not always clear what is included or excluded in any representation.

Business process *outsourcing* refers to service functions that are information intensive and that are transferred outside a company to a third party. Sometimes BPO data include captive services, where, for example, a company operates a call center as a separate cost

or profit center for its own operations. Business process *offshoring* refers to a shift of service operations and functions beyond a nation's borders. *Captive offshoring* occurs where a company establishes BPO outside its country border in the form of a subsidiary primarily for its own purposes.

The various outsourced and offshored functions are often categorized as all falling under the umbrella of BPO&O. However, strictly speaking, this is not a correct assignment. There are three main categories: knowledge process outsourcing (KPO), information technology outsourcing (ITO), and business process outsourcing (BPO).

BPO specifically refers to activities such as customer relationship management, human resource management, and enterprise resource management. Although BPO encompasses the widest range of skills, from call centers often requiring only a high-school diploma to complex financial services, it mostly falls into the low- to middle-skills range. ITO, as the name suggests, refers to outsourcing of IT services such as software development. The range of ITO services can require low- to high-skill personnel. KPO encompasses specialist activities that are knowledge intensive, such as research and development (R&D), market intelligence, and legal services, and are considered to be at the high-skill end of the spectrum.

ITO, KPO, and BPO are "horizontal activities" that are generic to different industries. "Vertical activities" are specific to industries. The sectors with the highest demand for offshore services are banking, financial services, and insurance (BFSI), manufacturing, telecommunications, energy, travel and transportation, health and pharmaceuticals, and retail. For example, a company in the BFSI sector might be active in finance and accounting outsourcing (FAO), ITO, KPO, it might run a contact center and/or be engaged in some other horizontal activity. The telecommunications sector might likewise outsource any of these activities.

While the diffusion of internet and telecommunications services has facilitated the expansion of the industry, not all of these activities take place online. Voice-based activities, such as contact centers, take place online and therefore the quality and cost of telecommunications are key competitive factors. Call centers are the lowest end of BPO and therefore also compete on labor cost. However, most other functions can take place with intermittent online activity, as information can be downloaded and processed offline. In such cases, the country will compete on skill and capability.

2.2 Global expansion of BPO&O

Offshore services have grown dramatically over the past decade. Conservative estimates put this expansion at about 26 percent annually between 2005 and 2010. Contact centers account for about 10 percent of the global BPO market, and ITO remains dominant at about 60 percent of the global offshore service market (Everest Group 2009b). Conservative estimates are that ITO will continue growing at 6–9 percent per year, and will be overtaken by BPO, which is expected to continue growing by 10–15 percent per year (Gereffi and Fernandez-Stark 2010b; Oshri et al. 2009: 12, 31). While contact centers

tend to be the focus of policy attention due to their employment intensity, they are amongst the slowest-growing subsectors of offshore BPO opportunities. Internationally, estimates put the value of the offshore services market at between US\$100 billion and US\$157 billion before the 2008 economic crisis, with the value of BPO varying between US\$30 billion and US\$140 billion (Gereffi and Fernandez-Stark 2010a: 6–7; Bartels and Lederer 2009; Oshri et al. 2009: 1).

It is difficult to assess the validity of prospects for future growth put forward by consulting firms in the sector. In 2005, Africa Analysis and Z-Coms (2005: 24–25) projected that only 60 percent of the global market would be tapped by 2008. This potential was linked to the possible creation of three million new direct jobs in offshored activities. Gereffi and Fernandez-Stark (2010a: 7) believe that BPO&O has achieved only 10 percent of its global potential. Smith (2006) and the BPO Partnership (2009) contend that financial services BPO has a potential value of US\$250 billion. Projections are made on the assumption that BPO&O growth will be driven by further cost-reduction benefits, as well as by growing capabilities and an expanding range of products.

The demand for outsourcing primarily emanates from a handful of countries with high labor costs, namely the USA and the UK, which account for up to 80 percent of all offshored service activities, and the Netherlands (Sako 2005). India, China and the Philippines have joined the group of outsourcers over the past decade (Bartels and Lederer 2009).

In the early 2000s, US offshoring was dominated by IT and followed by FAO. Contact centers were the third-largest component of their offshored services. The activity was stimulated by Indian software experts who had worked in the United States and then returned home to set up their own firms to provide services to the US market. At that time, over 50 percent of large US multinationals stated their intention to offshore these activities, with a preference to outsource to a third party rather than to captives (Oshri et al. 2009: 5). BFSI firms have become leading consumers of offshore services, and financial services now account for 40–45 percent of all offshoring activities (BPO Partnership 2009). Generally, IT and contact centers offshored by US firms have been outsourced, while finance and accounting have followed a captive model of offshoring in almost 70 percent of cases (Oshri et al. 2009).

Two countries dominate amongst BPO&O suppliers: India and the Philippines. India accounted for about 40 percent of the global BPO market prior to the 2008 crisis, down, however, from a share of 65 percent in 2001. The Philippines accounts for 15 percent of the global BPO market (Philippines Congress, 2009: 1). However the two countries have experienced distinct trajectories, which are discussed below. Canada and Ireland accounted for 27 percent and 5 percent respectively of global market share in 2007.

All other suppliers are emerging off a much smaller base. By 2007, China had a 3.3 percent share of the global market but this was growing by 30 percent per annum. Newcomers in Central Europe met growing demand from neighboring countries such as Germany and Austria. Mexico held 5 percent of global market share, providing low-end services in Spanish to the United States, Spain, and South America. Emerging African players include South Africa, Mauritius, Egypt, and Kenya (Frost and Sullivan

2009). Common amongst the emerging suppliers is the critical support given by government to take-off and expansion.

The BPO&O sector was not diminished by the global economic crisis from 2008. Gereffi and Fernandez-Stark (2010a) and ITC (2010) assert that the global economic downturn may stimulate rather than dampen demand for offshored services, especially in the drive to cut costs. In 2008 and 2009, growth rates in the offshore service industry as a whole remained positive, in excess of 15 percent. BPO&O clients are increasingly concerned with cost considerations: for 74 percent of firms that offshore services, labor cost savings have become more important as a result of the crisis. Competition to improve service and reduce costs intensifies with a rising number of supplying countries.

2.3 Potential gains for buyers

Outsourcing and offshoring of manufacturing processes, and the separation of production and consumption, have long been features of the global economy. BPO&O growth is associated with the development of technologies that enhance the tradability of services and the unbundling of corporate functions in pursuit of cost reductions, risk mitigation, and process improvements (Sako 2005). In the process, competition is created in service markets, and firms emerge to provide services to buyer firms (Sako 2005: 12). Fragmentation in consumer markets and rising labor costs in high-income economies, even once adjusted for productivity, are further contributors to this (Bartels and Lederer 2009: 3).

Outsourcing and offshoring business services are mainly motivated by the search for cost savings, as well as the aim of externalizing business cycle risks (see Mehta et al. 2006; Oshri et al. 2009). Cost reduction arises as a result of a combination of lower-cost country conditions, specialization and learning, and economies of scale. Offshoring may also extend the production cycle by making it possible to add shifts across different time zones.

There are risks entailed in outsourcing and offshoring. Typically, there are gaps between outcomes and expectations, related to the assessment of the expertise of the vendor, the quality of the delivery, and the expected cost reduction. The more standardized a process, the lower the risk. This potential mismatch raises the attraction of outsourcing domestically, in a nearby country, to a captive offshore entity, or to firms in countries where there are well established capabilities and similar cultures and legal frameworks (see Lacity et al. 2009; Oshri et al. 2009; Willcocks and Lacity 2009).

Country comparisons are only indicative of savings to be had and they depend on what is being outsourced (and offshored), as well as on the adoption by the vendor of new technologies and their potential benefits for the buyers of the improvements in the functions outsourced. The savings need to be substantial enough to outweigh the complexity and risk incurred in offshoring. Mattoo and Wunsch (2004: 6) suggest that productivity gains of the order of 15–25 percent are expected from outsourcing and it is thought that a minimum gain of 30 percent would be expected in a decision to offshore (ITC 2010).

2.4 Specialization and cluster development in host countries

For middle-income developing countries aiming to generate employment, the service sector and ITES offer important opportunities. There is growing evidence that, even in countries with expanding goods production, the proportion of employment in goods-producing sectors is falling and the share of services is rising. There is a turning point at certain levels of GDP per capita, where manufacturing employment becomes a smaller share of the total, and this turning point has fallen over time (Palma 2008). This turning point is lower, as is the share of manufacturing employment, in mineral-exporting countries like South Africa. Services accounted for at least 60–70 percent of net new employment growth during the high-growth phases of Malaysia, China, Korea, Chile, and Brazil (ILO, various). The more employment can be sourced from traded activity, the more opportunity there will be for expansion and for real-wage growth in the services sector. Offshored ITES offer an important opportunity for such growth.

BPO&O has emerged as a focus of interest in developing country industrial promotion efforts for a number of reasons. First, it is believed that BPO&O will continue to grow over a long period. Second, the diversity of BPO-related activities means that there is great scope for employment creation across skill categories, with a bias toward the employment of women (Sako 2005). Third, there is an implicit assumption that success is easily replicable: this remains to be proven, since no other countries have yet achieved near the scale of India or the Philippines. There are relatively low barriers to entry in respect of skills, technologies, managerial requirements, and domain knowledge for many BPO subsegments (ITC 2010: 1).

In the supplying country, BPO&O is seen to generate new employment, exports, and investment opportunities. Additional benefits also exist beyond the sector, such as potential improvements in the business culture through adherence to standards, IT and telecommunications development, and the stimulation of infrastructure investments (ITC 2010). In the Philippines and India, the mass expansion of ITES has contributed to keeping skilled employees in the country. Moreover, both countries have demonstrated substantial diversification in service offerings, subsector development, and technology spill-overs. Spin-offs may arise where BPO activity generates demand for other service sectors and for related manufacturing. Examples include linked activities as new products develop, increased demand for producer and personal services, property development, construction and materials, amongst others.

The benefits from outsourcing rely on the extent to which assimilation and creation of knowledge can be leveraged. However, this knowledge needs to be supported by sufficient organizational capital. Such capital, which relates to the skills required to manage work with teams and organizations, is acquired over time and through experience (ITC 2010: 11–12; Mattoo and Wunsch 2004).

ITC (2010: 9) notes that “[w]orking on offshore projects is a form of knowledge transfer from the wealthy nations to the developing world: the technical and domain knowledge gained through working for foreign clients can be re-channeled and used for domestic projects.” The development and availability of a skills foundation for securing knowledge is critical to securing and maintaining offshore business (Oshri et al. 2009: 62).

2.5 Choice of location

There are essentially five main factors that influence choice of location for offshore BPO facilities (Farrell 2006) including:

- costs decomposed into labor, infrastructure, and set-up costs;
- availability of skills;
- infrastructure quality;
- risk profile, including macroeconomic, regulatory, and intellectual property rights risks;
- the attractiveness of the local market and access to nearby markets.

Labor costs typically amount to 50–60 percent of the total costs of a BPO unit, but there are variations depending on the skill intensity of the activity. In the Philippines, 50 percent of total BPO cost is salaries and wages, 20 percent is infrastructure, 15 percent is for training and another 10 percent goes to utilities and communication (Philippines Congress 2009). In South Africa, labor makes up 58 percent of the cost of a 1,000-seat call center, 13 percent is spent on telecommunication and 14 percent goes to start-up amortization (BPO Partnership 2009: 34). Cost variations reflect differences in labor usage across BPO subsectors.

Labor costs matter more at the lower value-added level of BPO service value chains and in standardized functions. Costs related to managing relationships with clients, accounting for 5–7 percent of a typical enterprise's outsourced and offshored project, increase with risks. Capability to manage these contracts and relationships effectively is an important competitive advantage (see Willcocks and Lacity 2009).

Countries seeking to attract outsourced call centers require low-cost labor. The higher the skill complement, the less the influence of labor price on location choice. Low-income developing countries enter the market at the level of call centers for a range of reasons: barriers to entry are low in this segment; set-up costs are low; and contact-center-related tasks are easily replicable due to standardization and limited knowledge requirements. While the global growth in this aspect of outsourcing is slower than for other more knowledge-intensive activities, the scope for call centers is wide because they are used in serving customer needs for a wide range of goods and services.

2.6 Sector specialization and employment potential

Middle-income countries' competitive advantage will be found in specialization and quality service. BFSI is the fastest-growing BPO&O opportunity and appropriate to South Africa's capabilities, as shown below.

Developing financial services BPO&O is unlikely to directly create large numbers of jobs relative to the scale of activity. In contact centers, the scale of operation will expand almost directly in line with the business activity. In asset-management BPO, suppliers are likely to begin with a large infrastructure and more staff than required. This is

made possible by the higher profitability and scale of transaction. For example, a supplier may see “low volumes” as having assets under administration of less than \$25 billion. Profitability is achieved through volumes, which would not involve proportionate increases in employment. Administering services to retail banking may be more labor absorbing by comparison.

While the cost differential must be sufficient to warrant outsourcing, the higher up the value chain one goes, the less emphasis there is on labor and other input costs. Other factors such as quality, risk management or risk diversification become more important. Van der Heijden (2005: 25) lays out five levels and the associated key factors for buyers in asset management and related industries, with level 3 being a threshold where this differentiation takes place. This is shown in Table 24.1.

The service activities at higher skill levels, 3 to 5, are more appropriate to an upper-middle-income country cost structure. This means the country attracts offshore

Table 24.1 Service levels and activities: asset management and related industries

Service level	Activities	Key factors for buyers
Level 1: Data capture	Entering the details of trades manually on a back office system	Cost of labour (it is the major input) Overall absolute cost Location risk
Level 2: Supervision and checking	Checking and signing off that trades are entered correctly.	Some track record in these areas Cost Location risk
Level 3: Execution of specialist processes	Drawing up monthly fund accounts using the core back office system and supporting technology.	Proven ability to manage similar products at low error rates Some cost differential Location risk Client must be able to have regular physical contact with the supplier through a local office
Level 4: Supervision and management	Checking and signing off final client statements.	Proven ability to be a strategic business partner Proven track record in complex products Some cost differential required Availability of staff and low staff turnover Ability to meet onerous regulatory and compliance requirements Location risk
Level 5: Process design and integration	Setting up the back office systems(s) and processes to automatically interface with the client's accounting system.	As above Proven track record of innovative solutions in similar environment Proven track record of innovative products Familiar with client systems and applications High risk weighting (assessment of the risk of the supplier and his location)

Source: Van der Heijden (2005: 25).

activity on the basis of sophisticated oversight, risk management, or process design capability. These create relatively fewer jobs, but the lower-level activities do tend to be drawn along. For example, even if a client keeps level 1 to 2 activities (such as data capture) in-house, the outsourcer will nevertheless have to implement them anyway to ensure data integrity (Van der Heijden 2005). This is an absolutely critical approach to thinking about employment creation in upper-middle- and high-income economies. The employment opportunities are mostly generated indirectly through supporting services, as well as linkages into office support and related personal and business services. This is evident in India's experience.

Upgrading in the form of customized solution improvements is focused on the ability of external business service providers to meet as well as to adjust to buyers' demand, as well as to control expectations. Business service suppliers benefit from achieving scale as, unlike call centers, back-office processing has a greater component of fixed cost and the addition of services does not necessarily result in one-to-one employment expansion. The ability of business service suppliers to take on new functions through improved process-related expertise is critical to this expansion. Growing complexities developed from within the activities allow movements up the BPO value chain. Capabilities expanded at the business service provider level reduce the risk element that affects buyers. The performance of some key large, efficient, and effective service providers country then helps a country to develop a reputation for BPO expertise. Knowledge dynamics (for instance in the form of a deeper understanding of particular clients) can generate a progressive expansion of the portfolio of activities of individual firms where risk perception is reduced. This in turn enables activities that have higher margins and value-added.

3 BPO&O DEVELOPMENT IN INDIA AND THE PHILIPPINES

India and the Philippines are the global developing country BPO&O leaders, so their stories are instructive to other emergent countries seeking a substantial share of this activity. This section provides background to the evolution of BPO&O in India and the Philippines, which are both lower-middle-income economies.

3.1 Diversification in India

Overview and business strategy

The Indian BPO industry has progressed rapidly since 2000 in terms of revenue, employment and sophistication. Many countries look to its case with hope, but whether this success can be reproduced is still an open question.

The story began with the substantial presence of Indian software engineers trained in the United States, servicing US and EU markets, coupled with a strong interest among foreign investors in establishing operations in India. It is estimated that by 1995, 100,000 Indian software programmers were involved in this industry (Dossani and Kenney 2007). The Y2K scare in 2000 was leveraged well by Indian vendors, who offered low-cost technical support to overseas clients. It coincided with Indian telecoms deregulation and a global increase in the digitization of documents. This was the start of back-office processing in India, mostly in ITO, which evolved into finance and customer relationship management. The bursting of the dot-com bubble encouraged firms to look for lower-cost locations and relationships with Indian vendors were already well established. By 2006, 1.25 million Indians were providing offshore ITES, and by 2010, 2.5 million were engaged in offshore and domestic BPO&O activities, out of a formal workforce of about 44 million (NASSCOM 2010). By 2008, back-office processing accounted for almost 60 percent of the offshore BPO market in India (Everest Group 2009b: 16) and for a substantial portion of its growing process management competence (Dossani and Kenney 2007).

So, the first step in establishing the Indian BPO&O industry involved the development of Indian software engineers trained and working in the United States. The second step involved those engineers returning to India to start up companies servicing the US and EU markets. The companies provided low-cost services from India, delivered on US and EU ground. The third step involved delivering ITES directly from the base in India, the phase with the greatest jobs impact.

Evolving sophistication

ITO is the dominant form of services offshored to India, generating US\$45 billion in revenue, while BPO amounts to approximately US\$15 billion in revenues, of which a third is generated by contact centers. India has a 55 percent share of the combined global BPO and ITO market.

These services have become increasingly sophisticated and diverse (Dossani and Kenney 2007). The profile of services offshored to India transitioned from ITO to BPO between 2000 and 2006 (Dossani and Kenney 2007; Mehta et al. 2006: 335). Dossani and Kenney (2007) review the development of activity types over the short period of time from 2000 to 2006 and show that there were initially larger numbers in IT-related services ranging from programming to coding. By 2006, the IT services had grown in scale and sophistication but a plethora of other services also emerged: call centers, data entry, document digitization, medical services, chip design, and R&D, amongst others. The authors map the progression from five types of services in 2000 to twelve main types of services in 2006.

MNCs are now assigning key strategic and research functions to their Indian offices (see Athreye 2005; Dossani and Kenney 2007; Gereffi and Fernandez-Stark 2010b; Oshri et al. 2009: 31; Sako 2009). Having established a scale in core BPO skill sets in the onshore market and having established standardized IT and communication protocols to derive what Oshri et al. (2009: 7) describe as “[efficiencies] of inter-organizational

activities,” India has steadily diversified into an array of vertical and horizontal activities, focusing on niche-type BPO activities.

Knowledge acquired abroad was combined with local knowledge, allowing some imitation and a virtuous circle of knowledge acquisition and innovation. Vertically, R&D development occurred directly through foreign firms or indirectly through collaboration. R&D done for foreign manufacturing firms by captives generated outsourcing spillovers for Indian firms in some cases (see Mehta et al. 2006; Oshri et al. 2009). In Bangalore, horizontal and vertical collaboration in a cluster generated beneficial agglomeration effects, dynamic efficiencies through learning, and innovation (Basant 2006).

Table 24.2 shows that employment in ITES exports expanded substantially faster than the domestic BPO market. About 54 percent of the 430,000 BPO&O workers serviced the overseas market in 2000. By 2010, this figure had risen to 78 percent of the 2.5 million BP&O workers. IT services exports generated almost a million jobs, as compared to 765,000 in BPO exports and 361,000 through expanded domestic BPO services (NASSCOM 2010).

Indian companies contribute the largest share of IT services export employment. Indian companies account for 85 percent of ITES and 35 percent of BPO export revenue, with foreign multinationals contributing the rest. In 2008, Indian BPO companies had export revenues of US\$10 billion, as compared to US\$4.5 billion for MNCs. The MNCs tend to take their IT services offshore, while MNC BPO activity tends to be captive to non-IT MNCs (Kierkegaard 2008: 404). The big four Indian IT firms—Infosys, Tata Consulting Systems, Satyam, and Wipro—play an important role.

Labor and skills

India has done remarkably well in generating the range of skills needed to support this burgeoning sector, including high-level management, technical, and entrepreneurial capabilities. The sector also generates employment for middle- and lower-skill workers. It shows the possibility of making this leap, even in a low-income economy characterized by weak literacy.

A critical success factor was the presence of an educated workforce early in the cycle of transformation that supported the new investments in software-related activities (Basant 2006).

Table 24.2 Employment in India's BPO&O industry, 2000, 2005, and 2010

	2000	2005	2010
IT services exports	162 000	513 000	1 145 000
BPO exports	70 000	415 000	835 000
IT BPO domestic	198 114	365 000	560 000
	430 114	1 293 000	2 540 000

Source: Calculated from NASSCOM (2010).

The rapid pace of expansion has contributed to rising labor costs and, in some cases, shortages of college graduates to staff the industry. This may provide the space for competitors to emerge in other countries (see Sheth and Sharma 2006). Alternatively, the quality of Indian service suppliers and their tight and effective relationships with customers in the United States mean that they are still able to command a higher premium for their services than other providers.

Labor turnover is a critical concern in this industry globally and India is no exception, with rates reported to be in excess of 100 percent. NASSCOM and the government have been paying attention to this issue since 2005.

Numerous skills development programs target the range of industry jobs from entry to management level. Efforts have been directed toward securing a common assessment of skills and of expertise, so that certification is accepted as a national standard. There is a particular shortage of graduate engineers. A plethora of training schemes is in place at institutions such as colleges, complemented by a database of all IT and BPO employees to facilitate matching labor supply with demand.

Government support and industry associations

Two key packages of incentives drove the establishment and operation of foreign firms in India. These were “special economic zones,” developed in 2000 in the least developed parts of the country, and “software technology parks” (BPO parks with incentives secured through lobbying by the National Association of Software Services Companies, NASSCOM) (see Bhatnagar 2006). Investors in software technology parks, including wholly foreign-owned firms, are exempted from tax for ten years from establishment. These incentives have been criticized for failing to optimize tax revenues. The problem of limited revenues secured through O&O activities has been exacerbated by the marked growth of captives from the late 1990s. In 1999, 100 percent foreign-owned firms were allowed into the country for the first time. In 2000, 44 Forbes 500 companies had captive centers in India. This rose steadily to 71 in 2003, 110 in 2006, and 500 in 2008. This growth has taken place in software, retail, and financial services (Infosys 2006).

NASSCOM was established in 1988 to represent the sector. It has strategically influenced the Indian government in all areas pertaining to ITES (and to BPO within it). Keeping its consultative and market analysis functions, it supports the development of new service exports focused on ITES/BPO. Also of note has been its role in two areas: information security—NASSCOM guided the development of the IT Act of 2000 and its subsequent changes—and skills development.

3.2 BPO and BPO&O in the Philippines

Overview and business strategy

The growth of BPO&O in the Philippines began in the mid-2000s. Between 2000 and 2008, the contribution of business services outsourcing to GDP in the Philippines

increased from 0.1 percent to 3.6 percent (Philippines Congress 2009: 1). Overall, employment grew by an annual average of 68 percent and quadrupled from 100,500 in 2004 to 442,164 by 2009, in a formal urban workforce of about 9.5 million.

In 2008, two-thirds of professional service exports were in call centers, and call-center-agent employment in the Philippines matched that of India by 2010. Asia is a notable consumer of BPO services from the Philippines, accounting for 25 percent of all BPO services exports from that country. The Philippines also serves clients in the United States, the United Kingdom, and Australia. As in India, the BPO&O sector is highly concentrated in urban areas, especially in Manila, which is now the “world’s largest city destination for BPO activities” (Gereffi and Fernandez Stark 2010a: 18)

Call centers generated US\$2.7 billion in 2006 and employed 160,000 agents, about 76 percent of all BPO revenues and 68 percent of employment. By 2008, employment in call centers had risen to 198,000. These jobs are largely concentrated in a few large firms, including foreign-owned ones such as Convergys US.

The Philippines is the leading global player in the voice segment and is also active in the nonvoice segment (with some activities around FAO, HRO, and procurement outsourcing, although the bulk remains transactional). This sets the country up as a potential competitor to India.

Limited growth in sophistication

Two thirds of all BPO employment is found in call centers, and this has not changed as the sector has grown, over the period from 2004 to 2009. By comparison, less than a third of all Indian BPO jobs are found in call centers. In the field of nonvoice activity, the biggest employment gains were found in back-office and transcription services. These figures are shown in Table 24.3 (BPA/P 2010).

ITO contributed over 9 percent of all IT-BPO revenues and over 9 percent of all IT-BPO employment in 2009 (BPA/P 2009). The Philippines also has a hardware industry, and skills in this area are documented through the fact that Costa Rica is importing skilled workers from this industry to boost its own BPO development program (see Oshri et al. 2009). Niche activities have expanded, with higher value-added BPO activities such as medical prescription, publishing, and legal services, as well as new types of animation services for foreign buyers (Tschang, n.d.).

Table 24.3 BPO&O employment in the Philippines, 2004 and 2009

	Contact centres	Back office	Transcription	Animation	IT	Engineering services	Digital content/game development	Total
2004	64 000	15 000	6 300	3 000	10 000	2 000	200	100 500
2009	280 000	86 000	35 300	12 000	20 224	8 000	640	442 164

Source: Calculated from BPA/P (2010).

Labor and Skills

Industry experts emphasize that, given comparable location performance indicators, the Philippines has a much lower rate of labor turnover than India. Philippines Congress (2009: 2) reports that the rate of attrition in BPO is 62 percent, compared to 102 percent in India. By comparison, the attrition rate is 15–20 percent per annum in South Africa (BPO Partnership 2009: 23).

Scalability is a concern in the Philippines, with constraints on labor resources or human capital, particularly with regard to the more complex processes; the size of new BPO entrants remains small.

Roadmap 2010, a framework document guiding national developments and efforts around BPO, has deployed strong marketing efforts that led to substantial increases in investment in the BPO&O in the Philippines. It supports education through scholarships and skills development (through subsidies of up to 50 percent of training costs) and the development of individuals with middle management skills. The Special Programme for the Employment of Students targets poor students with a minimum level of education, to complement the focus on training and on employing college drop-outs.

The Philippines improved its BPO&O competitiveness between 2007 and 2009 (A. T. Kearney 2009) due to the quality of the education system: the country produces more college graduates than India. However, it is facing certain labor constraints (Sibal 2006). As is the case in India, there are problems with the quality of jobs (see Mehta et al. 2006). Furthermore, there is a lack of managers and, at least in the mid-2000s, there was a mismatch between available skills and industry demand. Although ICT skills are being developed, certifications are expensive and attrition rates are relatively high.

Government incentives and industry association

Government catalyzed the growth of BPO in the Philippines through focusing on software development, contact centers, BPO, animation, and medical transcription. Labor costs are still seen as a critical competitive advantage. The Philippines is expanding its BPO platform around the success of call centers. This dominant segment is still supported by policymakers and key BPO institutions.

Scalability may be constrained by current policy approaches. Many captives operate in the Philippines (Tschang, n.d.; ITC 2010); concern has been expressed that investment incentives which are sector specified by the Board of Investment are subject to renewal and are therefore uncertain. As is the case in India, substantial tax revenues are thought to have been lost through the tax-holiday status of a large proportion of BPO investment driven by foreign firms. Another concern is that BPO has been found to have generally displayed limited forward and backward linkages (Ramos et al. 2007).

The national Business Processing Association of the Philippines (BPA/P), an umbrella association set up in 2001, markets and provides support to the industry. Policy efforts intensified from 2007 with the introduction of Roadmap 2010. The Philippines government has provided incentives to attract offshore BPO investments and Roadmap 2010 intensified efforts in respect of human resource development, including at the higher management level, to address an issue that had arisen in the early 2000s (Tschang, n.d.):

the expansion of space available for BPO&O operations in cities and other support to the industry for expansion. A concern of Roadmap 2010 is to rapidly create direct as well as indirect jobs in and around the sector. The targets were aimed at doubling the country's global market share from 5 percent in 2007 to 10 percent for BPO by 2010 (equivalent to an 8.5 percent contribution to GDP) (Ramos et al. 2007).

4 BPO&O IN SOUTH AFRICA

Unemployment in South Africa, an upper-middle-income economy, is extremely high and especially severe for young people. Only 41 percent of its working-age population was employed, and the strict unemployment rate was 25 percent in 2010. In the same year, youth unemployment was 51 percent in the age group 15–24 years and 29 percent for those aged 25–34 (NPC 2011). The majority of unemployed are black African. Countries like India and the Philippines have larger populations, with low unemployment but very large informal sectors. They have managed to generate sufficient skills and capability, even in the context of relatively small modern sectors. In South Africa, more than 70 percent of workers are in the formal sector, and there is substantial sophistication to enable industrial diversification. However, this hides extreme inequality and exclusion. BPO&O provides one of the few global opportunities for mass formal sector employment creation for young high school and college graduates.

The services sector has been the most important source of employment growth in South Africa, and especially after 1997. The share of services in employment grew from about 63 percent to 70 percent between 1995 and 2009 (Quantec). The share of financial services rose from just over 6 percent of GDP to just over 12 percent over the same period. Business services also account for about 12 percent of GDP. This expansion has stimulated both high- and low-skill employment. BPO activity, whether captive or not, has expanded considerably as part of this mix; the offshore component of this has also expanded, but is still very limited.

There is much debate in South Africa about an appropriate industrial policy that can enable a shift to a more employment-oriented growth path. BPO&O, with an emphasis on offshoring, has been identified as a possible opportunity for large-scale employment creation. Indeed, the majority of global employment is now sourced from services, and it is therefore imperative that developing countries devote greater industrial policy attention to services trade (see Altman 2010). There is no other industry that might achieve this pace of job creation: in India and the Philippines, employment grew at over 30 percent annually in the decade starting in 2000. There is also evidence that only a fraction of global market potential has been realized. This is especially the case in activities where South Africa has competitive advantage, such as financial services.

South Africa's approach to deepening its position in the global BPO&O market offers an interesting case study in whether and how an upper-middle-income economy can effectively compete in, and garner significant employment gains from, this trade. As the

discussions above of India and the Philippines indicate, BPO&O can generate direct employment opportunities in call-center and back-office processing, as well as other services. Indirect opportunities may also arise through sector spillovers and multipliers which, for a middle-income economy, may be the main sources of new employment growth. While policymakers tend to focus on niches that might generate direct employment, a middle-income economy will likely be less competitive where there is a reliance on low labor costs. More potential might exist in competing in medium and higher-skill, but less employment-intensive niches that could potentially generate employment multipliers.

Reporting accurately on the BPO sector in South Africa is a challenge, as there are no official statistics and insights are gleaned from a number of primary and secondary sources. As with the international literature, there is substantial reliance on consulting reports, and no peer-reviewed scientific studies have been published. Some of the central reports include those produced by McKinsey & Co. (2005), Everest Group (2008), Frost and Sullivan (2009), and the BPO Partnership (2009) to support strategy building for provincial and national governments.

There are no official statistics for BPO&O. It is really a range of activities that could be categorized in different locations within the statistics—for example, one could ask whether an outsourced service administering payroll for a retailer should be categorized as “trade” or as other business services.

This case study begins by reviewing some key features of BPO&O in South Africa before turning to government’s approach to positioning the sector.

4.1 Overview of BPO&O in South Africa

South Africa’s BPO&O activities amount to less than 0.5 percent of the global BPO market, although they have been growing. In 2006, it was estimated that the outsourcing industry had 9,500 staff, 5,000 of whom serviced domestic clients and 4,500 of whom serviced offshore clients. Captive call centers, where companies run an in-house service, are a much larger employment sector. By 2007, it was estimated that there were about 80,000 contact-center agents in captive services, of whom only 33,000 were in outsourced services including offshore captives, with revenues of US\$885.2 million (BPO Partnership 2009: 22; Frost and Sullivan 2009). This was in a formal nonagricultural workforce of 9.5 million. The BPO Partnership (2009) estimates that employment in offshore BPO rose from 7,732 in 2007 to 21,752 by 2009.

Call centers grew by 9 percent per annum prior to the 2008 crisis. This can be compared to leading BPO centers that have grown by compound annual growth rates of 30 percent or more, such as India and the Philippines. Of the 33,000 BPO workers in 2007, 24,156 were call-center agents, 3,630 worked in ITO, 2,310 in FAO, 1,320 in KPO, and 990 in HRO. There do not appear to be more recent figures available. There is a tendency for South African companies to offshore their ITO services to India, and to outsource HRO and FAO onshore (Frost and Sullivan 2009).

Call centers dominate BPO activity in South Africa, and are the focus of policy attention due to their labor intensity. About 90 percent of BPO seats are in call centers, but only 13.5 percent of this activity is outsourced. This means that companies are mainly running their own call centers. There is a domestic capability in voice, business processes, and ITES, but limited development of South African companies that can attract offshore ITES business in a meaningful way.

The BPO sector is not highly diversified. One country, the United Kingdom, dominates the base of South African offshore customers; it accounted for 70 percent of offshore customer services in 2005, falling to 60 percent by 2007. South Africa had not yet succeeded in attracting significant outsourced business from the United States or the Netherlands, despite the former being the largest outsourcing nation and the language synergies with both countries. In 2007, only 1,056 BPO South African workers serviced the US offshore market, with most of the US business going to India and the Philippines. In the same year, only 370 BPO workers serviced the Netherlands. There had been hope that the similarity between Afrikaans and Dutch would attract the Netherlands but this was not realized, potentially due to preference for onshore or near-shore providers. The investment that has taken place has been through captives. For example, Royal Dutch Shell established a call center in Cape Town in 2008 to service its customers in Belgium, the Netherlands, and Luxembourg. South Africa also provides services to Australia, Ireland, Germany, and the rest of Africa (634 workers in 2007) (Frost and Sullivan 2009).

Geographically, BPO activity is concentrated in particular urban areas. One region, Gauteng (covering Johannesburg and Pretoria), absorbs about 70 percent of all BPO employees, while the Western Cape (Cape Town) accounts for 20 percent of BPO employment.

The distribution of BPO employment across vertical segments in 2007 was concentrated in BFSI, retail, and telecoms. A total of 10,980 BPO workers serviced 240 clients in BFSI, of which 55 percent were front-office and 45 percent back-office. Three-quarters of this activity was for the domestic market, and one-quarter for offshore clients (2,745). Most offshore business is in front-office activity. There is limited domestic outsourcing growth, as firms reported having had “bad experiences” and reintegrating services as a result. It is estimated that about 75,000 workers were in captive financial services in 2007 (Frost and Sullivan 2009). Foreign businesses tend to offshore call-center activity, especially those from the United States. While this is typically seen as more labor intensive, there have been moves since 2006 to automate this low end. It is more difficult to automate the higher end, where discretion is needed. However, firms also tend to prefer to keep higher-skill, more sensitive services in-house or in offshore captives.

In telecoms, there were 9,240 BPO workers, with 65 percent in back-office, and 95 percent oriented to the domestic market. The call centers were generally managed in-house through captive services (Frost and Sullivan 2009). A total of 4,290 BPO workers serviced the retail sector, with 60 percent in back office and 90 percent domestic. This business is often regionally located near the main stores in small centers. The public sector generated demand for only 660 workers, often in very small centers of 50 seats or less.

4.2 Assessing competitive advantage and employment potential

In the decade starting in 2000, South African efforts at promoting BPO have concentrated on trying to attract new offshore activities on the basis of generic capabilities. However, new entrants are able to copy or improve on generic capabilities and so this is becoming a poor differentiator. Specialized niches and demonstrated capabilities are increasingly becoming important to attracting BPO&O activity (Frost and Sullivan 2009; BPeSA 2011).

South African BPO companies tend to lack sufficient global presence to attract offshore business, but the country has the advantage of the presence of leading MNC BPO providers such as IBM, Hewlett Packard, Accenture, and EDS. Dimension Data is a South African company that has developed a global presence through acquisitions, including that of Merchants. In turn, partnerships have developed to strengthen domestic capability, such as that between Merchants and Adcorp, a labor placement company. Offshoring expanded particularly with the entry of MNC captives from 2005 onward. By 2009, the BPO Partnership reported that larger players had generated R1.5 billion (US\$214 million) of new foreign investment. This included IBM, Teleperformance (UK), Teletech (UK), Accenture, TCS, and the Budget Group, all starting between 2005 and 2007. There is a growing presence of Indian outsourcers such as Genpact, Aegis, and an alliance between Channel Holdings Ltd. and Mahindra Satyan BPO. Frost and Sullivan (2009) contend that future growth will depend considerably on near-shore servicing of African markets. South African companies have a comparative advantage in Africa with more sophisticated back-office skills, via pan-African operators such as Dimension Data, MTN, Standard Bank, and South African Airways. Some UK companies such as Fujitsu, Carphone Warehouse, and Virgin Mobile have directly outsourced to Gauteng Province, benefiting from relatively lower costs and cultural and language affinity (Frost and Sullivan 2009).

South Africa competes with mature destinations such as India and the Philippines, and with emerging offshore destinations such as Kenya, the Czech Republic, Mexico, and China. According to Everest Group, Johannesburg and Cape Town are about 50 percent cheaper than the United Kingdom and the United States respectively for front- and back-office work in financial services, 10 percent cheaper than some East European destinations such as Prague, but about 12 percent more expensive than Manila or Bangalore. Given the considerable gap in labor and telecommunications costs, it is surprising that the gap between South Africa and India is not greater. For example, an inbound agent in Manila and Bangalore is paid 32 percent and 70 percent less, respectively, than one in Johannesburg. By 2007, telecom costs were US\$8,000, US\$12,500, and US\$17,500 per megabit per second per year in India, the Philippines, and South Africa respectively. This gap should have closed to some extent since then, with the laying of undersea cable and introduction of greater competition and discount rates for some BPO investors. In addition, it is known that the telecommunications parastatal Telkom has negotiated special rates with individual investors on a case-by-case basis (BPO Partnership 2009: 18). The

costs of facilities and of real estate are central advantages in South Africa, at about half the costs in Manila and about 30 percent less than in Bangalore.

Quality improvements and further reductions in telecommunication costs are needed to counteract the cost gap between South Africa and India. As such, the BPO Partnership (2009) sees that a 30–35 percent reduction in telecommunication costs, combined with growing economies of scale, efficiency improvements, and a more favourable exchange rate, would allow South Africa to become 1.2 times more expensive than India compared to 1.8 times more expensive in 2009. In the context of the financial crisis, exchange rates between the Rand and the US dollar and pound sterling have been unfavorable to South African service exports. This is a long-run challenge for the country, with its commodity export profile and a highly traded currency linked to commodity prices. However, it is expected that South Africa will become increasingly attractive relative to India due to inflation differentials.

On generic capabilities, South Africa is considered to have adequate to very good infrastructure, connectivity, English proficiency, and overall education levels (see Everest Group 2009a; Gartner Research 2008). There are stated challenges in telecommunications costs and infrastructure, but these are also faced by many of the emerging countries such as Kenya. Telecommunication costs are declining and the services are improving. However, South Africa is falling behind on the ITU Development Index and the World Economic Forum e-Readiness index (see GCR 2010, Gillwald 2011). South Africa was 40th on the ITU ratings in 1995, and fell to 72nd in 2002 and to 92nd by 2008 (Gillwald 2011).

Competitive positioning in BFSI

There is growing interest in shifting from generic approaches to BPO promotion toward an emphasis on strategic sectors. South African BPO&O was, before the global crisis, assessed to have the most potential growth in BFSI, retail, and telecommunications, servicing the United Kingdom, the United States, and the Netherlands (Frost and Sullivan 2009). These opportunities were assessed on the basis of source country intentions to outsource and offshore, as well as South Africa's capabilities. These are scalable activities servicing large industries with deep business process needs. These industries would outsource or offshore FAO, IT services, HRO, KPO, or customer contact centers (Frost and Sullivan 2009).

By 2008, employment generated through BFSI O&O was very small. There were only 11,000 employees in South Africa's financial services BPO, as compared to India and the Philippines which respectively had about 380,000 and 130,000 employees. The scale of South Africa's financial services BPO employment was similar to that achieved by Argentina, Malaysia, or Romania.

Special attention to financial and insurance services has arisen since 2008 (BPO Partnership 2009). The South African market has a mature and economically sound financial sector, having been resilient to the global financial crisis through a prudent and conservative regulatory regime. Finance and business services accounted for 38 percent of gross value added and 15 percent of employment in 2010 (Quantec various).

Although the World Competitiveness Report ranked South Africa 54th out of 139 countries in 2010, the finance sector sophistication was ranked 9th (GCR 2010). Already a third of BPO employment is found in financial services, particularly in offshore captives (see Gelb et al. 2005; ITC 2010). The products on offer and regulations in place are similar to those found in the United Kingdom. South African companies have the advantage of being compliant with a range of standardized national codes of practice and quality standards required by offshore clients. These include Basel II, FSA 70 certification, ISO, Six Sigma, and Sarbanes Oxley (Frost and Sullivan 2009). Globally, there is a trend toward financial services offshoring and the intention is to target foreign financial services and BPO investors (Everest 2008). There is a growing presence of South African banks in global markets and foreign banks have engaged in mergers and acquisitions in South Africa.

There are specific advantages to expanding FAO&O for the South African economy. These enable a diversification into high-value-addition segments—in the area of back-office functions and new KPO opportunities—and in terms of leveraging technology. The latter is important, in the sense that technology is more advanced in financial services than in other sectors.

In BFSI, FAO offshore activity from the United Kingdom tends to be concentrated in lower-skill activities (such as accounts payable), with an apparent reluctance to offshore high-end riskier activities. There is significant pressure to prove data security. KPO activity, such as hedge funds or asset management, is generally offshored to captives (Frost and Sullivan 2009). This speaks to the necessity of attracting MNCs or encouraging MNCs already in South Africa to attract this business. It is less likely that South African firms will be sufficiently attractive, unless their global presence and therefore quality control are clearly recognized. Van der Heijden (2005: 14) and Oshri et al. (2009) argue that companies lacking global presence will have to become “suppliers of suppliers,” where they indirectly provide service through well-known MNCs.

4.3 Labor and skills

South Africa promotes itself as a location where large numbers of English-speaking high-school and college graduates every year enter the market, which expands by about half a million annually. The country has emerged from a history of extreme exclusion, where only a very small proportion of the black population completed a high-school education. South Africa now has near universal high-school attendance and illiteracy is rare amongst young people (Sheppard 2009). However, the quality of high-school output is such that reading comprehension and numeracy are weak. There is also limited work readiness, particularly as many young people live in communities with high unemployment and are poorly prepared through family or peer networks for the world of work (Altman 2010). This limits labor availability at the level of both agent and manager. It is a challenge faced across the economy, but especially in labor-intensive activities. Since 1996, there have been concerted efforts to expand industrial training, with an overhaul

of the entire system to introduce a new qualifications framework, enhanced funding—where firms pay a levy of 1 percent of payroll—and new training oversight bodies called “sector education and training authorities” (SETAs). While there have been mixed experiences, the SETA attuned to the BPO sector, namely the Services SETA, has been one of the more successful training authorities and has played an important role in generating a skills pipeline into the BPO sector. The higher-education system has substantial capacity, and the challenge for South Africa will be to expand its throughput rates so that a greater proportion of enrolled students complete their education and expand the pool of skilled labor (Sheppard 2009). A set of dedicated initiatives has been set up at national and local levels. At the national level, policies to address skills supply issues have been implemented, albeit unevenly. Accredited learnerships and standard bursaries in specific areas—such as accounting—are available. South Africa offers a series of incentives to foreign and local investors in BPO&O. The DTI’s GAS program ran from 2007 until 2010. This provided support for investors who did not displace existing jobs and for a maximum period of three years (DTI 2007a). Equity requirements were imposed, where 85 percent and 54 percent of those supported would be black and female respectively (DTI 2007b: 6).

A long-term strategy will fundamentally rely on the development of a broader skills base. In terms of skills development, noncost characteristics that pertain to the quality as well as the availability of labor at the relevant level of skills are important to generate new contracts with higher-value-added service activities. Dossani and Kenney (2007: 788) present education as a central element for tapping service-related prospects as follows: “Perhaps, the most important policy conclusion from our research is that countries that do not educate their populations will have no opportunity to participate in the globalization of services. The service sector is infinitely rich in opportunities.” It is the basic supply of skilled personnel (in technology, mathematics, statistics, and related fields), as well as specially accredited trainees, that signals the availability of a base of work-ready entrants.

Everest Group (2008) identifies two main dimensions critical to the expansion of financial services BPO, namely availability of skilled labor and existence of domain expertise. Within the skill category, South Africa has a key strength in the number of actuarial and certified analysts in the country, in absolute as well as relative terms. Financial services BPO is well suited to South Africa, especially in knowledge-intensive services where there is less cost competition, as shown in the study by Van der Heijden (2005) of two financial services subsectors, namely asset management and related financial services.

In sheer numbers of generic skills, South Africa falls short of its main competitors. South Africa produces 90,000 university graduates annually, as compared to 300,000 in Egypt, 480,000 in the Philippines and 3 million in India. A further 35,000 post-school diplomas are awarded annually in South Africa. The pool of experienced BPO supervisors and managers is very small, with only 3,000 in 2008, as compared to 20,000 in Mexico, 30,000 in the Philippines, and 80,000 in India. In more specialized expertise, South Africa has competitive skills supply. For example, in urban areas where BPO

is concentrated, similar numbers of commerce graduates are produced annually in Johannesburg (12,000), Manila (16,000) and Mumbai (28,000). South Africa has a stock of about 850 chartered financial analysts (CFAs), 770 actuaries, and 26,000 chartered accountants (CAs). India has 4,000 CFAs, 225 actuaries, and 90,000 CAs. The Philippines has 75 CFAs, 65 actuaries, and 15,000 CAs (Everest 2008).

4.4 BPO&O support in South Africa

BPO&O began receiving focused policy attention in South Africa from the early 2000s in the hope that BPO&O offered opportunities for job creation. Call centers were the initial focus of attention, and from 2006 more attention was devoted to specific niches such as BFSI.

The DTI (2010: 87) claims that “[t]here is the potential to create 56,000 direct sustainable jobs over 10 years in business process services with an increase in foreign earnings from the ‘exportable’ services sector.” This assumes a growth of employment in BPO of about 11 percent per year (as calculated by Everest Group, see BPO Partnership 2009). Frost and Sullivan (2009) contend that the limited amount of outsourced ITES to date reflects a potential for future expansion of BPO. Their report expresses the view that domestic outsourcing (rather than offshoring) is likely to be the biggest growth opportunity. In the context of the global opportunity, growth rates seen in some other developing countries, and South African capability, this seems unambitious.

For South Africa, demonstrated capability would originate through domestic outsourcing that could form a platform on which offshore activity can be performed. Frost and Sullivan (2009) propose that government should seek ways to raise the return on investment from domestic outsourcing to encourage its expansion. However, a strategy of building on domestic outsourcing is constrained by the extent to which firms are maintaining ITES such as customer care in-house (Frost and Sullivan 2009). Some domestic captives may choose to generate new revenue streams by attracting offshore business. Otherwise, offshore activity could arise only through captive multinational investment.

South Africa is an emerging international BPO provider, entering the competitive fray as a relative latecomer and with the cost structure of a middle-income country. It would typically not succeed in competition on the basis of cost alone, but it could compete on the basis of product quality, customer relationships, or some other differentiator. Policies have largely focused on promoting call-center activities, a particular BPO sub-sector, with relatively limited attention paid to value-added products in a range of activities such as back-office processing or to new service and industry sectors where there could be substantial competitive strength. More generally, the logic of policymakers has been to promote the most directly labor-intensive aspects of the BPO&O industry in a context of high unemployment at low levels of skills. However, this has been done on a comparatively small scale. The concomitant investments in telecommunications, skills, and specialized ITES have not been pursued at the scale or intensity needed to meaningfully position the country in the competitive fray.

South Africa's success is likely to be built on capabilities in certain niches. However, a review of marketing material might indicate otherwise. Promotional material and global presentations on South African BPO still express a generic approach to attracting investment (see BPeSA 2011; BPO Partnership 2009)

Other efforts are aimed at the development of a code of conduct to signal that South Africa is a quality BPO-supplying market for foreign buyers and investors.

The public policy approach has treated BPO as a stand-alone industry, rather than as a service integrally linked to other industries. The Human Sciences Research Council (Van der Heijden 2005) and Frost and Sullivan (2009) have shown that BPO&O arises through careful insertion into specific vertical industries (such as retail, BFSI or telecoms) and competitive advantage in certain horizontal activities (such as segments of FAO, ITO, KPO, HRO or call centers). This is over and above the generic requirements of competitive cost, regulation and standards, competitive telecommunications, or human resource supply. Hence, industrial policy should support both the outsource capability and the horizontal and vertical activities, many of which are found in service sectors. Yet services industries have been low on the industry and trade policy radar; most attention has been devoted to the expansion of tourism, with sometimes reference to "other services" or "high value services" in the Industrial Policy Action Plan (IPAP), which is the DTT's central communication of intention. The first IPAP was published in 2007 and IPAP 2 in 2010. The main contributions to service-industry support and development have been related to strong regulation and oversight of the finance sector and relatively weak oversight and regulation of telecommunications.

The 2007 IPAP identified BPO&O as a priority for a number of reasons, including its potential as an export growth sector and its potential for job creation. Industrial policy support has focused on investment promotion, training, and marketing. The orientation of South African industrial policy is such that contributions to learning, technology, and productivity are underplayed and yet these would be the factors that would be essential to South Africa becoming a premier BPO&O destination.

In 2006, the cabinet approved a substantial set of assistance and support measures to stimulate BPO under the Government Assistance and Support (GAS) program, with special focus on offshoring. This emphasis on offshoring, and not on outsourcing, was due to concern that the latter would displace jobs rather than create them. Given the investment approach globally requiring demonstrated capability, this will mean that South Africa will largely limit itself to trying to attract MNC-captive BPO activity, and will be less successful at attracting offshore business to South African third-party vendors. Everest Group (2008) identified limited vendor landscape and poor technology infrastructure as constraints. However, the policy approach does little to address them.

The incentive program for BPO operations was expanded in 2011, which pays investors for each full-time job created and maintained over a period of three years. It is estimated that this will reduce the cost of BPO operations by up to 20 percent. A "graduated bonus incentive" of 20–30 percent is also offered where 400 to 800 jobs are created, and it is intended to cover 50–60 percent of the capital investment per seat. Based on known

information about cost differentials in 2007, this incentive would make South Africa cost-competitive with other major destinations such as Manila or Bangalore.

Insofar as MNC captives are attracted to South Africa, restrictions on the movement of people across borders will need to be eased. For example, in the early stages of US offshore captive investments, 35–50 percent of staff are American (Frost and Sullivan 2009).

The industry promotion agency was strengthened with the establishment in 2006 of Business Process Enabling South Africa or BPeSA to replace the former South African Contact Centre Community (SACCCOM) that was set up in 2004. The mandate of BPeSA was enlarged to encompass more than call centers, extending to ITO, FAO, and HRO. However, BPeSA represents only 30 percent of South Africa's agent base. It represents the regional bodies and works in partnership with government (especially the DTI) and business.

5 CONCLUSION

ITES and BPO offshoring are largely new activities, having emerged over the past decade. India and the Philippines have taken the lion's share of the market, albeit with very different strategies. New countries have entered the competitive fray, most notably China, the Czech Republic, Malaysia, Mauritius, and South Africa, amongst others. South Africa is a small provider with potential in a context of high unemployment. BPO is a sector with rapid compound growth potential, expanding by a third annually in successful countries.

It is surprising that the cost differential between South Africa and lower-income economies is not great, and investment incentives should make up for the gap in the first three years of a project. South Africa is a middle-income economy with considerable capability in some key activities such as financial services. Its competitive edge will need to rely on specialist rather than generic skills, which are easily copied and some of which are increasingly being automated.

Some have argued that South Africa should promote the expansion of domestic outsourcing to enable the attraction of offshore business into local third-party vendors. By the end of the 2000s, it was still common for firms to maintain ITES such as contact centers in-house rather than outsourcing. Encouraging firms to outsource domestically, with the aim of strengthening the sophistication of vendors, may be politically sensitive in a context of high unemployment, as it may be seen as replacing "good jobs" in larger firms with "bad jobs" in smaller outsourced firms. Policymakers have therefore chosen to focus on attracting offshore business to MNCs. MNCs often prefer to offshore into captive services. A more targeted approach will therefore be needed to attract this business. Special support, such as easier movement of foreign personnel, will become essential.

Although the strategy for expanding BPO&O explicitly recognizes the need to offer niche products, promotional efforts continue to emphasize generics. There is little

attention paid in government industrial policy statements to the development of niche service industries, nor is there any apparent marketing that takes advantage of these niches.

Little attention has been paid in South Africa to attracting BPO&O business in sectors that have competitive advantage. An expansion of outsourcing necessitates an understanding not only of BPO, but also of how sector-specific dynamics influence the outsourcing of particular service functions. Some research attention has been devoted to BFSI, but it has not found its way strategically into sector promotion activities. Linking to areas of competitive capability offers greater possibility for technology spillovers and the stimulation of new industrial activities.

To achieve employment creation benefits, it will be essential that there are spillovers and linkages arising from the more skill-intensive activities that can be attracted and sustained.

The presence of an educated labor platform will be essential for the absorption and transformation of this knowledge for the purpose of BPO expansion and of movements up the value chain, both horizontally and vertically.

The generic approach, with emphasis on low-end contact services, and the slow pace of human capital development will impose high opportunity costs for South Africa. ITES may prove to be one of the few fast employment creators in global trade, that South Africa can ill-afford to squander.

NOTE

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