

**CALL CENTRES / BUSINESS PROCESS OUTSOURCING
(BPOs) FIRST PAPER**

**Current Situational Analysis of the Call Centres / BPOs Sector
in the Western Cape**

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1 Executive summary

Business Processing Outsourcing (BPO) is already a major industry in the Western Cape. Over 100 operations employ over 11,000 people, making it one of the top ten employers. Agent numbers have grown 25% over the past year and could realistically increase by 20,000 by 2008. This would have a significant impact on the local and national economy, adding around 0.5% to national GDP.

In South Africa as a whole there are already more contact centre operations than in Spain – if it were in Europe the South African industry would rank sixth largest installed base on the continent.

Business process outsourcing (BPO) is the transfer of to a third party of groups of tasks and responsibility for processes, which primarily involve the handling and manipulation of data (taken in its broadest sense to include voice data).

The BPO industry is therefore composed of those companies that specialise in undertaking responsibility for information intensive business processes on behalf of their clients. BPO operations are intensive users of IT and telecommunications.

The range of tasks which are outsourced is broad, but are typically important but non-core tasks such as back-office administration, data capture, and customer contact. Voice focused services tend to be more complex as the outcomes are far more variable. Cape Town operations excel at providing these services for both local and international clients. Regional experience of the financial services and insurance industries has given the local workforce the skills to be particularly competitive in these market segments, even though in general the Western Cape is not cost competitive with established Tier I BPO service provider countries such as India and the Phillipines.

The establishment of a new BPO operation – whether as a captive of an overseas parent BPO operation, a shared facility for a local corporate or an independent outsourcer servicing a range of clients – brings with it capital investment, secure jobs with good opportunities for advancement, skills training, and the potential to earn foreign exchange (effectively a form of export). But securing such business is complex, high risk and involves the support of a supply chain that must deliver both technology and skills – both of which are also good for the wider economy and society.

The opportunities for growth are considerable; the global market for BPO is already worth up to R250 billion by some industry estimates, of which \$32-35 billion was

undertaken offshore. By 2015, Europe will 'loose' a cumulative 1.2 million jobs to offshore locations. India has been the most high-profile destination, where the BPO industry is worth \$3.5 billion, supporting 700 world class operations employing more than 500,000 people.

Companies do this not only to benefit from lower costs, but also to access more effective processes managed by specialists, make use of scarce resources (especially staff), enjoy more predictable cost streams, spread risk across a number of locations, and allow management to keep its focus on the businesses core, value-adding activities.

The purpose of this research is to identify and recommend policies to the Department of Economic Development & Tourism that will assure that a significant proportion of this business comes to the Western Cape. This first paper seeks to understand the dynamics of the industry, and to review the industry support activities already in hand.

It does this by using existing research and knowledge to review the local industry within an international and regional context, under the following headings:

- **Current status of the industry:** The BPO industry in the Western Cape is established, dynamic and thriving, though still immature and with some way to go before it can confidently compete on an equal footing with competitors internationally. It is a non-extractive, labour intensive export oriented service industry, capable of attracting inward investment, with a wide range of up stream benefits and potential economic multipliers.
- **Factors driving the growth of the industry:** The factors driving the international industry include the existence of a strong skills base in low-cost developing countries; access to a low-cost global communications and computing infrastructure; overpricing of scarce skills in developed countries; globalization and global competition; the need to spread business risk across multiple geographies; and constraints to the further expansion by service providers in the current leading BPO locations. These together offer a significant window of opportunity for the Western Cape to grow and develop its offshore BPO industry in the coming 4 – 5 years.
- **What customers and investors are looking for:** Prospective customers and investors look at (1) the extent to which the Western Cape has the core intrinsic of a successful BPO centre (2) the extent to which a mature industry already

exists, and (3) the extent to which the local industry is mobilized and undertakes pro-active marketing efforts to attract customers and investors.

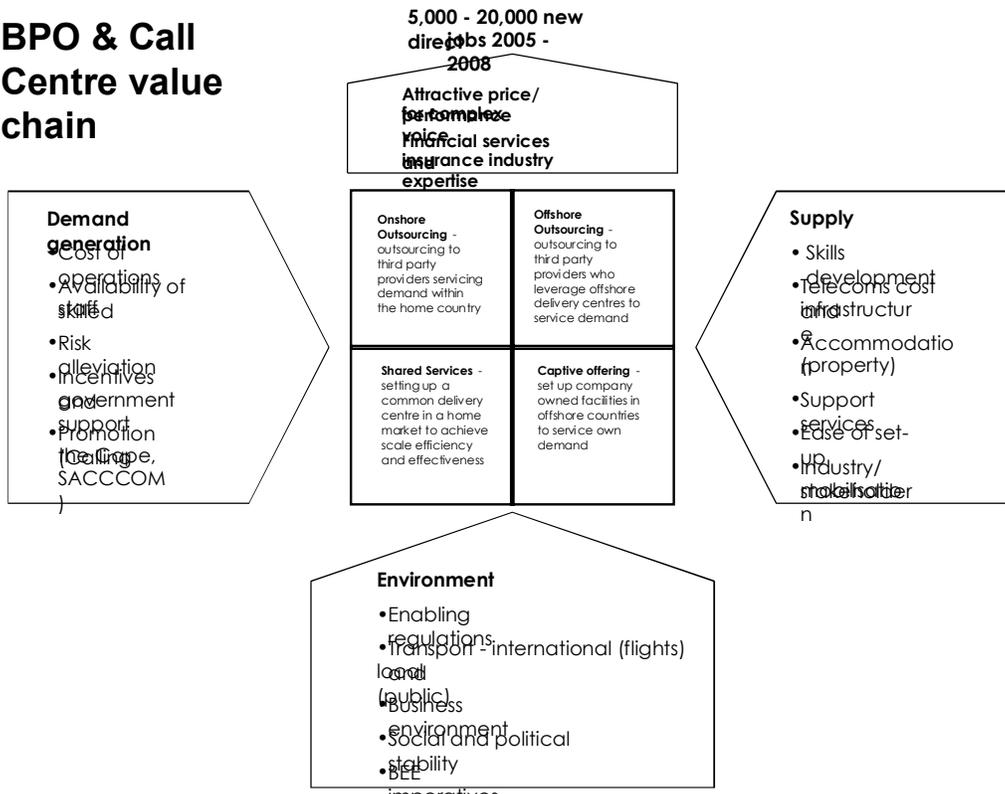
- Skills availability is one of the key requirements. Western Cape labour rates are high relative to other countries, and this contributes to a high overall hourly cost per full time employee.
- The Western Cape has a skills base that give it a competitive advantage in servicing the needs of the banking, insurance and telecommunications industries, and customer interaction based services.
- The language profile and cultural fit of the Western Cape make it suitable for the delivery of higher value, unscripted voice services
- Telecommunications costs have declined, but still are out of alignment with international competitors. The removal of Telkom's monopoly control of the SAT-3 cable is particularly pressing.
- Market maturity depends on a range of factors, including the maturity and resources of vendors, the availability of set-up assistance, and the availability of financial incentives and other forms of government support. The Western Cape is still at an early stage of its development in this regard.
- The proactive marketing efforts undertaken by *Calling the Cape* are recognized as a key factor in the success of the Province in establishing the industry thus far.
- Other relevant factors include the local importance of BEE, and the perceptions of international investors as regards the South African industry's capabilities.
- **Potential of the industry:** The Western Cape industry should position its offering on the basis of:
 - An attractive price performance proposition for selected services and target industries.
 - Layer on to this the advantages of language and cultural affinity and the provision of specialty services in key growth industries such as financial services and insurance.
- The local industry has huge potential to attract clients, justify inward investment and create jobs, provided that it can successfully position itself to provide those higher value services that give it a competitive and differentiated advantage. The *Calling the Cape* target of 20,000 new direct jobs created during the period 2005

– 2008 is achievable, though this will require considerable commitment and funding in promotion and other activities.

This information has been analysed using Porter’s Diamond Model to assess what is known about factor conditions; demand conditions; firm strategy, structure and rivalry; and the role of related and supporting industries are considered, as well as the role of government. It is clear that sufficient is known about the industry to reasonably propose strategies and policies to assist it. Not least, a number of existing shortcomings are identified.

An industry value chain can be discerned, which groups together demand generation supply and environmental factors.

BPO & Call Centre value chain



After review, these factors will form the basis of a subsequent investigation into the policy levers that could assist and support industry growth, and the recommendation of appropriate policies for the Western Cape government.

2 Introduction

2.1 Purpose of this study

The purpose of this study is to identify and recommend policies to the Department of Economic Development & Tourism of the Provincial Government of the Western Cape that will contribute to enabling the growth of the regional economy and the creation of equitable jobs through the expansion and development of the BPO sector.

This first paper is a current situation analysis. It seeks to establish a baseline by:

- Defining the current nature and extent of the industry
- Attempting to quantify the nature and extent of the opportunities for growth
- Assessing the available information to identify the factors that support or inhibit growth
- Assessing the available information to determine what factors are the Western Cape's favour, and which are not
- Defining a value chain linking together the various elements identified

The intention is to provide the basis for an identification of the policy levers available to the Provincial Government that will be addressed in a second paper. It is not a complete review of the industry, or a detailed analysis of its competitive position or strategy.

2.2 Approach

The approach to this report has been to:

- Define the BPO sector and place it in a local (Western Cape) context
- Use existing research and literature on the local sector, and plug any gaps in the current research base which limit an effective understanding of the industry current situation and potential through direct consultation
- Assess the current Provincial strategy for support of this sector
- Review other public sector support elements, and consider any relevant demand/supply market dynamics

This has been achieved by:

- Desk research of the broad literature on the sector and assessment of specific regional reports
- Checking of these findings with the understanding of key individuals in the industry
- Application of established industry competitiveness models and analysis of published government business support strategies

This will then enable the following to be objectively developed in a subsequent paper:

- A description of the value chain for the sector in the Western Cape
- An analysis of the key strategic levers that can be used to influence the BPO sector
- Recommendations for support of the BPO sector especially focusing on employment equity and black economic empowerment, economic growth and development and job creation

2.3 Sources

The information in this report is largely derivative.

The following local reports have been identified as relevant. These form the basis of the information contained in this report. Together they provide a representative picture of the status of and opportunities for the BPO industry in the Western Cape.

- Blue IQ 'Offshore Business Process Outsourcing and South Africa – An Investigation into the Business Case for Gauteng-based Companies' October 2002. This is well-researched study focused on Gauteng. It seeks to explore the key question of how South African companies might best position themselves to win BPO business.
- *Calling the Cape* 'Sector Development Strategy and Summary Business Plan – July 2004 – July 2007'. This has been augmented by information drawn from the *Calling the Cape* web site (*Calling the Cape.org.za*). Together these provide an excellent summary of local priorities.
- *Calling the Cape* 2004 Annual Report.
- Deloitte/ *Calling the Cape* 'Contact Centres and Business Process Outsourcing in Cape Town' 2004 Key Indicator Report. This is a detailed report based on empirical research. It builds on the earlier Infonomics report. It is aimed at investors, companies looking to offshore BPO to Cape Town, and local BPO

companies themselves. It includes a useful cost analysis that allows local companies to benchmark their own cost against industry averages and ranges. This research should be repeated frequently, and compared with similar data for competitor locations.

- Infonomics South Africa & Shortech International 'The Market for Business Process Outsourcing in the Western Cape' December 2003. This study undertook empirical research of the Western Cape industry; it focused on the financial service segment, with the intent of identifying the major issues facing the industry. It uses the industry background sketched by the BlueIQ report as a basis.
- McKinsey & Company 'Creating employment and economic wealth through developing the South African BPO&O sector'. Executive summary and exhibits prepared for Johannesburg City Council, 8 November 2004. The full report was not available. However, this report and accompanying exhibits is a definitive summary of the global BPO opportunity; analysis of the extent to which South Africa is currently positioned to exploit this opportunity; and initiatives required to secure the economic benefits.
- Mital Research 'South Africa 2002/3 Call Centre Country Report' October 2002. This is a briefing report aimed at overseas clients and investors – primarily in the UK. Sponsored "without editorial influence" by Trade and Investment South Africa (a part of the DTI).
- Paladin Consulting in association with Consulta Research, with additional input from McKinsey & Company 'Research study into the BPO & O Sector in South Africa' Trade and Investment South Africa (TISA) November 2004. New report with some new detail but no novel significant insights. Good analysis of the competitive strengths of the major BPO destination countries and the relative position of South Africa.

Other papers and articles that have been used as sources are listed in an appendix.

Individuals who have been contacted for direct contributions are also listed.

3 Review of the local industry

3.1 Definition of the call centre and BPO industry

For the purposes of this policy review:

Business process outsourcing concerns the transfer to a third party of groups of tasks and processes, which primarily involve the handling and manipulation of data (taken in its broadest sense to include voice data).

When these outsourced processes require voice communication with customers, this is typically done using a **call centre** or **contact centre** (the later term more specifically encompassing both outbound and inbound calls)

When this third party has been specifically established by a parent corporate enterprise to meet its needs (either the shared needs of several divisions or its need to locate these activities in another location for reasons, for example, of cost savings or risk management) then it is referred to as a **captive** operation. These captives may be set up in the same country as the parent or elsewhere. For example, Cape Town has a large captive call centre owned by Budget Insurance serving its UK market. Many of the call centres in South Africa are captives that have been set up, for example, by banks or insurance companies based in South Africa or elsewhere to undertake their customer service, data cleansing and other voice-based activities. Since they are separate subsidiaries (through 100% owned by their parent) and invoice their parent for their services, they are usually considered to be 'outsourcers'.

If the third party provider is located in another country then it is referred to as an offshore operation. **Offshoring** is therefore the practice of outsourcing to a third party in locations situated fairly far away from the parent company's location, e.g. the USA 'offshores' to India.¹ Offshoring may be done:

- By a multinational setting up a captive in another country
- By a corporate outsourcing to an independent third party in another country
- By a corporate outsourcing to an independent third party vendor, that has itself set up its own 'captives' in other countries (also known as an 'international outsourcer')

Other terms sometimes used in relation to BPO are:

- **Onshoring** – outsourcing to a third party in the same country (or nearby, aka 'nearshoring')
- **Outsourcers** – independently owned companies specifically set up to undertake BPO activities for third parties. These clients may be local (e.g South African) or

¹ This definition taken from Paladin Consulting 'Research study into the BPO&O/CC Sector in South Africa' TISA 2004

international. They are typically focused either on a particular industry (for example, the travel industry), or sometimes on a particular kind of service delivered to clients across different industries.

The TISA report² reproduces the following diagrammatic summary provided by McKinsey & Company:

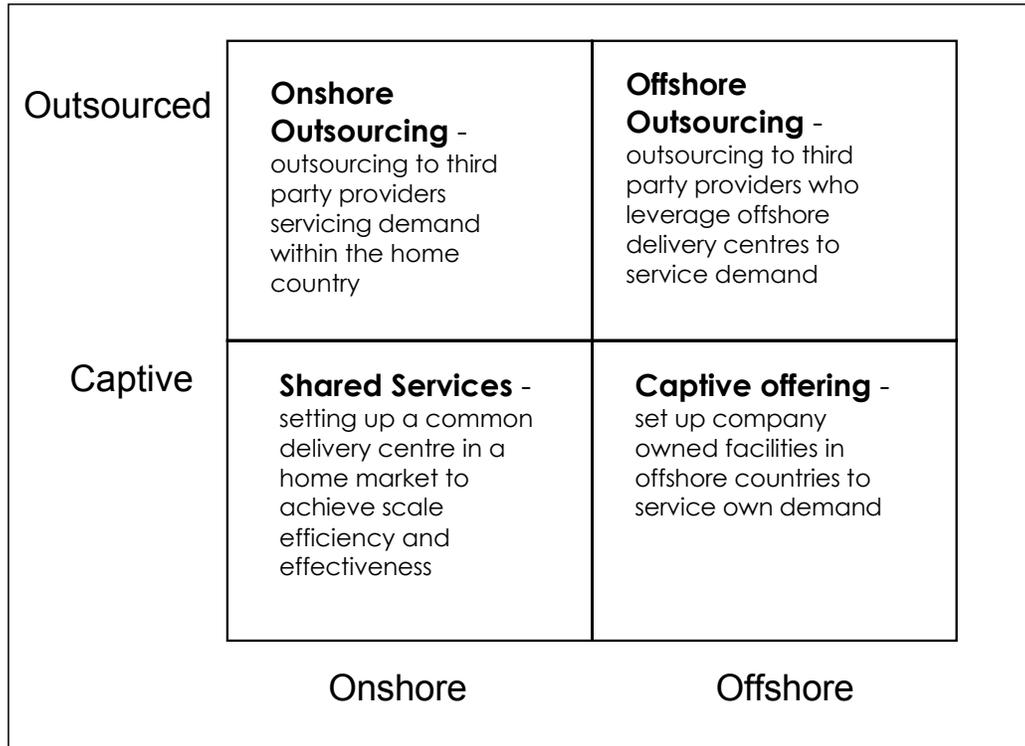


Figure 1: BPO industry definitions

The **BPO industry** is thus defined as being composed of those independent companies that specialise in undertaking responsibility for information intensive business processes within a business function on behalf of their clients on an ongoing basis.

Whilst the Western Cape BPO industry is happy to attract outsourced business from local corporates, or to attract the establishment of locally owned captive call centres, the major opportunity lies in getting offshore business from:

- Overseas companies contracting with local independent BPO companies
- Overseas companies setting up captive operations in the Western Cape
- Overseas BPO vendors setting up in the Western Cape to meet the needs of their international clients

² Paladin 2004, ibid

3.2 Examples of BPO services

Almost any business process that can be defined and ring-fenced can be outsourced. Examples include³:

- Human resources and payroll administration
- Finance and accounting back office functions, such as managing creditors, processing loan applications. Related call centre functions include outbound tele-sales or dealing with inbound queries
- Asset management back office functions
- Administration of retail investment products, such as unit trusts
- Banking and related data processing, such as credit card transaction processing
- Property management services, such as property accounting functions or collections (which may make use of a call centre)
- Customer services and retention, including customer relationship management (CRM)
- Expense claim administration
- Insurance industry functions, such as claims processing and policy administration. Related call centre activities include claims advice and acceptance, data cleaning and records up-dating
- Electronic media design
- Professional services, such as actuarial services, architectural and engineering design
- Secretarial services – especially legal and related
- Healthcare functions, such as audio transcription of medical records, diagnostics (e.g. analysis of ECG recordings), and payment claims processing. Related call centre activities include health insurance advice, pre-clearance for hospital admissions, or outbound research surveys
- Web site and database maintenance
- Travel and tourism management functions such as hotel reservations, car hire and flight ticket bookings
- ICT system administration

³ This list of outsourced business processes is based on those in BlueIQ 'Offshore Business Process Outsourcing and South Africa – An investigation into the business case for Gauteng-based companies' October 2002, and Paladin 2004, *ibid*, augmented by a web search of international BPO service providers

The extent to which instances of these activities constitute BPO can vary depending on the business relationship. Sometimes these are nothing more than traditional outsourcing (for example, the contracting of advertising to an agency) conducted at a distance. But provided that the activity:

- Primarily concerns the manipulation of data (in the widest sense - including voice) rather than the production or movement of physical products;
- Requires a significant degree of two-way information exchange, co-ordination and trust;
- Is supported by the use of ICT;⁴ and
- Is delivered under a long-term (multi-year) contract)

... then it can probably be considered an outsourced business process.

3.3 Segmenting the BPO industry by activity

A common way of categorising BPO activities is illustrated in the following diagram.⁵ This groups the kinds of activities given as examples above under four headings:

- **General back-office** – the kinds of generic administrative activities undertaken by any large company
- **Corporate services** – functions or parts of functions that have themselves become identifiable professions or industries
- **Customer contact** – epitomized by generic processes though using company specific information. Typically hard to manage and with their own efficiencies of scale. Can vary widely in complexity.
- **Other niche verticals** – processes more specifically defined by the client industry. Typically more data intensive and generally of higher value.

⁴ However, sometimes companies downgrade their technology when they move processes abroad, making their production less automated so they capture more benefits from lower labour costs (Ref: Edwards 2004, ibid)

⁵ Ref: Paladin 2004, ibid, p8. Acknowledgements to the DTI

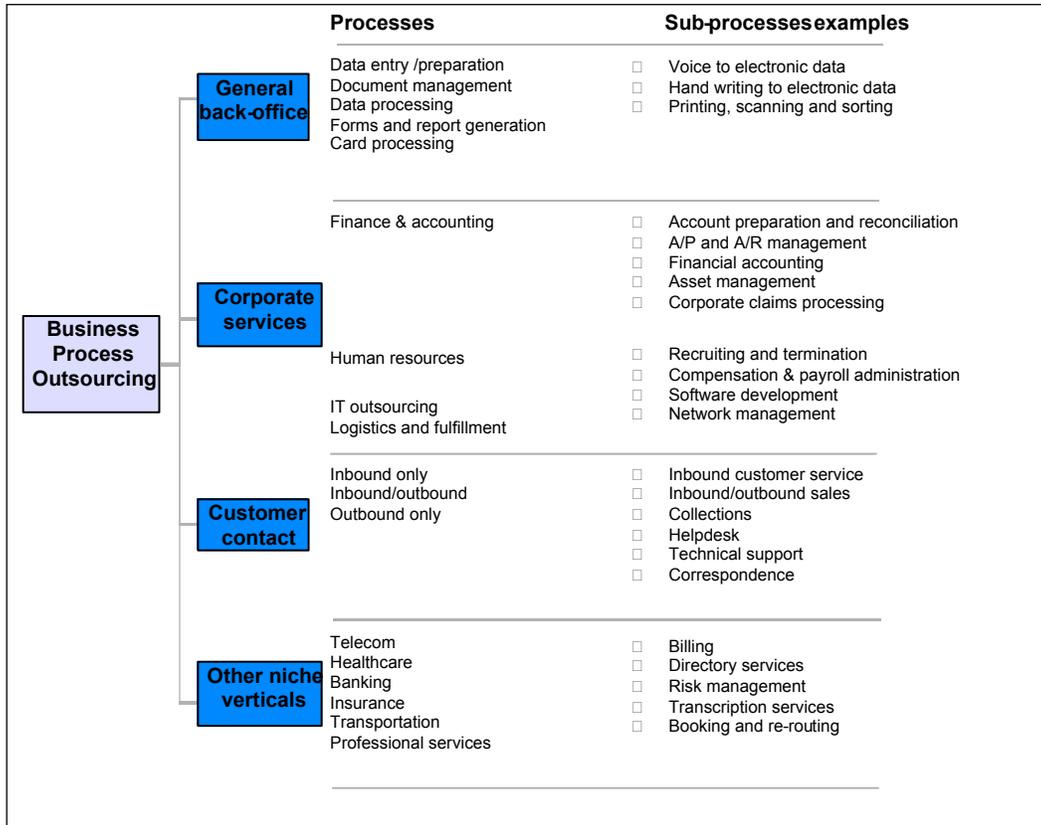


Figure 2: BPO sector breakdown

Sometimes writers and commentators refer to ‘BPO’ and ‘contact centres’ as though they are two separate things; ‘business process outsourcing’ is used to mean back office rather than call or contact centre work. As this diagram makes clear, contact centre services are a sub-set of BPO, which also includes data management activities that have little or no need for voice communications. ‘Contact centers’ should be considered a tool used to facilitate customer contact, either inbound (e.g. customer service, help desk, sales, technical support, bookings and reservations) or outbound (research surveys, data capture and cleaning, telemarketing and sales).⁶

⁶ This apparent tautology has been justified by *Calling the Cape* on the basis that ‘contact centre work forms the lion’s share of the BPO work being conducted in the Province. When writing about the industry, a balance needs to be drawn between terminological exactitude and writing for the specific intended audience. Companies looking to invest in or outsource to contact centres (and the consultants that advise them) may only think of themselves as being “contact centre people” rather than “BPO people”. Many of the investors and consultants that we deal with exclusively focus on contact centres.’ (Source: Luke Mills ‘Government response to BPO Paper’ (first draft) 22 March 2005.

Outsourcing that involves physical materials – such as contract production – are not normally considered business processes. Additionally, BPO is generally not⁷:

- IT outsourcing (whereby entire IT systems, including hardware and software, and taken over by a service provider and provided as a service to the client).⁸ The client makes use of the facility to manage its data – and so is still in charge of the processes enabled by the outsourced IT infrastructure
- A single project. In contrast, BPO services are typically provided in terms of a multi—year contract. Contracts of between three and seven years are typical.⁹
- Applications management (whereby the functionality of an IT application is provided and maintained, but no responsibility or role is taken for the data that it processes, which is still done by the user)

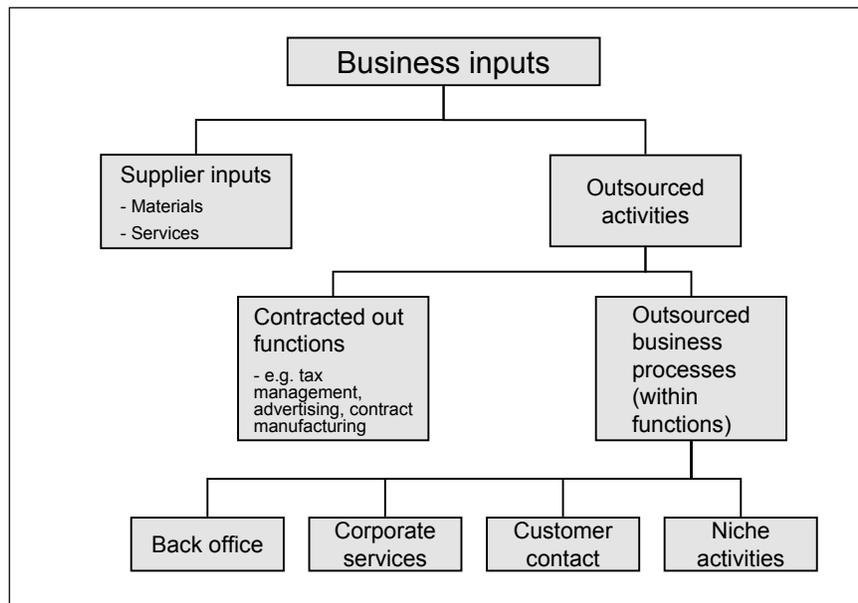


Figure 3: Understanding what outsourced business processes (BPO) are, and are not

⁷ This list based on that in Infonomics South Africa and Shoretech International 'The Market for Business Process Outsourcing in the Western Cape' December 2003, p3

⁸ There is some dispute in the local literature about this. The TISA report (TISA 2004, *ibid*) considers 'services to the IT and technical services industry, which includes processes such as infrastructure management, network management and maintenance and software development and maintenance' as examples of BPO.

⁹ Infonomics et al 2003, *ibid*

'BPO' therefore refers to the hand over of responsibility of processes that are an integral part of the outsourcing company's activities. Consequently, BPO is not:

- IT facilities outsourcing
- Services such as project-based consulting, systems integration, or applications management
- The supply of goods or services as inputs into the value adding process, even if done in terms of a long term contract
- Undertaking some business function such as production, or facilities management (this may be *outsourcing*, but it is not *business process outsourcing*)
- Providing a support service such as advertising, desk-top support, banking or staff recruitment
- Providing a non-core (though none-the-less critical) service such as telecommunication connectivity or office cleaning

Neither is the supply of inputs to BPO outsourcers – such as, for example, bespoke software development or IT equipment – a part of the BPO industry.

Expanding on this definition, a number of different industry sub-sectors can be identified and use to categorise BPO services. One approach is that taken by the DTI to break down the sector into back office, corporate services, customer contact and niche activities. Another is to consider the extent to which the outsourced business processes are *voice or data intensive*, and have *high or low complexity*.

Voice or data intensive

Companies providing BPO services can be categorized as either focused primarily on using agents to deliver voice communications, or on processing data.

Call centres – these are focused on voice communications with customers of their client; they use ICT systems to maintain customer records and track activity, as well as to enable communications

Data centres – these are focused on IT intensive data processing; most data intensive BPO is concerned with back-office functions or corporate services.

Forrester Research¹⁰ breaks down these data focused activities as follows:

¹⁰ Quoted in Infonomics et al 2003, ibid

- Simple bulk transactions, such as processing stock trades or credit card transactions. The market size was estimated to be \$58 billion by 2008; it is the easiest segment to master
- Human resources and finance & administration requiring more sophisticated individual skills
- High-volume vertical processes that involve the administration of insurance policies and the processing of loan applications

Low or high complexity

These business processes can be arranged along a continuum of complexity. Typically, **more complex** outsourced processes attract higher prices, but also:

- Require more specialist skills
- Are more ICT intensive
- Are more difficult to manage or automate
- Depend on a higher level of trust and process integration between client and service provider

Examples of high complexity outsourced processes¹¹ are:

- Customer enquires, help desk services and other unscripted call centre services
- Credit collection
- Finance and accounting back office functions
- Insurance renewals
- Insurance claims processing and administration
- Professional services
- Travel reservations

Low complexity outsourced processes are:

- Clearly defined with little variability in the process or outcome
- May require specialist skills to establish, but can then be automated or scripted

Examples of low complexity outsourced processes¹² are:

¹¹ Partially based on Luke Mills 'BPO Services Matrix' in 'Getting the Offshore Business Model Right for the Customer' personal communication 30 March 2005

- Directory enquiries
- Data cleansing
- Data entry and transcription
- Cheque or credit card reconciliation and processing
- HR administration
- Stock trade transaction processing

Some activities, such as dealing with insurance claims, involve both voice and data and can be highly complex.

Voice/data focus and low/high complexity can be used to create a matrix on which specific BPO examples can be positioned:

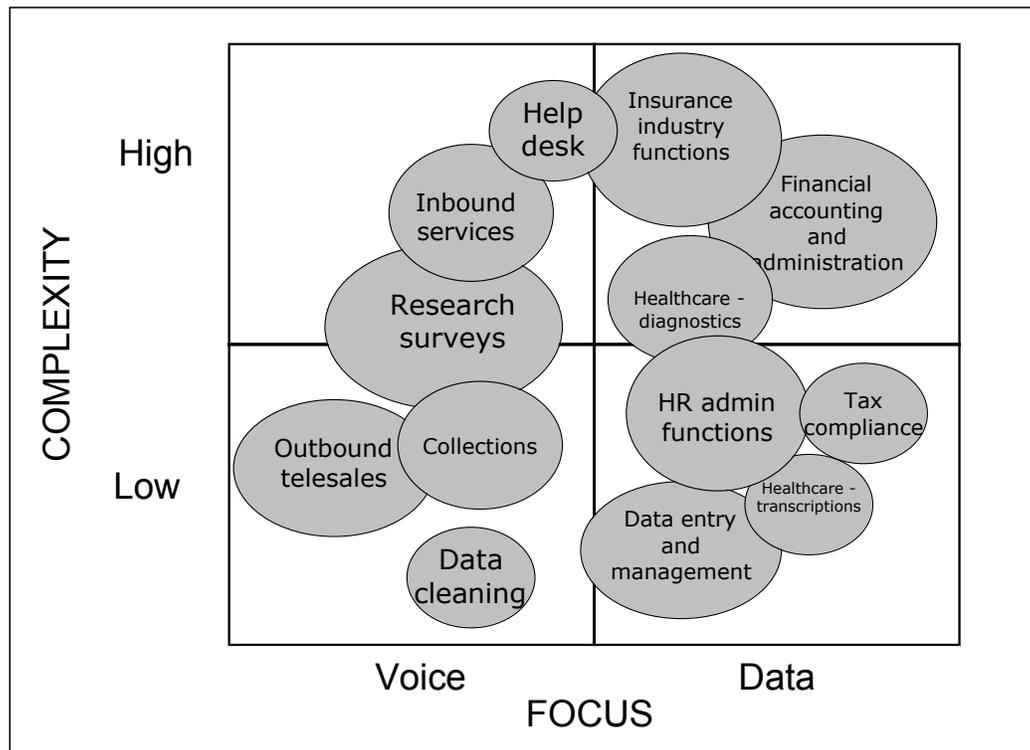


Fig 4: BPO focus/complexity matrix

In India, most the BPO industry's revenue comes from relatively low-complexity high-volume back office data focused work such as data entry of health-insurance claims, rather than voice. Out of a BPO workforce of between 600,000 – 800,000, there are only about 160,000 contact centre seats delivering voice focused services. India's

¹² Partially based on Luke Mills 'BPO Services Matrix' in 'Getting the Offshore Business Model Right for the Customer' personal communication 30 March 2005

combination of intellectual horsepower and low labour rates makes it unbeatable in the data quadrants.¹³ Only China has more people and lower labour rates – but it cannot (currently) provide English or European language voice based services.

3.4 Local industry baseline description

3.4.1 International context

Due to the varying definitions of the BPO sector, figures are only indicative. There is no doubt that the transfer of business processes from the developed world to developing countries (both to outsourcers or to captives) is an inexorable trend, which is still in its early stages. The following provides some indication of the opportunities:

- Gartner estimate that the global BPO market was worth \$114.9 billion in 2000, and will grow to \$170 – \$180 billion in the period 2005 - 2008.¹⁴¹⁵ EDS (one of the world's largest outsourcing firms) estimated the global market to already have been worth \$180 billion in 2002, and to exceed \$250 billion by 2005.¹⁶ This includes outsourcing within countries.
- The BPO industry in India is already worth \$3.5 billion, with some 700 world-class call service providers employing more than 500,000 people.¹⁷ By 2008 revenues are expected to reach \$21 - 24 billion.¹⁸
- By 2015, America is expected to have lost 74,642 legal jobs to poorer countries, and Europe will have 118,712 fewer computer professionals.¹⁹ Overall, 3.3 million US business-processing jobs will be performed abroad.²⁰

¹³ Ref: Ben Edwards 'A world of work' Economist Surveys 2004, *ibid* and Luke Mills 'Government response to BPO Paper' (first draft) 22 March 2005

¹⁴ Gartner Dataquest, quotes in Infonomics et al 2003, *ibid*

¹⁵ Gartner, global offshoring predictions June 2004, quoted in McKinsey & Company 'Creating employment and economic wealth through developing the South African BPO&O sector'. Executive summary prepared for Johannesburg City Council, 8 November 2004.

¹⁶ Quoted in Paladin 2004, *ibid*

¹⁷ Deloitte/ *Calling the Cape* 'Contact Centres and Business Process Outsourcing in Cape Town' 2004 Key Indicator Report

¹⁸ Edwards 2004, *ibid*

¹⁹ Edwards 2004, *ibid*

²⁰ John McCarthy '3.3 million US services jobs to go offshore' Forrester Brief, November 11 2002, quoted in Martin N Baily, Diana Farrell 'Exploding the Myths About Offshoring' McKinsey & Company April 2004

- 16% of all the work done by the world's IT-services industry is already carried out remotely, away from where these services are consumed.²¹
- Europe will lose a cumulative 1.2 million jobs to offshore locations by 2015 – mostly from the UK, and most significantly by financial services firms.²² A survey of the world's 100 largest financial services companies found that they expect to transfer a cumulative \$356 billion of operational costs and two million jobs offshore in the five years between 2004–9.²³
- 1.2 million European IT jobs will move offshore with the next decade – and South Africa is in the top ten of likely recipients.²⁴
- BPO to offshore locations was worth between \$32-35 billion in 2002 – just 1% of the \$3 trillion worth of business functions that could be performed remotely... the market is expected to grow at 30 – 40 percent annually over the next five years.²⁵

No breakdown of market share by country is available.

Local experts give most credence to the estimates provided by McKinsey²⁶. They predict the global offshore BPO market to grow from approximately \$10 billion in 2004 to between \$50 billion and \$60 billion by 2008. This dramatic growth will be driven by increasing levels of offshoring by existing early-movers, plus an increase in the number of companies willing to offshore their processes in the next 3-4 years. Between 40-50% of this opportunity will be in the financial services and insurance industries.

Further, they expect that this dramatic market growth will create an additional 3 million direct jobs worldwide by 2008. Of these one million are likely to remain 'nearshore' to the countries primarily generating demand (the USA and the UK), but two million will be relocated based on price and quality criteria.

²¹ Edwards 2004, *ibid*

²² Andrew Parker 'Two-Speed Europe: why 1 Million Jobs Will Move Offshore' Forrester Research Inc August 18 2004

²³ Infonomics et al 2003, *ibid*

²⁴ 'SA might win Europe's IT jobs' Finance24, 11 February 2005, downloaded from <http://www.finance24.com/finance/companaies>

²⁵ Vivek Agrawal, Dian Farrell and Jaana K Remes 'Offshoring and beyond' McKinsey Quarterly 2003

²⁶ McKinsey 2004, *ibid*

Using the number of seats in contact centres servicing offshore clients as an indicator, Cape Town had $\pm 0.3\%$ global 'market share' in 2004.²⁷

3.4.2 International sources of business

The most important sources of business for the global BPO providers are the United States and Britain, which already account for roughly 70% of the offshore BPO spend.²⁸ But the greatest growth area for new business over the next few years is expected to be from Europe, followed by Asia-Pacific (which is still a very small part of the world market).²⁹

McKinsey note that only countries with 'relatively liberal employment activities and labour laws (that) give companies flexibility in reassigning their activities and eliminating jobs' will lead the next BPO wave in the short term. Ireland (itself a BPO destination in the past) and the Netherlands are other sources of contracts. BPO is not expected to grow so rapidly in southern Europe, because of the large number of small firms. Though they are two of Europe's largest economies, businesses in France and Germany are less likely to outsource due to less liberal labour laws and language issues. However, outsourcing from these countries to North Africa and Eastern Europe is understood to be accelerating.³⁰

The IDC groups the business functions that constitute most outsourced business processes into nine broad categories³¹:

- Human resources
- Logistics
- Purchasing
- Engineering / R&D
- Marketing
- Sales
- Administration
- Legal
- Finance and administration

²⁷ Raw figures provided by Luke Mills, personal communication. Cape Town had 1,400 offshore call centre seats out of global total (nine countries) of 445,300. However, it is difficult to accurately distinguish between total call centre seats and those specifically dedicated to offshore work.

²⁸ Agrawal et al, 2003, *ibid*

²⁹ BlueIQ 2002, *ibid*

³⁰ Luke Mills 'Government response to BPO Paper' (first draft), 22 March 2005

³¹ Quoted in Paladin 2004, *ibid*

In the near term, the biggest growth in demand is expected to come from customer care, finance and accounting and human resources management. These non-core activities are common to most businesses. Financial services already account for over 30% of the total global BPO market.³²

Many observers note that many large companies that first decide to move some of their operations offshore to reduce costs (like GE Capital, British Airways and Amex) later took the next logical step of handing these activities over to a local service provider. A number of Indian outsourcers started life as offshore captives of American corporations.

The regions to which South African outsourcers currently supply services have been ranked as follows³³:

- Western Europe – 14.3%
- Northern America – 9.1%
- Southern Africa – 8.7%
- South-central Asia – 6.6%
- Southern Europe – 6.6%
- Northern and Eastern Europe – 5.9%

3.4.3 National Competitors

The major competitors for this expanding business are:

- Established 'Tier 1' countries – principally India, but also including Malaysia, the Philippines and China. ³⁴
- 'Near-shore' countries with existing business ties to the principle sources of demand, such as Ireland, Portugal and Poland, and Mexico and the Caribbean countries
- Counties with specialist skills in good supply, such as Russian IT programmers or Chinese product R&D specialists.

Other countries with dynamic and growing outsourcing industries variously mentioned as competing for offshore BPO business include Brazil, Canada, Chile, Czech Republic, Dubai, Guatemala, Hungary, Mauritius, New Zealand, Thailand and

³² BlueIQ 2002, *ibid*

³³ Paladin 2004, *ibid*

³⁴ Malaysia, the Philippines and China are sometimes treated as 'Premium Tier II' countries, in recognition of the significantly larger size and maturity of the Indian industry which is the premier Tier I location.

Singapore.³⁵ The main attraction of these countries is a large pool of English speaking, skilled labour with low costs coupled with a sophisticated telecommunications and network infrastructure.

Key new entrants identified by McKinsey are Thailand, Mauritius, Singapore, Dubai and even Nepal. It will be important for South Africa and the Western Cape to understand what its strengths and weaknesses are relative to these offshore locations.

South Africa is an emerging 'Tier II' BPO location.³⁶ It is recognised as a "steadily improving"³⁷ destination for offshoring service provision and investment. It has the advantage of "fundamental advantages" in the global high growth industry segments of financial services and insurance.

At the country level, the regions that compete with the Western Cape for offshore BPO business are greater Johannesburg and greater Durban.

3.4.4 Western Cape

The BPO industry in the Western Cape is long-established, but considerably smaller than that in Johannesburg. However, in the last twelve – eighteen months it has grown at a faster rate.

At the end of 2001 there were 410 full-sized³⁸ contact centres in South Africa – more than in Spain (which has a similar population). In addition there were 125 smaller 'pocket' contact centres (this excludes a unknown number of in-house contact centers operated by businesses and government). If South Africa were a European country, it would have the sixth largest installed contact centre base.³⁹

Deloitte's estimate that in South Africa there are 80,000 full-time equivalent contact centre and other data-focused BPO positions, of which only 10-15% undertake offshore work.⁴⁰ In 2002 there were four contact centres with more than 500 seats;

³⁵ The TISA report contains a fairly detailed analysis of how South Africa compares with several of these other countries and regions across a variety of measures and factors.

³⁶ Paladin 2004, *ibid*.

³⁷ McKinsey 2004, *ibid*

³⁸ i.e. more than 20 seats

³⁹ These comparisons taken from Mital Research 'South Africa 2002/3 Call Centre Country Report' October 2002

⁴⁰ Compare this with the 2002 estimate by Mital research that there are 79,000 contact centre employees in South Africa – more than the total employed in Scotland or the Republic of Ireland

centres between 201-300 seats accounted for the largest number of total seats; one in five contact centres had between 31-50 seats.⁴¹

In 2002 Mitial Research found that there were 62 contact centre operations in the Western Cape – 15% of the total:

Table 1: Geographic distribution of contact centres in South Africa, by site⁴²

Region	Number of sites	% of total
Greater Johannesburg	238	58.0%
Cape Town	62	15.2%
Other	45	10.9%
Greater Durban	30	7.2%
Pretoria	21	5.1%
Other KZN	12	2.9%
Port Elizabeth	3	0.7%

By 2004, The *Calling the Cape*/ Deloitte Indicator Report found that in the Western Cape there are 105 contact centre or BPO operations (up from 71 in 2003) operated by 83 companies.

Western Cape industry statistics⁴³

The Western Cape industry currently has 9,784 agent seats, 8,245 agents and a total staff complement of 11,276 employees. The average operation has 93 seats, employs 79 agents and 107 staff in total.

30% of the region's 83 companies are outsourcers; these companies derive 55% of their revenue from international clients. Cape Town has both internationally owned outsourcers, and locally owned outsourcers servicing international clients. On average these outsourcers have eight clients; they have a 90% client retention rate since the launch of operations.

Old Mutual has the largest single BPO operation in the region – a captive call centre with 900 seats in two buildings in Pinelands. Other notable operations in terms of size include Dialogue, a UK based outsourcer located in the CBD Foreshore (550 seats); and CSC, a data focused BPO outsourcer with 200 employees.

⁴¹ Mitial Research 2002, ibid

⁴² Mitial Research 2002, ibid

⁴³ Drawn from Deloitte 2004, ibid and Luke Mills personal communication

The industry is now one of Cape Town's top ten employers and, according to *Calling the Cape* (based on the findings of the Deloitte Indicator Report), has employment growth comparable with tourism and IT. The Deloitte survey found that headcount at existing operations is expected to grow by an average (weighted for operation size) of 47% over the next two years. Some are expecting staff to increase by as much as 500%.⁴⁴ (The source and impact of this anticipated growth is explored further in the next section.)

The major industries currently served are:

- Financial services – 20% (the financial services industry is the largest employer in the Province)
- Insurance – 13%
- Tourism – 13%
- ICT & telecommunications – 11% (Mitial estimated telecoms contact centres to be 14% of the total, and IT contact centres be to 9.2%)
- Retail – 9% (Mitial – 8.5% of national)
- Utilities – 7% (Mitial – 3.7% of total)

The public sector accounts for 3%. This is not yet as significant as it is in the UK or US. Public sector outsourcing is an important potential source of business for local SME and BEE operations.

The Deloitte 2004 Key Indicator Report notes that the importance of financial services "... should be no surprise. The financial services industry has long been a mainstay of the Cape Town economy, and is also one of the main industries driving the global trend to locating staff offshore. This industry accounts for close to 4,000 seats, including the largest contact centres in Cape Town (Old Mutual, Sanlam, Metropolitan) as well as the largest BPO outsourcer (CSC) and a good proportion of the new international investment (including Fusion Outsourcing/ Budget Insurance, a major UK insurance company)."

An important recent feature is the development of contact centres serving multiple industries. The six companies involved account for 9% of agent seats; 55% of their revenue is derived from international clients.

Overall there are 33 outsourcers serving local and international clients (most of these are captives or currently have just one client). These employ approximately 1,500 of

⁴⁴ Deloitte 2004, ibid

the ±9,000 agents in the industry (the balance are employed by local captives). Cape Town therefore has 12.5% of the country's BPO agents involved in international outsourcing.

Assuming sales of ~£10/ seat/ hour, a working month of 168 hours and 80% utilization, the outsourcing segment of the industry has revenues of ±R300 million per year (using an exchange rate of R12/£1). This excludes the revenue of very small providers of niche services, of which there may be several hundreds.

Using the number of call centre seats as an indicator of market share, out of nine countries providing offshore outsource call centre services South Africa has a 10% 'share of seats'. Cape Town alone has a 1.8% share. But this is distorted by the number of operations actually supporting offshore customers – on this basis Cape Town's share is probably closer to 0.1%. The 'seat share' leaders are India and Australia, with shares of 35% and 33% respectively. Note though that this also ignores the dominance of data focused services in India.

Western Cape industry landscape

The services offered by Cape Town BPO firms are predominantly voice focused – outbound call, customer services, credit collection etc. The range of more data focused activities – data capture, securities administration financial accounting, credit card administration, etc – is relatively limited and volumes are low by global standards. This reflects the particular strengths of the Western Cape industry, and matches expert expectations as the services offering greatest opportunity for growth.

There are eight⁴⁵ companies providing data focused services (not contact centres) including global players such as CSC, EDS Deloitte and Accenture. But only CSC is engaged in IT-intensive management of an entire business process. The others are relatively small operations supporting HR/payroll or plain IT support. None employ more than 50 people. The number of 'pure-play South African owned' data focused BPO companies in Cape Town "is zero".⁴⁶

The Infonomics report contains the following local contact centre and data focused 'success stories':

- Dialogue Group – contact centre owned by UK parent servicing a number of international clients; employs 550 people.

⁴⁵ Deloitte 2004 figures, updated by Luke Mills, personal communication

⁴⁶ Deloitte 2004, *ibid*

- Mindpearl – financially independent subsidiary of Swiss International Airlines offering contact centre services for the airline and travel industries. Part of a network of six global operations providing 27x7 service in 22 languages.
- Global Telesales – a Lufthansa captive, with 120 locally recruited German-speaking agents.
- Tasc Administration – the largest outsource investment administration service provider in South Africa, with 130 staff.
- Computer Sciences Corporation (CSC) – largest international insurance business process outsourcer. Operates from Canal Walk in Cape Town, servicing final clients in the US and the UK. Anticipating revenues of R1 billion by 2008, creating 1,000 new jobs.
- 3iSolutions – provider of document capture (tachograph charts) and contact centre services. Employs 65 people.

Other outsourcers serving international clients include Merchants, BSC, The Grove Group, Sales Engine, Old Mutual, Sanlam, Direct Axis, Customer Care Solutions, Digicall Solutions, Soluz Telemarketing and Ask Africa.⁴⁷

During 2004 there was R380 million of new investment in eight new investments in the Western Cape, plus an additional R25 million for expansions. This represented 30% of the total international investment reported by Wesgro.⁴⁸

The Mitial report is of the view that local demand for contact centres is already fully provided for, since those large companies which need a contact centre to service their business needs having already done so. Future growth in the number of contact centres will primarily arise from meeting the needs of international clients and investors.⁴⁹

Currently all significant BPO companies and call centres are located in the Cape Town metropole. *Calling the Cape* reports that it is doing some work with the George municipality to explore feasibility of non-CT call centres. Certainly, smaller niche BPO operations may be viable, but given the customer or investor requirements (see section 4) the opportunities outside of Cape Town for the establishment of significant new operations is severely limited.

⁴⁷ A longer list of firms in the industry (though with less detail of activities) is given in the TISA report

⁴⁸ Luke Mills 'Government response to BPO Paper' (first draft), 22 March 2005. Investment value recorded at a total cost over lifetime of commitment.

⁴⁹ Mitial Research 2002, *ibid*

3.4.5 Current availability of jobs and skills⁵⁰

Agents working in the BPO industry potentially perform a variety of tasks depending on their employer. Essentially the generic roles (other than accounting and administrative staff) are:

Agents – earn from R2,500 to R4,000 per month as a starting salary. The industry average salary is R5,278 per month. Agents typically work 168 hours per month. Required skills and attributes are typically:

- Matriculation certificate
- Good written and spoken English
- Good verbal communication (voice quality, neutral accent, grammar and articulation)
- Good computer literacy (typing, email, internet)
- Developed interpersonal skills – good team player
- Good telephone manner and telephone etiquette
- Personal drive and ambition

Agents have the potential to become a supervisor (aka team leader) within two years, earning up to R8,000 per month.

Supervisors – earn up to R7,246 per month as a starting salary. The industry average salary is R8,553. Supervisors typically work 175 hours per month. Supervisors need industry experience, together with supervisory and administrative ability.

Trainers – Performance appraisals are a regular aspect of BPO operations – some call centre operations conduct reviews every week. Some performance indicators are monitored in real time. Day-to-day coaching and mentoring is continually needed to keep standard up and costs down.

When recruiting, BPO operations tend to hire for aptitude and then train staff to acquire relevant product and industry knowledge.

Agents typically receive 28 days of training before commencing work and a further 281 hours of training per year thereafter.

⁵⁰ Deloitte 2004, *ibid* and 'Career Advice for the Contact Centre Industry' fact sheet published by *Calling the Cape*

Individuals with industry specific training skills are therefore in high demand. The ratio of agents per trainer (78 agents for each trainer) is low by international standards, indicating that scope exists for the industry to employ considerably more trainers even at current levels of growth.

Other roles include:

- Workforce scheduler
- Quality assurance
- Business analyst
- Process specialist
- Centre manager – typically with at least ten years of industry experience, earning up to R40,000 per month.

The number of supervisory, training and managerial staff employed for every 100 agents is given in the following table.⁵¹ Current and future staff levels are projected.

Table 2: Typical industry ratio of agents to other staff

Position	For every 100 agents there are:	On the basis of current agent complement of ~9,800, there are:	25% growth in agents	50% growth in agents
Agents	--	9,800	12,250	14,700
Supervisors	10	980	1,225	1,470
QA staff	4	392	490	588
Trainers	1.25	122	153	184
Managers	2	196	245	294
	total	11,490	14,363	17,236

Thus, if the industry can achieve and sustain compound growth of 25% per year (as per current expectations) for a few years, then the impact in terms of new jobs created can be seen to be significant.

On average, salaries in the Western Cape are 10% less than in Gauteng, though there is a greater range. Agent salaries can be up to one fifth of equivalents in the UK, Ireland or the Netherlands.⁵²

⁵¹ Adapted from information in Deloitte 2004, *ibid*

⁵² Analysis extracted from Mital Research 2002, *ibid*

3.4.6 Current BEE profile

Most companies in the sector have employment equity plans (which must be submitted annually to the Department of Labour by all companies with more than 50 employees). The legislation requires companies to ensure that their staff profile, at both agent and management level, is broadly consistent with the demographics of the Western Cape (unless there are bona fide reasons for non-compliance e.g. a need for German language skills).

At the individual firm level, the Deloitte survey⁵³ of 2,700 employees in the local industry found the following⁵⁴:

Table 3: Race and gender breakdown of BPO industry employees

	Race				Gender	
	African	Coloured	White	Indian	Male	Female
Agents	10%	52.4%	37%	0.6%	38.5%	61.5%
Supervisors	14%	52.6%	28.6%	4.8%	41.3%	58.7%
Managers	4.8%	31%	60.8%	3.5%	44.9%	55.1%

At the industry level, 8 of the 33 outsourcers (i.e. independently owned companies – not captive operations belonging to a corporate parent) are black owned. 50% of these 33 outsourcers have some measure of black shareholding.⁵⁵

3.4.7 Enabling sectors

BPO as an enabler of other industries

A vibrant and growing BPO industry is an important tertiary sector capable of creating and absorbing significant numbers of individuals as employees. Within South Africa, the industry is an important component of the financial services, IT healthcare and telecommunications sectors. As such it is an important enabler of productivity improvement and competitiveness in these and other industries. Productivity is good; anecdotal evidence suggests that international investors have been ‘more than

⁵³ Deloitte 2004, ibid

⁵⁴ For reference, the demographic split in the Western Cape is approximately 50% coloured, 25% African and 25% white

⁵⁵ Luke Mills ‘Annual Report of the Cape Town Call Centre Development Association’ 1 February 2005

satisfied with South Africa productivity in relation to other offshore destinations as well as home markets of the US, UK or the Netherlands'.⁵⁶

Sectors supplying the BPO industry

From the supply side, the enabling industries that support the BPO sector are:

Telecommunications – the cost of voice calls and data connectivity and reliability of service are both the most significant cost input after staff, and a critical enabler of international competitiveness. All operations are currently obliged to procure this input from Telkom, though two international outsourcers with local operations have telephony deals with UK based BT.

Voice traffic is delivered to contact centres via combinations of analogue lines, basic rate (ISDN), primary rate (30 channel E1), and Telkom's VOIP.

Generally, voice calls have been three to four times more expensive than in other offshore locations such as India and the Philippines. Recent changes have improved the situation somewhat (voice costs are now – for the first time – on par with India), but there is still much room for improvement.

Data connectivity is mainly provided via the SAT-3 cable, which lands in Cape Town, with redundancy through the SAFE cable.

The market for data carriage is significantly more deregulated, with a number of ISP and VAN providers licensed to carry data. Competition between these local and international providers of data networks has resulted in lower prices. The cost of a 2Mbs international leased line is now ±R80,000 per month – 100% less than 18 months ago. But this is still considerably more than the cost enjoyed by international competitors. The importance of telecoms deregulation is explored further in the analysis (section 4).

Skilled employees – although IT enabled, the BPO industry is primarily people intensive. The competitive strength of Western Cape companies is in high complexity (unscripted) voice focused services, and so requires a labour pool of educated, English speaking computer literate individuals if it is to compete internationally. The importance of the education system in the region to the future success of the industry is therefore considerable.

⁵⁶ Deloitte 2004, *ibid*

Recruiters and staffing services are an important conduit of trained personnel into the industry. Several large companies operate in the Western Cape, including Kelly Staffing Services, Quest Connect and Emmanuels Advance.

BlueIQ considered the senior management level skills needed to negotiate and manage large outsourcing contracts to be in short supply.⁵⁷ The competitive position of the Western Cape in this regard is explored further in the analysis (section 4).

IT hardware and software, telephony systems – these are the basic tools used by BPO operations, and represent a significant capital (set up) cost as well as ongoing operating cost in terms of support, licensing, etc. Agents must also be trained in their use.

The Deloitte report states that these inputs ‘are in the main significantly cheaper when purchased in Cape Town rather than in the US or UK’.⁵⁸ This is because the total cost includes a significant labour portion for set-up and configuration, which is available at a significantly lower cost locally than in the US or UK.

Property – the accommodation requirement of BPO companies are quite specific. A key driver of location selection is access to the fibre optic ring (eliminating one point of failure). Generally buildings which are not connected to fibre can be connected but the implementation time for this can be as much as 12 months. Other requirements other than physical space include adequate parking and/or close proximity to public transport. The importance of the availability of suitable property is a factor considered further in the analysis (section 4).

Transport – being people intensive, BPO companies need to be sited where they are easily accessible by road and by public transport. Given the round-the-clock, multi-shift nature of many operations, staff need to be able to travel to and from work safely and dependably at any time of the day or night. It is a legal requirement (as well as a sensible precaution) for employers to make provision for transport for workers working late at night.

Overall, capital set-up costs range from around R10,000 – R20,000 per seat for a basic back-office or contact centre operation, through to more than R60,000 per seat for a high spec site running sophisticated technology. Relative set-up costs are analysed in section 4.

⁵⁷ BlueIQ 2002, ibid

⁵⁸ Deloitte 2004, ibid

Other industry inputs include specialist recruiters, trainers and consultants; furniture suppliers; and providers of business continuity back up sites.

4 Competitive analysis

The following analysis has two goals:

1. Enable a review of the relevant public sector support programs already in existence,
2. Prepare the way for the definition of the industry value chain and identification of policy levers and recommendation (paper 2)

The analysis is not novel, but based on an assessment of existing research. It takes the following format:

- Understand the factors driving offshore BPO growth
- Assess what customers and investors are looking for in an offshore BPO location
- Analyse how the Western Cape measures up to these expectations and requirements
- Identify any other relevant factors that need to be understood with impact the growth of the local BPO industry
- Assess what the potential might be.

4.1 Factors driving BPO industry growth

The factors driving the future growth of the international BPO offshoring are, for the most part, outside of South Africa's control, but are well understood. They need to be considered so that the Western Cape's competitive positioning can be assessed.

These factors can be summarised as:

- **A strong skills base in low-cost countries.** The existence of a reservoir of well educated, motivated individuals – many possessing useful European language skills – and capable of taking up well-paid jobs in the services sector is hugely attractive to multinational corporation and BPO vendors looking to lower costs, remain competitive and spread risk. Financial savings from lower-cost economies' labour rates (at acceptable levels of risk) is the primary driver of offshoring.⁵⁹

⁵⁹ 'Why offshore for companies?' Slide presentation by CM Insight

- **Low-cost global communications and computing infrastructure.** The increasing sophistication and low cost of international voice and data communications combine to make remote delivery of IT and business services more practical and economically viable, though this will vary between offshore destination companies.
- **Overpricing of scarce skills.** American and European IT and services professionals command substantial salary premiums compared with similarly qualified people working in other disciplines. These are – in turn – considerably higher than salaries for similar jobs in many developing countries.
- **Global competition.** In sectors like financial services, global competition to drive down costs has accelerated fiercely during the past 10 year. Global companies competing across many markets are forced to bring their cost base into line. At the same time, quality must be assured. If an underlying premise is that the outsourcer should add strategic value to the client's overall business, then buyers expect "that they should be better at performing the process in question than they are".⁶⁰
- **Business continuity.** Deloitte Research⁶¹ and the TISA report⁶² notes that since the events of September 11 2001, business continuity has become a further driver off offshoring and outsourcing. This can be achieved by spreading geographic risk, favouring the use of multiple offshore operations. The geographic separation of South Africa, together with low political risk and shared time zones should make it attractive to European buyers. Infonomics also identifies clients' multiple destination strategies as providing potential opportunities. In addition to spreading risks, these also allow buyers to make use of complementary skill sets in different parts of the world.
- **Limits to expansion of current market leaders.** Datamonitor⁶³ notes that 'amid rapid expansion, Indian BPO operations are already facing a tightened supply of skilled IT workers, a worry rate of attrition and low staff loyalty'. By some estimates 70% of the new call centre capacity installed in India in the past year is lying idle.⁶⁴ This will create opportunities for other countries to learn from early

⁶⁰ Blue IQ 2002, ibid

⁶¹ Quoted in Infonomics et al 2003, ibid

⁶² Paladin 2004, ibid

⁶³ Quoted in Infonomics et al 2003, ibid

⁶⁴ Quoted in Paladin 2004, ibid

mistakes, focus on emerging client expectations, and take new business away from the existing market leaders.

- **Service failure.** Forrester Research⁶⁵ and others assert that globally clients are experiencing problems with BPO vendors who are not delivering their promised level of service due to lack of breadth in their capacity. When costs are higher than expected and service levels are lower then necessarily creates opposition to outsourcing. Quality of service will therefore become increasingly important aspect of service provider choice, and operators who can provide and assure this will have a competitive edge. This is especially important for voice-based services. On the other hand, basic transaction processing is becoming a commoditised service.

McKinsey⁶⁶ expects the majority of the incremental demand in the coming years to be placed on the basis of price and performance considerations. The proximity of the offshore service provider to the customer will be less important than the existence of cost savings, acceptable quality of service and the scalability of the talent pool.

- **Growing importance of non-cost drivers.** Infonomics⁶⁷ summarises the BlueIQ report's assertion that increasingly, outsourcing is not driven by cost alone. A number of the previously noted reasons for outsourcing that are not directly cost related include:
 - Access to more effective business processes undertaken by specialists
 - Access to dedicated world-class technology
 - The opportunity to refocus the management of the outsourcing company back on its core business
 - Access to scarce resources through the supplier's own resource base (e.g. staff)

An interesting supply-side factor that may also drive growth is the emergence of entrepreneurs who have been through the 'training ground' of the established contact centre industry who leave to set up their own outsource companies.⁶⁸ As contact

⁶⁵ Quoted in Infonomics et al 2003, *ibid*; also see Alexa Bona 'The myths and realities of customer service outsourcing' Gartner Research 2005

⁶⁶ McKinsey 2004, *ibid*

⁶⁷ Infonomics et al 2003, *ibid*

⁶⁸ Mitial Research 2002, *ibid*

centre technologies become more affordable⁶⁹ and other supply-side constraints are addressed, then the number of such independent start-ups entirely dependent on serving third-party clients is likely to grow.

Key message: There is a significant window of opportunity for South Africa and the Western Cape to grow and develop its offshore BPO industry in the coming five years. Growing demand, together with supply constraints from traditional BPO suppliers and an increasing emphasis on quality (in terms of cost/performance) could allow Cape Town to successfully position itself as an attractive 'Tier II' destination. McKinsey⁷⁰ anticipate a 'surplus demand pool' in India, the Philippines and China of between 200,000 and 500,000 jobs (i.e. these countries cannot supply between 200,000 and 500,000 people to meet demand). A significant opportunity exists to meet some of this demand from the Western Cape.

4.2 What customers and investors are looking for in an offshore BPO location?

BluelQ⁷¹, Deloitte, McKinsey and others have all directly addressed this have all issue. In summary, companies looking to outsource assess potential country locations using three criteria⁷²:

1. Has the Western Cape the core intrinsics of a successful BPO centre?

- Depth and breadth of the skills pool (agent and manager levels) capable of providing required capability and productivity
- Specialised skills, languages, technology and other relevant capabilities including business process design and management. An associated important 'soft' issue is cultural fit
- Telecoms infrastructure – quality and costs
- Cost of operations (including set-up costs – property, recruitment, training, etc. – plus input costs including salaries, rentals, utilities, transport, travel)
- Risks (e.g. data protection, business continuity, social and economic environment)

⁶⁹ Especially with the recent advent of robust open-source contact centre software

⁷⁰ McKinsey 2004, *ibid*

⁷¹ BluelQ 2002, *ibid*

⁷² Based on McKinsey analysis, quoted in Paladin 2004, *ibid*. Augmented by Deloitte 2004, *ibid*; information ("BPO Location Checklist") provided by Luke Mills; the analysis contained in McKinsey 2004, *ibid*; and own analysis

- Sustainability of operations (business environment and political stability)

2. Does market maturity exist?

- BPO vendor maturity, including ability to scale; capacity and capability (as demonstrated by track record), financial strength, and availability of service offerings and vendor options
- Maturity of support services (e.g. recruiting firms, training services, disaster recover sites)
- Enabling regulations, including employment law and standards of political, economic and corporate governance
- Set-up processes and prevalence of 'red-tapeism'
- Financial incentives and other forms of government support

3. Does the Western Cape undertake pro-active marketing efforts to attract investments?

- The level and visibility of government support and the effectiveness of industry bodies
- Target market efforts (industry coordination and marketing strategy)
- Brand building (appropriate positioning and promotion, South Africa's profile overseas)
- The existence of reference sites

4.3 How does the Western Cape measure up to these expectations and requirements?

On the basis of an analysis of the existing research and expert opinion, the following observations can be made. This is not a full exposition of the status of each factor, but a summary analysis.

4.3.1 Has the Western Cape the core intrinsics of a successful BPO centre?

Labour availability and cost

There is no doubt that Cape Town and the Western Cape has a significant potential labour pool. The western Cape has a labour force of almost two million, but an

unemployment rate of 26%.⁷³ At issue are the standard of skills available and the relative cost of labour.

An expanding supply of labour is a prerequisite for demonstrating ability to scale, particularly in the delivery of voice-focused services where the Western Cape has advantages. The labour pool deficit is one of the key challenges facing existing market leaders, which is partially the reason why South Africa has an opportunity to enter the market in a significant way.

The Western Cape produces about 11,000 graduates per year, 25,000 matriculants, and about 40,000 school leavers with English as a first or second language. BPO companies recruit entry-level staff at matriculant level. Staffing companies report up to 4,000 experienced contact centre agents on their books at any one time.⁷⁴ But the pool available to the BPO industry is estimated to only be 15,000 – 20,000 people per year.⁷⁵

McKinsey's analysis therefore reasonably concludes that agent talent supply is not an immediate issue; however, it will become a barrier in two or three years time if aggressive growth is pursued – especially as the industry requires growth to fuel its growth in the first place. Even a 15% compounded annual growth rate in agent numbers will constrain growth in coming years.

In the same manner, currently middle managers are plentiful in the established call centre and financial service industry. But there are already gaps apparent in the availability. McKinsey estimate that the existing available pool of international standard BPO managers is only 250-300 in South Africa as a whole.

Calling the Cape point out that lack of middle and senior management skills is a major inhibitor of growth of BPO everywhere in the world.

Several local companies have expressed difficulty in attracting team leaders, supervisors and managers. McKinsey note that consequently, international clients are likely to bring their own middle management from their home countries. This will mean that in the short term at least, resident and work visa red tape will become an issue, whilst the draw of the Cape lifestyle could become of some relevance in persuading companies to invest in Cape Town in preference to elsewhere.

⁷³ *Calling the Cape* 'The Western Cape – People, Skills and Resources' Press Pack Fact Sheet

⁷⁴ Luke Mills 'Cape Town – Getting the Offshore Business Model Right for the Customer' (presentation) – personal communication

⁷⁵ McKinsey 2004, *ibid*

Along with telecom costs, labour costs are the key drivers of the overall competitiveness of the costs of operations. McKinsey report that typical South African labour costs (including wages, benefits, recruiting costs and labour support costs including training) are around 2.5 times higher than in the Philippines or India. This contributes significantly to an overall cost of operations of about \$17.70 per hour per full time employee. This is \$7 – 8 higher than the Philippines (\$9.50) or India (\$8.69). However, agent salaries in Cape Town are still around a third of European costs and so it is still possible to achieve up to 40% cost savings for high-value voice work.⁷⁶

Key message (1): Skills availability is one of the key requirements for investors and customers. A growing supply of skilled agents and managers is one of the drivers of growth – allowing market forces to create demand for appropriately skilled labour should not be relied upon as without the availability of this labour in the first place such demand will not materialize.

Key message (2): South African labour rates generally are relatively high; even though Western Cape rates are on average 10% lower than in Johannesburg, they still contribute disproportionately to a high overall cost per full time employee per hour relative to Tier I competitors. Telecom cost reduction and increased scale of operations can reduce this (according to McKinsey by up to 17%⁷⁷) but this will not be sufficient to close the gap. Consequently, the Western Cape must target those higher value services where it has a competitive advantage in terms of skills.

Skills

The prevalence of English as the common language gives the Western Cape a strong advantage when bidding to provide voice-focused services to the USA and UK. The additional availability of other languages – especially German and Dutch (which Afrikaans speakers can quickly be taught to emulate) – also gives the Western Cape an opportunity to sell services to European countries.

The skills base in South Africa (and Cape Town in particular) provides a fundamental advantage in a few industries and service lines that are experiencing strong growth.⁷⁸

- Industries:

⁷⁶ Luke Mills 'Cape Town – Getting the Offshore Business Model Right for the Customer' (presentation) – personal communication

⁷⁷ McKinsey 2004, ibid

⁷⁸ McKinsey 2004, ibid

- **Insurance** – The insurance industry in South Africa is mature. Cape Town has many large experienced players with scalable insurance infrastructure. Its products are sophisticated and similar to life products in the UK. This has resulted in a skilled labour pool with good product knowledge and marketing understanding
- **Banking** – South Africa has a sophisticated banking environment, with well regulated financial services. It has developed an automated environment based on excellent technological platforms. Together with the wide use of business English this gives the country a strong advantage.
- **Telecoms** – South Africa has a scalable telecommunications infrastructure based on a good level of technical know-how and capability.
- Service Lines
 - **Customer Care** – relative to its competitors, there is a strong customer service culture in South Africa. South Africans are perceived abroad as helpful and non-confrontational.
 - **Payment services** – South Africa has a successful track record in this area. Local people understand credit as a result of a strong credit culture. This is underpinned by suitable infrastructure with appropriate technology platforms.
 - **High-end customer interaction offshoring** – i.e. complex ('unscripted') voice focused services. Cape Town has skilled talent especially in financial services and insurance. Even the high end of the labour pool is available at significantly lower cost than in the US/UK.
 - **Administration and back office** – technical and business skills give local operations the capability to deliver against specifications and SLAs in a short period of time. South Africa cannot hope to compete with low complexity transaction processing

The Value of effective interaction

- 70% of customer decision-making is based on how we are treated, and only 30% on the product itself. (Source: John McKean, Customers are People, The Human Touch)
- 71% of senior business leaders in the UK and US agree that customer experience is the next big battleground (Source: Beyond Philosophy)
- 70% of consumers angry or irritated by bad calls (Source: Henley)
- 49% will tell others if it was very positive (Source: Henley)
- Effective, high quality and branded conversations do have a tangible value – US companies now using C_Pro as a metric (how many customers promote us?)
- What makes for successful voice? Good conversation!

capacity of India, but could aim at higher complexity niches.

The delivery of data focused back office services is obviously less dependent on language ability or cultural empathy. The outsourced undertaking of many low complexity processes is effectively a commodity, bought on the basis of reliability and cost. The Western Cape cannot compete effectively – typical back-office staff costs in Cape Town are around \$1,000 per month, whereas back office staff in India or the Philippines cost closer to \$500. The differential is primarily in labour rates and connectivity.

Further, in terms of scalability, India has a huge pool of educated people who can do clerical and administrative work, as well as more complex IT driven tasks such as analytics. In the major cities firms are able to ramp up to 5 000 people for an invoice processing operation very quickly indeed. This has never been done in South Africa. And such massive programmes don't need product knowledge (or a good accent and customer service manner for that matter), just brainpower.⁷⁹

Key message: South Africa and the Western Cape has a history and culture that gives its people the skills to offer high-quality, high complexity voice focused services, especially in the financial and insurance industries. This potentially allows the Cape to compete for offshore business in those market segments where it can be cost competitive. Customer interaction based services are the largest BPO segment (23% of the global BPO market, reckoned to be worth \$33 billion by 2008.)⁸⁰ Such work is also more people (rather than purely IT) focused and so has the potential to become a major employer.

Language and cultural fit

Given the necessity for the local BPO industry to focus on offering higher complexity, voice focused services, then language and cultural fit issues become important. (See text box⁸¹.)

Mital considers 'the majority of people in South Africa (to have) a good command of English grammar and vocabulary. ... contact centre agents are generally well equipped in terms of voice/speech profile and 'sympathetic' diction to enable them to

⁷⁹ This analysis of the ability of Cape outsourcers to compete for the delivery of back office service due to Luke Mills, personal email communication, March 2005

⁸⁰ Luke Mills 'Cape Town – Getting the Offshore Business Model Right for the Customer' (presentation) – personal communication

⁸¹ Luke Mills 'Cape Town – Getting the Offshore Business Model Right for the Customer' (presentation) – personal communication

communicate effectively over the telephone. ... Even in cases where accent neutralisation training is required, this can be effectively achieved with minimal intervention. The South African English accent (viewed as a mother tongue variety of World English) is generally well received. ... contact centre agents do not generally present issues as compared to other offshore (particularly Asian) locations.”⁸²

Focusing on unscripted voice service is not without its problems; it has a high capex requirement (training, IT systems) as well as a high execution risk. Convincing customers that this can be done is itself complex, making such contracts long and difficult to acquire.

The difficulties in delivering a good service are illustrated by the problems that Amazon.com, Delta, Microsoft, Dell and others are having – all have recently pulled their voice process contracts from Indian call centres.

Key message: The language and cultural profile of the Western Cape makes it suitable for the delivery of higher value, unscripted, voice services. As with the skills base, this potentially allows the Cape to compete for offshore business in those market segments where it can be cost competitive. Language neutralisation and other aspects of training will become key development input issues.

Telecoms infrastructure and costs

International telecommunications are a prerequisite for the growth of the BPO industry. Typically telecommunications related costs are second only to labour costs in determining the competitively hourly rate.

Telkom has tailored offerings for the contact centre industry, though these are volume dependent and hard to achieve given relatively small contracts. Costs are still high compared with those in competing countries. McKinsey provide the data for the following analysis.⁸³

Table 4: Comparative country telecoms costs

Country	Typical cost of operation \$/ hour/ full time employee	Telecom costs \$	Percentage of total costs of operations
South Africa	17.69	2.26	12.8%
Hungary	19.72	1.44	7.3%

⁸² Mital Research 2002, ibid

⁸³ McKinsey 2004, ibid

Philippines	9.50	0.83	8.7%
India	8.69	0.36	4.1%

To give another example provided by *Calling the Cape*⁸⁴, large investors who build call centres for 1,000 seats or more require 45 Mb of connectivity (voice and data) from their home market to their offshore centre. From the US to the Philippines, this connectivity costs \$21 000 per month. From the US to South Africa, this costs over \$350 000 per month. Luke Mills says “It is not reasonable to expect investors to pay a 15 times premium for connectivity, which is essentially a commodity”.

The Deloitte Indicator Survey⁸⁵ found other anomalies: the survey of costs found that some companies were paying as much as R3.00 per minute (presumably for outbound international calls, though this is not clarified) whilst others pay as little as R0.65. A further analysis of the potential impact of VoIP technology (recently liberalised) indicates that over time the per-minute cost of an international call should reduce to R0.15 (\$0.02), which is comparable with that available in other leading offshore destinations.

Since the Indicator Surevy was completed, deregulation allowing VoIP is believed to have brought the cost of leased lines with voice quality of service from South Africa to the major global markets to par with India. Additionally, voice is now on offer through MPLS over data circuits – this is likely to be the most economic and satisfactory option for international call centres.

Clearly, further competition in the telecoms sector is critical for the future viability of the BPO industry. Whilst the telecoms environment is no longer the absolute break on investment that used to be, it is still far from helpful. Unless this changes relative costs may remain too high.

In principle, the Telkom monopoly was legally ended several years ago. However, persistent delays in licensing a Second Network Operator (SNO) have delayed the onset of much needed competition in the telecommunications space, and maintained an artificially high voice and data cost regime. Whilst there has been some improvements - notably in the cost of international links for call centre operators (primarily brought about by government pressure on Telkom rather than competition *per se*) it was anticipated that further competitive pressure and the introduction of legal VOIP services (in the form of the liberalisation noted above) would result in

⁸⁴ Luke Mills, personal communication

⁸⁵ Deloitte 2004, *ibid*

deeper price cuts. This has not materialised in any substantial form, primarily due to the monopolistic hold by Telkom on the international undersea (SAT3) cable. The Department of Communications has publicly stated its intent to view the undersea cable as a national asset, rather than a private asset, but no formal decision in this regard has been promulgated.

Nevertheless, significant indicators of a substantive mindshift in understanding the economic impact of high telecoms costs are clearly discernable. National government is clearly in favour of further liberalization, not least to stimulate growth in other areas – especially the contact centre arena, that is brought about by reducing the cost of telecommunications. This realisation is in no small measure attributable to organisations such as *Calling the Cape* lobbying Provincial and National Government.

As a result of the various determinations made by the Minister, the operators of call centres will be entitled to obtain voice services including VoIP (Voice over Internet Protocol) services from value added network service providers (VANS) in addition to enhanced data services. Significant savings could be achieved by call centre operators when acquiring their voice and data requirements from VANS. In this regard, savings would be achieved through the removal of interconnection charges paid by value added network service licensees to Telkom in conveying calls over Telkom's PSTS (Public Switched Telephone System). VANS could also look at innovative ways of structuring their charges and could perhaps base their voice services on bandwidth utilisation as opposed to the conventional call per minute based charge for voice services. Significant savings on international voice calls could also be achieved through making use of a VoIP service provided by a VANS, as a number of South African VANS have parent companies⁸⁶ which own one half of the international circuit (the other half being owned by Telkom) and would be able to obtain better rates for the international conveyance of voice traffic.

In addition, call centre operators should now be able to obtain cheaper telecommunication facilities, such as additional bandwidth, from VANS than they can from Telkom. In this regard, the service level and security offerings which are ordinarily provided by VANS may be infinitely more suitable to the needs of call centre operators than Telkom's present offerings. It should further be noted that through the use of virtual private network technology, VANS can now provide their clients with a national and an international voice and data network which has the appearance of a private telecommunication network. As such, call centre operators

⁸⁶ e.g T-Systems, which is owned by Deutsche Telecom, which has a minority share in the SAT3 cable.

should be able to link all of their international branches and offices to the South African operation and to save significantly on voice calls transmitted over such a network by making use of VoIP. VANS should also be able to provide additional multimedia services incorporating voice for their customers and as such, call centre operators should consider using VANS to provide them with international and national video conferencing and other multimedia application services.

Key message: telecommunications costs are widely recognized as a key factor in the international competitiveness of the outsourcing industry. Recent changes in the regulatory regime should allow cheaper and better services to filter through. But significant challenges remain; more competition at the physical network level and opening up access to the SAT3 cable.

Risk of operations

Operational risk has a range of factors:

Data security: Companies offshoring their processes need to be confident that their customers' personal data is as secure, and that their own IP will be protected from misappropriation. South Africa's IP protection and privacy laws are of a high standard and are seen to be enforced.⁸⁷

Regulatory risk: a stable and transparent environment (even if the regulations are not viewed as entirely appropriate or fair) is an important consideration for investors. The most important area is labour relations; there are problems both of perception (not necessarily founded in reality) as well as some genuine concerns, as expressed by members of the industry. From an external investor's perspective, the Labour Relation's Act is seen as inflexible compared to the US/UK, and affirmative action is seen as a potential threat once the industry is governed by a charter.⁸⁸

South Africa scores reasonably well in terms of the transparency and fairness of the legal system.

Security risks: this is the risk area of most concern to investors in South Africa. Significant perception issues exist around personal security and crime rates, founded in valid comparative statistics. In this regard the perception profile of Cape Town gives it an advantage over Johannesburg.

⁸⁷ McKinsey 2004, *ibid*, Exhibit 18

⁸⁸ McKinsey 2004, *ibid*, Exhibit 20

Disruptive events risk: that is, likelihood of disruption as a result of uncontrollable events. McKinsey reckon that South Africa is on a par with Ireland, India and the Philippines.

Country investment risk – that is, the extent to which a stable political microeconomic environment exists that provides security to investments. South Africa's relative level of political, social and economic stability is comparable with India and considerably better than the Philippines.

There are also risks associates with staff availability and capability, and infrastructure (primarily telecommunications, but also property and transport).

Key message: South Africa is perceived to be an economically politically stable country for investment, comparing generally favourably with other offshoring locations. But investors have perception issues with regard to personal security and crime, and are intimidated by the labour laws (at least initially).

Other significant factors

Property: *Calling the Cape* report that at the moment there is very little property available in Cape Town that meets international call centre standards. Some property is starting to be developed on a speculative basis but is unlikely to be ready until 2006. Current investors are therefore forced to refurbish older and sub-standard buildings, which adds time and cost to the set-up process.

Recruitment and training: there are a number of specialist call centre recruitment and training companies in Cape Town. These can adequately respond to demand provided that the supply of agents and others can be maintained.

Transport and travel: these can impact the cost and efficiency of operations. Cape Town scores reasonably for international flight connections, but the standard and availability of public transport for staff – especially at night – is poor. 24/7 operations must expect to provide transport to and from work for their staff. The Indicator Report identifies the inadequacy of the local public transport system – together with crime – as negative investment factors.

Summary

The Western Cape has the intrinsics needed to support a viable BPO and call centre industry.

Calling the Cape state that 'there is a growing acceptance globally of the fact that South Africa in general, and Cape Town in particular, has many of the requirements needed to become one of the top five global locations for contact centre and

business process outsourcing for the developed world markets'.⁸⁹ The reasons for this are given as:

- **Competitiveness** – the industry is internationally competitive, having attracted R380 million in new investment in 2004 – mostly from UK companies.
- **Employment intensiveness** – the industry – especially the contact centre segment – is highly labour intensive. Direct jobs created in 2004 were over 1,000, with over 4,000 people employed as a result of consequent multipliers.
- **Sustainability** – the level of skills training required (averaging 10 weeks and costing R20,000) is such that once created jobs are expected to stay in the Province indefinitely. A sufficiently large pool of employees can be assured (partially through proactive training programmes) to meet industry needs.

However, as pointed out by BlueIQ, there are a number of important supply-side constraints that limit the potential of the industry. South Africa is 'stuck in a limbo between the skills of the first-world industry, and the costs and people resources of the developing world'.⁹⁰

4.3.2 Does market maturity exist?

Market maturity is usually considered in terms of the number of existing firms, the time that they have been in operation and the level of competition between them. In these terms, Mitial⁹¹ sites the relative maturity and size of the domestic industry as a positive feature. However, considering BPO offshoring as an emerging industry, other factors associated with setting up in business and benefiting from incentives is a further issue.

Vendor maturity

Most researchers acknowledge that the South African BPO market is still immature, both in terms of scale and the range of services supplied. Local potential buyers of outsourced services are also somewhat narrow in their attitudes and approach; most believe that the main reason to outsource is to reduce costs. Suppliers therefore focus on providing a low-cost service rather than being a strategic partner. This is at

⁸⁹ Mills, *ibid*

⁹⁰ BlueIQ 2002, *ibid* p12

⁹¹ Mitial Research 2002, *ibid*

odds with the positioning needed to appeal to the more mature international BPO buyer.

In a young industry, independent outsourcers with a sufficient track record to prove capability and capacity are inevitably thin on the ground. A lack of international experience of multiple large contracts is one of the biggest and most difficult obstacles facing the Western Cape industry.

However, the great majority of counties seeking to develop their BPO offerings also have an immature market.⁹² Some of these have firms that have, none-the-less, successfully concluded significant deals, often in the face of similar or higher obstacles.

Two routes are identified to overcome this:

South African corporations with international investments may outsource the administration processes of these overseas divisions back to South Africa. Infonomics fingers Sanlam, Old Mutual and Capital Alliances to be considering this. Further, Discovery Health has announced that it will manage the back-office administrative processes of its PruHealth UK joint venture in South Africa. (The perception problems created if they do *not* do so are referred to below.)

Second, local outsource industry could grow by attracting investment from either established BPO outsourcers with the necessary track record and financial weight, or multi-national corporations setting up their own captives. Homegrown operations are unlikely to succeed quickly unless they can partner with an existing overseas vendor (meaning that they will not have to sell directly to the end client) and are willing to grow incrementally by initially demonstrating competence at executing smaller contracts.

Ability to scale and financial security

Outsourcing is a volume business. The way to make money in outsourcing is to be big. Volume is required over a sustained period to recover initial capital invested. The challenge for any new entrant is how to quickly become large enough to reach critical mass. All large operations in the Western Cape have been established as the South Africa operations of exiting international operations, which can channel work to Cape Town. The risk involved in setting up a new independent business with the resources to take on large-scale contracts without already having such business contracts already secured is prohibitive. And no one will give such a contract to a start-up

⁹² This point taken from Infonomics et al 2003, *ibid*.

operation, as it cannot – by definition – have the necessary track record and experience. This ‘Catch-22’ is the biggest problem facing new entrants.

This is a major reason for the absence of large locally owned large BPO operations. Understandably, banks are unwilling to finance new large operations unless they have secured business in advance – but this is difficult to do without having an operation already up-and-running.

As in other sectors of South African business, this is not helped by the relative scarcity of risk/ venture capital and the conservative position taken by the major banks

Large scale and high complexity BPO operations require high up front IT investment; to attract business firms need a strong balance sheet. The longer term nature of contracts and the larger size of such deals ‘militates against new entrants and means that market is likely to remain dominated by very large outsourcers such as CSC, EDS and other premier global IT outsourcers’.⁹³ No local equivalents to India’s Wipro or Infosys are on the horizon. The number of South African BPO firms with experience of migrating large-scale international business processes is only a handful (three to five by McKinsey’s estimation).

Key message: Large scale BPO operations are only likely to take route in the Western Cape as a result of investment by multinational corporates in captives or the establishment of operations by international third party vendors to service existing international clients. An emphasis on inward investment (balanced with encouraging local company formation and expansion) is therefore needed.

Business set-up assistance

Setting up in business in South Africa is straightforward and free from bureaucratic or corrupt interference, requiring only registration with the DTI and SARS. But since other competing countries have established specialist dedicated agencies who are providing easy set-up processes for companies (such as one point of contact with government agencies and facilitation of visa requirements) South Africa has fallen behind other locations. Approvals can take up to seven weeks, whereas the norm is 2 –4 weeks.⁹⁴

⁹³ Deloitte 2004, *ibid*

⁹⁴ Paladin 2004, *ibid*; BlueIQ 2002, *ibid*; MckInsey 2004, *ibid*

Financial incentives and other forms of government support

There is a general acceptance of government commitment to drive down the costs of doing business in general. National government support for business is geared towards ensuring the provision of economic infrastructure, and support for skills development and training.

Support for the BPO industry, mainly through the establishment of associations and promotion agencies, has been mostly at the provincial level, though a national body has recently been established. The 2003 Provincial Growth & development summit recognized the BPO sector as a potential engine of economic growth.

The Services SETA has reportedly spent approximately R110 million funding BPO Training and a significant additional amount is in the process of being secured from the National Skills Fund. These amounts are far in excess of the Skills Development Levies received from BPO firms.⁹⁵

The following financial incentives are available to BPO companies setting up in South Africa, or seeking to attract overseas customers:⁹⁶

Table 5: Incentive available to investors in the BPO industry

Category	Source	Type	Formula
Capital subsidy	Small to Medium Enterprise Development Program (SMEDP)	Cash rebate	Up 16% of investment in qualifying assets
Land	None		
Job creation	Learnership (Services SETA)	Cash grant to cover training costs	R20K per agent
Job creation	Learnership (Services SETA)	Tax break to cover training costs	R50K per agent
Job creation	Learnership (Services SETA)	Refund of training costs for specific training towards recognized qualifications within the National Qualifications Framework	Additional R10K per agent
Training	DTI Skills Support Programme	Cash grant	50% of training costs up to 30% of total salaries typically R10K per agent

⁹⁵ Rae Walpe City of Cape Town comments on the Draft paper first report, 22 March 2005

⁹⁶ Source: Luke Mills, personal communication; McKinsey 2004, *ibid*; Radian research

Category	Source	Type	Formula
Export	Export Marketing and Exhibition Assistance	Cash grant	Contribution to costs: R30 – 50K per trip
Export	National Trade Pavilions	Cash grant	Contribution to costs: R30 – 50K per trip

The National and Provincial Departments of Labour have developed a BPO ‘Cadet’ training program for the unemployed using the National skills Fund; *Calling the Cape* has applied for funds to train and place 800 people.⁹⁷ This will involve a three month working program to prepare them for contact centre work plus nine months workplace experience, leading to a NQF Level 2 qualification.

A Gainful Employment Grant has been announced but not yet implemented. Employers will receive R6,000 when hiring a learner (from a learnership programme) into a permanent position.

A BPO specific incentive programme has been approved by the national government Cabinet, but the DTI has yet to develop the operational guidelines required to draw down the funds. Anecdotally this incentive is due to be implemented from April 2005.⁹⁸

Due to an historical anomaly and the way in which the SETAs are funded, the Services SETA – to which most new BPO firms subscribe – has relatively little money available for contact centre and other BPO services training. Last year there was a temporary withdrawal of learnership funds from the Services SETA. These events are especially unfortunate, since McKinsey consider the ‘trained managerial pool to be small’ and ‘behind other (offshore) centers on availability of talent’.⁹⁹

Key message: Government is committed to addressing all barriers and obstacles to investment and to drive down costs of doing business. The BPO industry has been specifically singled out for support. This support has both a supply side aspect (skills development) and a demand aspect (industry bodies to promote the industry).

⁹⁷ Rae Walpe City of Cape Town comments on the Draft paper first report, 22 March 2005; ‘Government Support for Cape Town’s International Contact Centre and BPO Industries’ *Calling the Cape* Press Pack Fact Sheet

⁹⁸ As at April 15, no one at the DTI could be contacted to comment on the status of this initiative.

⁹⁹ Quoted in Paladin 2004, *ibid*

Generally speaking, incentives are a market distortion and unsustainable. But the need for them is driven by both market failure (e.g. training incentives to ensure an adequate supply of skills) and by competition (other countries offer them and so South Africa must match them). South Africa has a range of investment incentives, but these are perceived to be “significantly behind other locations”¹⁰⁰ and “nice but not enough”¹⁰¹. In the key area of skills incentives (which are both an incentive to investors and a factor in booting the supply of a critical input) multiple bureaucratic problems need to be overcome.

One-stop centers that assist with business set-up, and an efficient bureaucracy that is transparent and fair can be as valuable as incentives. In India and elsewhere, some incentives are effectively special dispensations for BPO investors to get around entrenched problems associated with red-tapism; a better approach is to reengineer the bureaucratic problems out of existence entirely.

4.3.3 Does the Western Cape undertake pro-active marketing efforts to attract investments?

The most key organisation undertaking both industry coordination and promotion is *Calling the Cape*. Support for *Calling the Cape* by the Provincial Government and the City of Cape Town is the principle mechanism by which government provides support for the Western Cape BPO industry.

Calling the Cape

Calling the Cape is a not-for-profit Section 21 company established in September 2001 to market Cape Town and the Western Cape as a world-class location for ‘the IT enabled services industry... with a strong initial focus on call centres’.¹⁰² It is a cluster initiative set up by the local private sector and funded by the City of Cape Town and the Provincial Administration. It works closely with Wesgro (it is based in the same offices) but is distinct from it. It acts as both a specialist investment promotion agency and as a regional trade association and networking body for the industry. *Calling the Cape* has three full time employees.

¹⁰⁰ McKinsey 2004, ibid

¹⁰¹ Quoted in Paladin 2004, ibid

¹⁰² Mills 2004, ibid

Its goal is to '... create 20,000 new jobs for young (mostly) black unemployed people, reinforcing economic growth, social stability, black enterprise development and skills upliftment'. It intends to achieve this by focusing on the following key objectives:

- Grow inward investment – the target is R500 million new investment by 2007
- Increase employment (every R1 million invested creates around 50 direct jobs, 120 indirect jobs and in total helps to support around 800 people) – target is 25,000 new direct jobs by 2007
- Increase the competitiveness of outsourcers in Cape Town – to the level where they can compete with India. Target is 10 world class outsourcers by 2007
- Position *Calling the Cape* as the industries leading sector association
- Develop the skills pool – thus assuring the industry of its critical input
- Encourage genuine broad based black economic empowerment
- Industry leadership through SACCCOM (the national industry body) to ensure that national issues are addressed with government

Calling the Cape provides the following services to potential investors and clients:

- Information resources
- Service provider guidance
- Guided itineraries
- Problem solving
- One point of contact for government
- Impartial advice
- Its other activities can be split into three main areas:
- Marketing
- Research & Analysis
- SME development

Future goals include:

- Attract at least one global multinational outsourcer to Cape Town
- Match last years' new investment level
- Support products for start-up BEE companies
- Training academy and training management infrastructure
- Ensure the success of SACCCOM
- Reduce the dependency of the organisation on government funding

These are realistic given its past record, but resource intensive. *Calling the Cape* will require more funding support if it is to be confident of success.

In 2004, *Calling the Cape* had a total budget of 1.5 million. Comparable bodies in Gauteng and Durban received public funding of around R2.5 million.

Assessment of effectiveness

The 2005 Annual Report¹⁰³ contains the following 'report card', to which an assessment has been added:

Table 6: Effectiveness of *Calling the Cape*

Objective	Activities	Performance	Assessment
Implement marketing strategy	Promotional trips, website, international events, inward investment trips.	Investment commitments of R380 million, with over 2,000 new jobs created.	Strategy matches local strengths and global opportunities. A selection of reference cases has also been developed.
Organise Call Centre conference in Cape Town	Assist with organisation of International Offshore Customer Management Conference.	Held November 2004 – 130 delegates attended.	International awareness of the Cape as a BPO call centre destination is apparently good in UK and other target markets.
Develop training strategy	Cadet scheme with Services SETA.	60 learners assisted; 65 students received Dutch language training for Afrikaans speakers.	Number small given industry needs. Needs to be scaled up.
Increase labour supply	Outreach programmes to raise awareness of employment opportunities.	Reached 10,000 young learners in the Cape Peninsular area.	Impressive figure. Impact unknowable.
Develop incentive offering	Brief government officials and agree products.	Government-Industry forums created.	Package of appropriate incentives AND easy to access bureaucracy is

¹⁰³ Annual Report of The Cape Town Call Centre Development Association, 1 February 2005

Objective	Activities	Performance	Assessment
			needed.
Package investment offering	Existing incentives marketed.	Implementation and delivery of skills related incentives delayed. No property related incentives.	Property related incentives and/ or development schemes are needed.
Set up national call centre 'council'	Set up organisation to lobby national government and further industry's interests.	South African Contact Centre Community set established. McKinsey study commissioned.	McKinsey study is of high value – now must be acted upon! Western Cape stands to benefit disproportionately from national marketing efforts.
Industry diversity and empowerment	Assist with SME development; work on transformation charter	Assisted with formation of 8 new BEE outsourcing companies; 50% of 32 outsourcing firms have some black shareholding.	This program is critical to ensure local involvement in the industry at the management and ownership level.
Improve industry and supplier visibility	Create industry Business Directory	40 companies listed in directory; monthly newsletter read by over 3,000 professionals.	Critical tool to unify the industry and boost its visibility.
Develop membership scheme to establish and drive industry learning and standards	Membership scheme launched – directory, newsletter, white papers, benchmarking reports, training programs, etc.	Membership scheme launched October 2004.	Need for industry standards and self-regulation important for the future.

Marketing strategy

Calling the Cape has built its marketing strategy around the following:

- A correct assessment of the competitive advantage of the Western Cape being in higher value, complex (unscripted) voice interaction. This segment can demand higher costs. Hence its focus on voice focused call centres as against data focused back office services.
- A realistic assessment that significant growth in the industry will primarily come from inward investment, rather than from locally owned companies themselves negotiating large contracts directly with US or UK corporates.

- A focus on the UK market, which has strong language, business, and cultural ties with the Western Cape. It is also in the same time zone.
- An understanding that international promotion is best done as the South African industry as a whole, rather than by *Calling the Cape* alone.

In support of this, *Calling the Cape* has devoted its industry development strategy to:

- Building industry cohesion as the basis for setting industry standards and self-regulation
- Attempting to increase the supply of skills, which is the key industry input
- Lobbying government do address those factors where the country falls short of its competitors

Calling the Cape has further explained its current emphasis on contact centres rather than voice focused back office work as follows:¹⁰⁴

- Resources do not allow it to pursue industry development activities across the whole spectrum of segments. Activities have been focused on those most likely to result in sustained job creation.
- South Africa is not as competitive for pure back office work as it is for front office. The small number of data focused back office BPO companies in Cape Town reflects this – they are split across disparate industries and there are few common denominators between them. This makes effective industry development challenging, particularly in a resource stressed environment.

Interviews with a selection of stakeholders indicate that *Calling the Cape* is doing the right things and is on the whole doing them very well. Given the resources available to it, *Calling the Cape* has achieved a considerable amount of visible success.

One of the reasons given for its success is the unified structure that it has adopted. The public-private structure of *Calling the Cape* has ensured stakeholder alignment behind a common set of goals and values. As an industry membership body supported by government, with its day-to-day activities integrated with those of Wesgro, it has been able to gather board support and tap in to resources within the industry, government agencies and government itself. This should be compared with the disparate and sometimes even competing activities in other regions.

¹⁰⁴ Luke Mills 'Government response to BPO Paper' (first draft), 22 March 2005

The support of the industry is evidenced by the increased financial support which it is providing; *Calling the Cape* has already attracted R350,000 in private sector revenue this year.

SACCCOM acknowledges that *Calling the Cape* is way ahead of other regional bodies due to good partnerships with government, private sector involvement and the commitment of resources by the Provincial Government. *Calling the Cape* is seen as leading the national agenda for BPO industry development.

Feedback from overseas visitors that have been hosted by *Calling the Cape* appreciate the professionalism, energy, passion and enthusiasm of its staff.¹⁰⁵

Infonomics¹⁰⁶ identified three main key selling points of the Western Cape which rightly deserve promotion. These are:

- **Past experience** of serving the financial services industry (especially the life and short term insurance industries), which has created a significant pool of skilled financial services workers. This includes knowledge base and process management skills.
- Other **positive labour-related issues**, including positive work ethic; close ethnic and cultural alignment with target markets; good labour relations environment.
- **Western Cape lifestyle**. This is commonly perceived as attractive with several positive consequences. Local employees “seem happier” at work than in other South African centres leading to lower staff attrition rates and improved business efficiency and service levels. International managers who may be required to relocate to South Africa are more willing to move to the Western Cape than to other regions.

Key message: Prospective investors are particularly interested in understanding the unique value proposition of a particular location. *Calling the Cape* has correctly identified the overall market niche in which Cape Town has a competitive advantage, and has developed an appropriate and marketing strategy and business development strategy to address this.

¹⁰⁵ Based on trip reports following inward investment tours. Personal communications provided by Luke Mills

¹⁰⁶ Infonomics et al 2003, ibid

McKinsey, Blue IQ and others point out that when compared with the target market efforts conducted in other countries, those currently being conducted at a national and provincial level are not of a similar scale or sophistications.

In the Case of *Calling the Cape*, this is not because it is not doing the right things, but rather because it lacks the resources to be more effective.

The delayed payment of promised Provincial funding to *Calling the Cape* risks sabotaging the impacts achieved so far. *Calling the Cape* record makes it deserving of more money, paid over when promised.

Calling the Cape has been a major actor in the recent formation of a national Call Centre organisation – the South African Call Centre Community (SACCCOM). A summary of its activities and those of the other players involved in the future of the industry is provided in an appendix to this document.

4.4 Are there any other relevant factors that need to be understood which impact the growth of the local BPO industry?

Existing research identifies the following factors as being relevant to the growth of the local industry, all of which seem credible.

4.4.1 Outsourcing is a hard sell

First it must be recognized that selling the services of *any* outsource BPO service is difficult. BlueIQ¹⁰⁷ and others have researched and made this point forcefully. Offshore outsourcing deals are complex; concluding arrangements by which clients hand over control of significant business processes are inevitably drawn out and each unique. Large international companies will always evaluate multiple options before making a decision – from the buyer's perspective procuring the services of an outsourcer is fraught with stresses and risks. The rate of conversion from enquiries to deals is inevitably low.

As a result, concluding significant offshore outsourcing deals requires patience and money. Vendors must have significant resources to sustain the long sales cycle. Deals are more likely to those vendors who can demonstrate both a track record and financial security. The later is required to both assure the client that they can afford the best available technology and resources, and give confidence that they can compensate the buyer if things go wrong.

¹⁰⁷ BlueIQ 2002, ibid

Key message: Rapid growth of the locally owned industry is unlikely; the immediate opportunity lies in attracting foreign investment by firms that already have the track record and financial resources. This will boost the international profile of the region as a BPO centre, and lead to the development of the necessary local skills. Progressive local ownership of large BPO companies is a longer term prospect, that is unlikely to be realized unless there is the necessary inward investment in the short term.

4.4.2 Black Economic Empowerment and the ICT Charter

BEE is a critical issue in the local BPO industry, not least because there are so few majority black-owned companies in the industry (8 at present). The following factors have been identified as being relevant to the furtherance of BEE in the industry.

- The BEE charters for the ICT and Financial Services sectors make provisions for the support of BEE from both an equity perspective and a procurement perspective. In most cases, the compliance with the relevant BEE charter will be driven by the whether the contact centre is a captive centre (in which case compliance will be driven by the parent organisation) or a stand-alone independent outsourcer (in which case compliance will be driven by the largest customer category). In almost all cases, it will be the big market players who push the envelope for compliance and use BEE as a competitive tool. Unfortunately, this may not be good news for small independent contact centres, who have neither the equity relations nor the compliance capabilities of the large companies, and hence may lose out on local outsourcing - which is the staple diet of small black owned contact centres.
- The increasing availability of highly skilled black contact centre managers, specialists and team leaders, who could form the core of the next generation of ownership of contact centres, will give impetus to the transformation of the industry. This could also be a factor in the brokering of foreign investment in joint ventures with local BEE companies, which is one possible route to equity empowerment.
- The preponderance of Government and parastatal organisations to have high BEE criteria in tenders should result in BEE compliance becoming a significant factor in public sector procurement. Indeed, the history of black owned contact centres is rooted in public sector procurement.
- Inward investment in contact centres (captive or not) has not focussed on BEE as an issue; however, the determinations in the latest round of discussions about the

ICT charter point to the fact that whilst the equity of multi-national contact centres may not be a pressure point for BEE, procurement and SME development probably will be. BPO companies are thus as likely to be measured in terms their actions rather than their ownership.

- The active role being played by organisations like *Calling the Cape* in promoting BEE and new business development in the sector (e.g. forging partnerships, advise, funding indicators etc.) is an important driver of transformation.

Key message: The picture that emerges is that BEE in the local BPO industry is at an early stage. As in other industries, local and especially public sector procurement are a key driver in the development of black-owned companies. However, foreign owned companies with international clients are not dependent on public sector procurement, and so pressure must put on them in terms of their own procurement, skills development and employment equity.

4.4.3 Doubts about the local industry created because the overseas divisions of South African multinationals do not run their back-office operations from home.

This is identified by BlueIQ, who noted that the big South African financial services companies resident in the UK (like Old Mutual and Investec) do not run their back office operations from South Africa. “If South African companies do not make use of the South Africa opportunity then is it really an attractive opportunity?” However, the institutions and other do in fact run a proportion of their back office operations supporting international divisions in South Africa. *Calling the Cape* dismisses this as being important, and points out that outsourcing has not really taken of fin South Africa. But the point remains that the perceptions of international investors and customers is an important factor to be monitors and influenced.

Key message: It is important for the local industry to promote its services to South African companies, and to generate case studies of local BPO companies providing service to these companies (especially in support of their overseas divisions).

4.4.4 Political backlash

In some developed countries – notably the USA – there has been increasing opposition to ‘offshoring’ white-collar jobs to other counties. This has been aided by reports of failed outsource contracts.¹⁰⁸ A wave of economists and others have

¹⁰⁸ See, for example, Paul Vechiato ‘Gartner riles outsourcing industry’ ITWeb 8 March 2005, (www.itweb.co.za)

discounted the economic arguments¹⁰⁹ and placed them in realistic context, but political pressure to prevent US firms from 'moving jobs offshore' continues, and may accelerate in the event of an economic downturn.

Key message: The local industry need to be well prepared with an economic and business case for giving outsource contracts to Western Cape firms.

4.4.5 Other factors

Other factors mentioned by researchers and commentators include:

- Employment of foreign nationals and work permits for skilled managers
- Impact of HIV/AIDS

In summary, the challenges facing the local industry are many. Some of these are features of the industry itself; others are common to business in South Africa as a whole. But clearly there are a number of issues that the industry could address collectively and/ or that government could do (itself or thorough government sponsored industry bodies) to improve both perceptions and competitiveness.

4.5 Given the market position of the Western Cape, what is the potential?

4.5.1 Western Cape industry positioning

*Calling the Cape*¹¹⁰ considers Cape Town's value proposition as a location for BPO investment and services to be:

1. Culturally aligned, skilled, highly committed agents with clear English
2. Competitive costs and long term stability
3. Extensive customer service, technology and operational experience
4. High quality communications, transport, power, and transport infrastructure
5. A safe, politically stable business location with a high quality of life

The local depth of expertise in financial services and tourism has been widely noted as a strength. Deloitte note that there is 'considerable expertise in processing mortgage claims and personal loans, retail financial products, general insurance, life/

¹⁰⁹ See, for example, Edwards 2004, *ibid*; Charles L Schultz 'Offshoring, Import Competition, and the Jobless Recovery' The Brookings Institution Policy Brief August 2004; Lael Brainard and Robert E Litan "Offshoring" Servicing Jobs: Bane or Boom – and What to Do?' The Brookings Institution Policy Brief 132 April 2004

¹¹⁰ Ref: www.callingthecape.org.za

pensions and credit cards'. And 'given the similarity of terms of product structure and distribution to the mature markets of the UK, US and Australia, it would appear to make sense for companies to focus their attention on financial services clients ... where added-value offshore locations (are preferred to) the lowest cost market'.

Infonomics and others make the point that given its current state of relative immaturity, the local outsource industry can best be expected to grow by attracting investment from either established BPO outsourcers with the necessary track record and financial weight, or multi-national corporations setting up their own captives. Homegrown operations are unlikely to succeed quickly unless they can partner with an existing overseas vendor (meaning that they will not have to sell directly to the end client) and are willing to grow incrementally by demonstrating increasing competence at executing smaller contracts. BlueIQ concur: 'Local suppliers will be in the best position to win large contracts if they form strategic alliances with global suppliers, and use the skills of specialist consultants and intermediaries'.

Such partnerships could potentially benefit from the established strong investment ties between the US/UK and South Africa.

4.5.2 Positioning strategies

McKinsey¹¹¹ has defined six generic market positioning that can be adopted by country industries given their strengths and weaknesses. This is reproduced here:

THERE ARE 6 BPO&O STRATEGIC PLAYS THAT COUNTRIES CAN ADOPT

	Description	Example countries
Factor cost gating criteria - Does the country provide at least 20-30% factor cost advantage?	Physical proximity play <input type="checkbox"/> Offshore delivery from countries in geographical proximity of source markets <input type="checkbox"/> These centres provide some cost advantage and very limited risk exposure	<input type="checkbox"/> Canada <input type="checkbox"/> Ireland <input type="checkbox"/> Caribbean
	Scaleable price performance <input type="checkbox"/> Provide service above benchmark levels (managed by SLAs) and a strong cost advantage (30 to 60% savings) <input type="checkbox"/> Scaleable talent pool exists <input type="checkbox"/> Availability of hygiene requirements (e.g., basic infrastructure etc.)	<input type="checkbox"/> India <input type="checkbox"/> China <input type="checkbox"/> Philippines
	Specialised play <input type="checkbox"/> Specialised capabilities with reference to talent pool, infrastructure, regulations that can enable offshoring of specific processes (e.g., actuarial services in insurance)	<input type="checkbox"/> E&D (China, India) <input type="checkbox"/> Animation (Philippines)
	Disaster recovery play <input type="checkbox"/> Serve as a preferred fall back center in case of any disruptive event in key location(s) <input type="checkbox"/> Provides some cost advantage against source markets	<input type="checkbox"/> Singapore <input type="checkbox"/> Philippines
	Regional shared services play <input type="checkbox"/> Historical centers of regional consolidation where companies have their regional headquarters <input type="checkbox"/> Have resident project management skills which can potentially be used for front end integration of services	<input type="checkbox"/> Singapore <input type="checkbox"/> Ireland <input type="checkbox"/> SA
	Language/cultural familiarity play <input type="checkbox"/> Countries (might not necessarily be near shore) with strong historical and cultural linkages to source markets <input type="checkbox"/> Privileged language capabilities for specific source markets (e.g., Germany, Japan)	<input type="checkbox"/> China for Japan <input type="checkbox"/> Philippines for USA <input type="checkbox"/> Eastern Europe for Germany <input type="checkbox"/> S.A for Netherlands

¹¹¹ McKinsey 2004, ibid - Exhibit 8

Figure 5: BPO positioning strategies

Two positioning are the most prominent among successful players, namely physical proximity (enabling near-shoring from, for example, US to Mexico or UK to Ireland.) and scalable price performance (companies expect a minimum cost improvement of 30-40%, and then start to compare cost/quality trade-offs as scale ramps up).

Since the Western Cape cannot use physical proximity to appeal to its target customers, the alternative is to:

- Primarily ensure that the industry offers an attractive *cost/quality* (or 'price performance') proposition.
- Layer on to this the advantages of *language and cultural affinity* and the *provision of specialty services* in key growth industries such as financial services and insurance.

Some of the services identified by McKinsey that South Africa (and especially the Western Cape) is well positioned to offer includes:

- Actuarial servicing and risk underwriting
 - Insurance in-bound customer call centres
 - Credit card and cheque processing
 - Asset management administration
 - Collections
- A third aspect is the potential to focus on multi-national corporations with a presence in Africa (what McKinsey refer to above as the *regional shared service play*).

Key message: As represented by the *Calling the Cape* strategy, the Western Cape BPO industry has adopted a realistic and viable market position capable of attracting both investment in new business and customers for existing independent outsourcing businesses.

At the firm level, most local companies seem less sure of their competitive strengths and do not seem to promoting themselves in a sufficiently targeted way (at least as far as a survey of company web sites can reveal).

4.5.3 Assessing potential

There are a number of ways of assessing this:

1. What kind of growth are existing companies expecting?

Headcount at existing companies is expected to grow by an average (weighted for operation size) of 47% over the next two years (2005 – 2006); some are expecting staff numbers to increase by as much as 500%.¹¹²

Using current levels of employment as a starting point, the industry could grow by a factor of 5 over the next five years (2004 – 2008) if it can sustain a 50% CAGR.

Table 7: Projected Western Cape BPO industry employment at different growth rates

	Current staff (2004)	2005	2006	2007	2008
15% CAGR	11,490	13,214	15,195	17,475	20,096
25% CAGR	11,490	14,363	17,953	22,441	28,052
50% CAGR	11,490	17,235	25,853	38,779	58,168

However, the existing industry includes captives run by local companies, as well as internationally owned captives and international outsourcers. The number of people employed in the segment doing offshore work was only 1,400 in 2004. This was a 311% increase on 2003, but still a relatively small number of people. As previously noted, this can best grow by either:

- Overseas companies setting up captive operations in the Western Cape; and/or
- Overseas BPO vendors setting up in the Western Cape to meet the needs of their international clients.

2. What kind of growth is the industry as a whole planning for?

Calling the Cape is planning:

- To support the growth of existing companies, especially outsourcers. Here incremental employment compound annual growth rates of 10 – 50% are possible.
- To attract overseas investment – employment compound annual growth rates of several hundred percent are possible in the short to medium term if one or more

¹¹² Deloitte 2004, *ibid.*

of the significant enquiries currently at a advanced stage can be converted. Just two or three new operations each of ±500 seats would put Cape Town ‘on the map’ and give the local industry the profile and critical mass needed to project it into the premier Tier 2 league. Employment in the offshore segment could then quickly grow to as many as 20,000 people – 14 times current levels.

3. What kind of growth is realistic?

The key variables that will determine the extent to which the Western Cape will share in the growth of the global BPO market in the next five years are:

- Cost competitiveness (cost-quality in competitive niches) relative to other countries and other regions within South Africa; and
- The extent to which it can offer and effectively promote a distinctive proposition for offshoring and outsourcing in its two best positioned industries (financial services and insurance).

On this basis, McKinsey have offered three potential growth scenarios for the industry:¹¹³

Table 8: BPO industry growth scenarios

Scenario	Description	Key assumptions	Impact on SA
Fringe player	<ul style="list-style-type: none"> • SA misses the international BPO offshoring opportunity • Top centres (e.g. China, India) sort out supply side constraints • 2-3 more distinctive emerging centres (e.g. Malaysia) are able to provide a more distinctive proposition 	<ul style="list-style-type: none"> • Tier II demand surplus of 10% • Continental European demand to be offshored 0% • SA share of demand surplus 3.9% • SA price competitiveness index (out of 5) of 2.5 • 2008 cost of \$16.77/hour/FTE 	<ul style="list-style-type: none"> • 16-20 thousand jobs (4-5 thousand direct, 12-15 thousand indirect) • Inward investment of \$28-32 million • Nominal GDP grows by 0.1% in 2008
One of the Tier II players	<ul style="list-style-type: none"> • Demand gap for US-UK demand as 	<ul style="list-style-type: none"> • Tier II demand surplus of 27% • Continental 	<ul style="list-style-type: none"> • 65-70 thousand jobs (16-18

¹¹³ McKinsey 2004, ibid – Exhibit 26

Scenario	Description	Key assumptions	Impact on SA
	<p>India & China not able to address supply bottlenecks</p> <ul style="list-style-type: none"> SA becomes one of the 5-6 Tier II locations for BPO investments SA attracts share in accordance with relative attractiveness on key criteria 	<p>Europe demand to be offshored to be 0%</p> <ul style="list-style-type: none"> SA share of surplus demand 4.5% SA price competitiveness index (out of 5) of 3.0 2008 cost of \$14.54/hour/ FTE 	<p>thousand direct, 49-52 thousand indirect)</p> <ul style="list-style-type: none"> Inward investment of \$106-119 million Nominal GDP grows by 0.3% in 2008
Premier Tier II player	<ul style="list-style-type: none"> SA is able to attract a disproportionate share of financial services and insurance sectors Continental Europe demand reaches half its predicted potential 	<ul style="list-style-type: none"> Tier II demand surplus of 35% Continental Europe demand to be offshored to be 50% SA share of surplus demand <ul style="list-style-type: none"> Financial services, insurance, telecoms, 8.4% Other 5.6% SA price competitiveness index (out of 5) of 3.7 2008 cost of \$12.30/hour/ FTE 	<ul style="list-style-type: none"> 140-160 thousand jobs (35-40 thousand direct, 105-120 thousand indirect) Inward investment of \$265-285 million Nominal GDP grows by 0.7% in 2008

An additional factor to be considered is the extent to which the Western Cape succeeds in capturing this new business in preference to its provincial competitors. Attracting 5,000 new jobs means getting:

- All of the new jobs created national under Scenario 1 (Fringe Player) – and still only getting 4-5 thousand jobs)
- ±30% of the new jobs created national under Scenario 2 (Viable Tier II Player)

- $\pm 15\%$ of the new jobs created national under Scenario 3 (Premier Tier II Player)

If the Western Cape gets one third of all new national BPO jobs, then this means anything between 1,500 and 12,500 jobs. And the larger the South African industry becomes, then the greater the proportion of jobs likely to come to the Western Cape. In the best case, 50% of the 40,000 new jobs could come to Cape Town. This is in line with *Calling the Cape's* own goal of 20,000 new direct jobs by 2007.¹¹⁴ Achieving this will have a significant impact on the Western Cape economy. Direct employment in the BPO industry would increase by a factor of 3, and around 100,000 new indirect jobs would be created.

Even 10,000 new jobs would place a significant strain on inputs – especially the availability of skilled, employment-ready staff and suitable property to accommodate them.

What the Western Cape needs to do to ensure this happens is the subject of the second part of this project.

Key message: the local industry has huge potential to attract clients, justify inward investment and create jobs, provided that it can successfully position itself to provide those higher value services that give it a competitive and differentiated advantage. A target of 20,000 new direct jobs created during the period 2005 – 2008 is a bold target, but achievable.

5 Synthesis: BPO industry value chain

The dynamics of the global BPO industry are complex, and the nature of the opportunity and factors influencing it are equally involved. From a policy formulation perspective, the issues are as follows:

The best opportunity for the Western Cape lies in the region and the industry positioning itself as offering an attractive price/ performance capability for complex voice based services. The local workforce (agents and management) has historical expertise in the financial services and insurance industries, whose products and services are similar to those of these same industries in the main counties with demand (the UK and the USA).

Depending on how successfully this opportunity can be addressed, between 5,000 and 20,000 new direct jobs could be created during the period 2005 – 2008.

¹¹⁴ Annual Report of The Cape Town Call Centre Development Association, 1 February 2005

The most likely route to the achievement of this is by attracting foreign investment by either established global BPO vendors or corporates establishing captive operations. They could do this by forming partnerships with local players.

The drivers of demand that will attract this investment are:

- Competitive cost of operations
- Availability of skilled staff
- Clear understanding by the Western Cape of the risk alleviation strategies and needs of investors, and an appropriate response
- Availability of appropriate incentives and government support
- Vigorous international promotion by *Calling the Cape* (at a provincial level) and by

BPO & Call Centre value chain

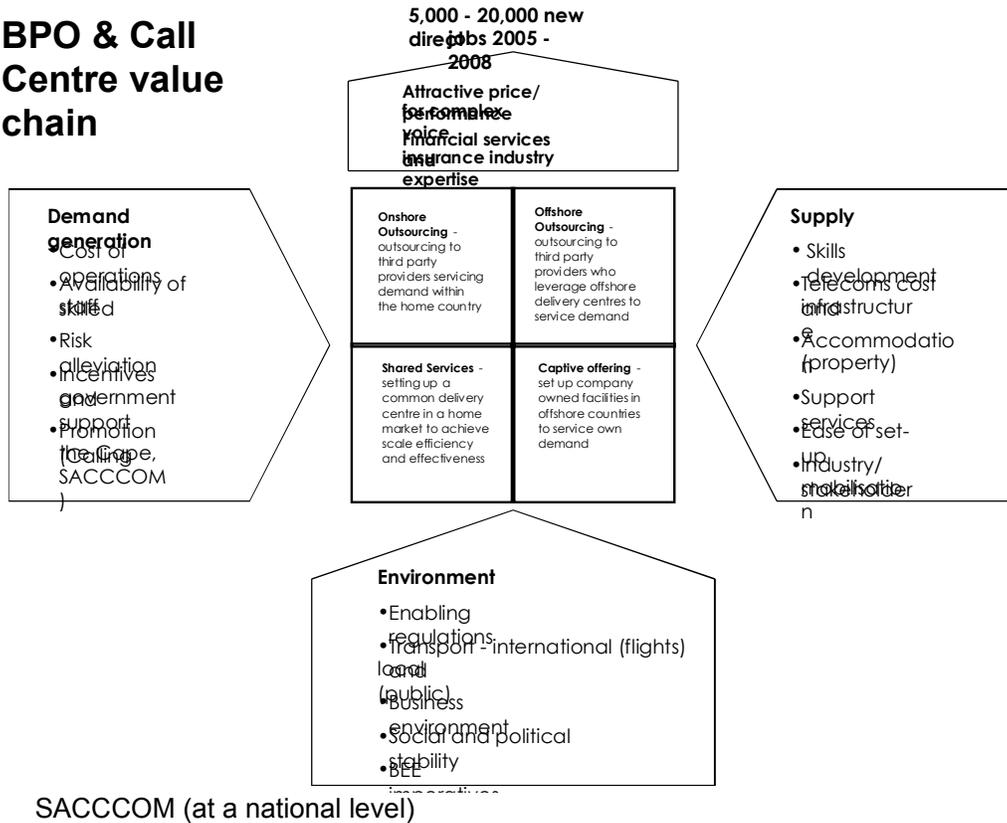


Figure 6: Western Cape BPO industry value chain

The key supply factors that need to be constantly improved are:

- Skills development and assuring a supply of trained labour
- The cost of telecommunications and the infrastructure that supports it

- The availability of suitable buildings to accommodate BPO operations (up to 500 agent seats)
- The availability of support services, including technical support, training, business process migration consultants, etc.
- Ease of business set up and prevalence of red-tapism (including bureaucratic obstacles to accessing incentives)
- Industry mobilization, including integration of effort between industry and government, and industry awareness of international investor's perceptions of South Africa's capabilities

The wider environmental factors that more directly impact the industry are:

- The extent to which the regulations that directly impact the industry are enabling (or not)
- The frequency and availability of international flights connecting to the UK, USA and Europe
- The efficiency and safety of local public transport (for agents)
- The stability and transparency of the overall business environment
- Social and political stability of the country
- BEE imperatives, and the extent that these can be reasonably and easily accommodated by foreign investors

6 Assessment of Provincial Government impact

At a high level, the current strategy for sector development in the Western Cape has been outlined by the Directorate of Sector Development in the Western Cape Department of Economic Affairs.¹¹⁵

The strategy relies on a range of different interventions to develop local industry sectors. It was not envisaged that the level of intervention be aimed at the firm level or at the macro level, but that the main focus be on building the linkages and networks between firms, institutions and government. This approach was dubbed as 'collaborative'.

Sector development

¹¹⁵ See Nigel Gwynne-Evans 2000 'A Collaborative Approach to Regional Sector Development: Provincial Department of Economic Affairs: Western Cape'.

The Western Cape Department of Economic Affairs defines sector development as ‘any targeted action focusing on a particular sector¹¹⁶, niche or cluster’.¹¹⁷

Against this backdrop the role of provincial and local government has expanded by becoming more focused on the needs of firms. The provincial government has identified a key role through this strategy to foster an environment for collaboration between tiers of government, business, labour and various support bodies. The regional approach states that it is the ‘un-traded interdependencies’ amongst and between the players, which are seen to be central to successful modern economies, and where the dissemination of information and speed by which firms adapt and respond is becoming critical. *The approach further states that provincial government should promote collaborative practices to encourage adaptive learning and innovative practices that will lead to dynamic learning regions.*

The regional sector strategy lists core action areas for collaborative strategies around which the Provincial Government has been focusing. These have been categorised in the following table:

Table 9: Provincial Government sector development strategy

Action	Requirements
Encouraging inter – firm level collaboration	<ul style="list-style-type: none"> • Encourage networking between firms and institutions • Develop adaptive learning • Encourage collaborative projects (export councils) • Arrange joint marketing initiatives
Firm level restructuring	<ul style="list-style-type: none"> • Focus on improving the efficiency and productivity of the firm • Encourage firms to focus on quality development, economies of scale and core competencies

¹¹⁶ A sector is defined as a grouping of firms involved in the production of a similar product.

¹¹⁷ A cluster can be defined as a ‘geographically bounded concentration of similar, related or complementary businesses with active channels for business transactions, communications and dialogue that share specialised infra-structure, labour markets and services and that are faced with common opportunities and threats’ S Rosenveld ‘Regional business clusters that work’ 1995 in Nigel Gwynne-Evans ‘A Collaborative Approach to Regional Sector Development: Provincial Department of Economic Affairs: Western Cape’ 2000 p5

Action	Requirements
Facilitating new investment	<ul style="list-style-type: none"> • Identify investment opportunities for both foreign and local investors • Encourage reinvestment and expansion of local firms • Identify opportunities for up and downstream investments
Focused education and skills development	<ul style="list-style-type: none"> • Create a culture of continuous learning • Ensure appropriate skills development • Facilitate better co-operation between industry and training institutions
Enhancing infrastructure	<ul style="list-style-type: none"> • Engage on behalf of the specific sector with other government agencies
Encourage innovative behavior	<ul style="list-style-type: none"> • Encourage firms to raise the level of R & D and form partnerships to develop new products and services
Empowerment	<ul style="list-style-type: none"> • Help to facilitate the identification of new opportunities for black participation and ownership.

The BPO industry, amongst other, has been targeted by the PGWC for collaborative support in light of the fact that it is characterised as a high growth sector having a competitive advantage over many of the other sectors, and capable of achieving a high level of labor absorption.

Table 10: Assessment of the current Provincial Government sector support approach

Action	Requirements	Assessment
Encouraging inter – firm level collaboration	<ol style="list-style-type: none"> 1. Encourage networking between firms and institutions 2. Develop adaptive learning 3. Encourage collaborative projects (export councils) 4. Arrange joint marketing initiatives 	<p>The primary vehicle for encouraging networking has been <i>Calling the Cape</i>. This has attracted most contact centers including outsourcers as members. This has resulted in some collaborative effort to address key supply side issues, such as telecommunications costs and the availability of skills. There is also collaboration nationally in the form of participation in the South African Call Centre Community.</p> <p>Detailed sector development strategy</p>

Action	Requirements	Assessment
		<p>for 2004 – 2007 exists. Joint promotion has been undertaken.</p> <p>SACCOM will further encourage inter-firm collaboration.</p>
Firm level restructuring	<ol style="list-style-type: none"> 1. Focus on improving the efficiency and productivity of the firm 2. Encourage firms to focus on quality development, economies of scale and core competencies 	<p>Advice provided when requested by <i>Calling the Cape</i>. Several private sector BPO industry consultants practice in the Western Cape.</p> <p>Improvement of standards and service quality is critical in a youthful industry. Current services of local firms generally do not meet the very demanding standards of major international corporates. Further, companies must position their services more specifically where they have competitive advantage.</p>
Facilitating new investment	<ol style="list-style-type: none"> 1. Identify investment opportunities for both foreign and local investors 2. Encourage reinvestment and expansion of local firms 3. Identify opportunities for up and downstream investments 	<p>Major focus of activity of <i>Calling the Cape</i> and Wesgro.</p> <p>Opportunities for local investors documented and promoted. Scope exists to further refine an investment targeted approach based on the niches where the Western Cape industry can be competitive.</p> <p>Support for further investment and expansion provided by <i>Calling the Cape</i> – no investors have pulled out of SA and the majority are increasing their investments.</p> <p>Refined brand positioning (national and provincial) needs to be addressed.</p> <p>Opportunities for upstream suppliers well understood – supply is sufficient and has capacity to grow.</p>
Focused education and	<ol style="list-style-type: none"> 1. Create a culture of continuous learning 	<p>Major focus of <i>Calling the Cape</i>. Skills development at the region, industry</p>

Action	Requirements	Assessment
skills development	<ol style="list-style-type: none"> 2. Ensure appropriate skills development 3. Facilitate better co-operation between industry and training institutions 	level to ensure a skills pool to feed into the industry (as against firm level training of new hires) is planned but not yet happening to the extent required. In some cases support promised has not been forthcoming.
Enhancing infrastructure	Engage on behalf of the specific sector with other government agencies	The major issue has been telecommunications and skills. <i>Calling the Cape</i> lobbying has contributed to recent telecoms liberalisation. Movement to improve public transport also needed.
Encourage innovative behavior	Encourage firms to raise the level of R & D and form partnerships to develop new products and services.	No major impact identified. There is a need for research, information dissemination and strategy consulting interventions. <i>Calling the Cape</i> does not currently have the resources to provide this.
Empowerment	Help to facilitate the identification of new opportunities for black participation and ownership.	Critical goal to bring about equity and a stable society. Two main issues for empowerment companies are access to customers and access to finance. No direct interventions noted other than encouragement and facilitation by <i>Calling the Cape</i> . Government's own procurement policies need to be addressed.

7 Conclusion

The BPO industry already plays a significant role in the Western Cape economy, and could potentially grow to become even more important. The characteristics of the industry closely match the needs of the region and the goals of government – it is a non-extractive, labour intensive export oriented service industry, capable of attracting inward investment, with a wide range of up stream benefits and potential economic multipliers. It has already shown itself to be competitive in certain segments – notably voice based services for the financial services and insurance industries.

The most promising approach to growing the industry is to attract foreign investment in large scale captive or third party vendor operations, whilst also promoting existing firms to pursue local and international opportunities that will enable them to progressively move up the price/ quality curve.

The *Calling the Cape* goal of 20,000 new direct jobs by 2008 is bold but achievable. This would add 0.5% to national GDP, and have major impact on the Western Cape economy.

As well as stimulating demand through the expanded activities of *Calling the Cape* (co-ordinated with similar national programmes) and the design of appropriate incentives, a range of opportunities for supply side interventions present themselves. These include ensuring an adequately skilled supply of labour; facilitating the availability of suitable accommodation and associated facilities; addressing the inadequacies of the public transport system; and doing all possible to drive down the cost of telecommunications - including the potential involvement of the City of Cape Town (which has a PTN license) in the provision of local broadband connectivity linking with global network. Lobbying to reduce the monopoly control that Telkom has over the SAT-3 undersea cable through regulatory intervention will be equally important if the cost of both outgoing as well as incoming traffic is to be lowered. This is an important component of the industry's cost competitiveness where there is immediate opportunity for improvement.

The follow-up paper will evaluate policy levers and make recommendations accordingly.

8 Appendix 1 : Understanding the BPO the industry

There are many definitions of the term 'business process outsourcing'.¹¹⁸ Generally it is used in a broad sense to mean 'the transfer of a non-core business process, by a buyer, to a supplier'.¹¹⁹ Gartner Dataquest more precisely defines BPO as 'the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected processes based on defined and measurable performance metrics'.¹²⁰

8.1 Outsourcing

Outsourcing is "the delegation of tasks or jobs from internal production to an external entity".¹²¹ In its broadest sense it refers to "the practice of hiring a third-party suppliers to carry out some of the functions of an organisation".¹²²

The supply of inputs in the form of raw materials has been a constant feature of manufacturing and production oriented businesses – it is by processing these through a series of transforming activities that outputs are created that can be sold at a profit. Those activities needed to run the business that do not directly add value to the final product, or are outside of the business managers' competencies, are routinely procured from others. These commonly include services such as security, payroll administration, tax administration, freight logistics, property management, and office cleaning. Companies providing services themselves often outsource these functions to specialists. Because the suppliers of these services are focused on these activities, then they can usually do so more effectively and cheaply than their customers could do so for themselves.

Many production oriented businesses in developed countries have gone so far as to redefine their core activities as being nothing more than product design, branding and marketing, and have outsourced production (and sometimes even product development) to companies in other counties with lower costs. Outsourcing of this

¹¹⁸ The recent report by TISA ('Research Study into the BOP&O / Call Centre Industry of South Africa' 2004) starts out by noting the 'blurred boundaries regarding what the ... sector does / does not consist of' and the 'huge debate and controversy about the definition'.

¹¹⁹ BlueIQ '2002, ibid

¹²⁰ Quoted in Infonomics 2003, ibid, p3

¹²¹ Ref: Wikipedia 'Outsourcing' <http://en.wikipedia.org/wiki/outsourcing> as at February 15 2005

¹²² Paladin 2004, ibid

nature has become a feature of globalization, with supply chains spanning several continents.¹²³

A report by BlueIQ takes the story further: 'outsourcing ... processes such as payroll administration have been outsourced by many businesses for a long period.

However, over the past five years outsourcing has become increasingly more prevalent, across a wider number of companies and covering a wider number of services. Companies are increasingly rusting outsourcing companies with important processes ...'.¹²⁴

Such management and day-to-day execution of an entire business function by a third party service provider has become possible using information and communication technology. This has allowed information be digitized, and distributed to the other side of the world as easily as to the office next door.¹²⁵ IT companies – which are familiar with the ability of ICTs to enable this – have often been first to re-structure their operations by outsourcing. But ICT is most importantly an enabler of outsourcing, rather than the focus of the outsourced activity.

8.2 Business process outsourcing

Business process outsourcing (BPO) is a natural evolution of the provision of services through outsourcing. Business process outsourcing is generally understood as more than just buying inputs from a vendor, or buying non-core services from a provider. Rather, BPO outsourcing involves the transfer of a significant amount of management control; a degree of two-way information exchange, co-ordination and trust are involved.¹²⁶ BPO involves long-term – rather than project based – contracts, and a significant degree of systems integration. The dividing line between traditional outsourcing and BPO is a fine one; rather these are part of a continuum.

The driver of outsourcing business processes – such as aspects of product development or customer support, or back-office administrative tasks – has primarily been competitive pressures on companies to lower their costs, requiring managers to search out the cheapest sources they can find. Often these are located in other countries with a lower cost base. More recently, the improvement in the quality of the

¹²³ See, for example Edwards 2004, *ibid*

¹²⁴ BlueIQ 2002, *ibid*

¹²⁵ For more about the impact digital technology on the world economy, see, for example Emmanuel C Lallana 'The Information Age' Asia-Pacific Development Program Asia-Pacific e-Primers series, May 2003 available from <http://eprimers.apdip.net/series/info-economy/> at February 23, 2005

¹²⁶ Wikipedia 2005, *ibid*

business process outcome potentially possible by transferring responsibility to specialists has also become important.

The ability to transfer business processes across borders has become possible because of:

- The global reach of telecommunications networks and the internet
- Increasing management know-how needed to analyse business processes and tasks, and where appropriate to automate them using ICTs (also known as reengineering or business process management)
- The more general globalization of the world economy, making the movement of money and goods easier
- Disparities in incomes between different countries and regions
- Rising levels of education in low-cost countries and the consequent availability in these countries of skills that are in demand in developed countries
- The rise of English as the most widely spoken international language

8.3 Why companies outsource their business processes

The most often mentioned benefits to companies that outsource business processes typically include¹²⁷:

- Lower costs, resulting in improved capital and labour productivity (Note that this may not necessarily result in higher profits as in competitive markets comparable companies will be subject to the same competitive pressures)
- Access to more effective business processes that will improve their own service and competitiveness
- Access to scarce resources through the supplier's own resource base (e.g. staff)
- Access to dedicated world-class technology
- Predictable cost streams – budgeting becomes more predictable, and the risk of changes in the cost structure supporting the outsourced process is transferred to the service provider
- Better service, including for example, 24/7 call centre availability

¹²⁷ This list of benefits developed from that in BlueIQ 2002, *ibid*, and benefits noted in Vivek Agriwal, Diana Farrell and Jaana K Remes 'Offshoring and beyond' The McKinsey Quarterly Special edition: Global directions 2003

- Spread of risk – tasks can be spread across a range of sites and providers
- The opportunity to refocus the management of the outsourcing company back on its core (value-adding) activities Transfer of jobs considered undesirable or lacking in prestige (and so subject to high levels of staff turnover) in developed countries, yet which are attractive in developing countries

9 Appendix 2: Gap analysis – is there an effective understanding of industry situation and potential?

This section is an attempt to tease out any fundamental gaps in the published understanding of the industry. This is critical if the recommended policies are to apply limited resources effectively.

9.1 Approach – Porter’s Diamond

In his book ‘The Competitive Advantage of Nations’ Michael E Porter introduced a model that helps to understand why some nations are more competitive than others, by determining factors of national advantage. This approach has become known as the ‘Diamond Model’.

This model can be used to assess the extent to which there are any gaps in the existing research that limit an understanding of the determinants of national advantage. Each of the four aspects of the model will be discussed and compared to the research summarized above.

As a point of departure it is prudent to examine the model before proceeding further.¹²⁸

Traditionally, Porter states, economic theories of international trade propose that comparative advantage are located in the factor endowments that a country has inherited. These endowments may include land, location, natural resources such as minerals and energy, labour and local population size. These factor endowments cannot be readily changed or manipulated, and are for the most part inherited.

Porter argues, however, that sustainable industrial growth has hardly ever been built on these inherited factors mentioned above alone and that a nation can create new advanced or specialised factor endowments such as skilled labour, a developed technology and knowledge base, government support and a culture that is conducive to developing industrial growth. He uses a diamond shaped diagram as the basis of

¹²⁸ This summary adapted from <http://www.quickmba.com/strategy/global/diamond/> as at 14 March 2005

his framework to illustrate these determinants of national advantage and assists governments in laying a foundation to help establish their industries. This diamond represents the national playing field that countries establish for their industries.

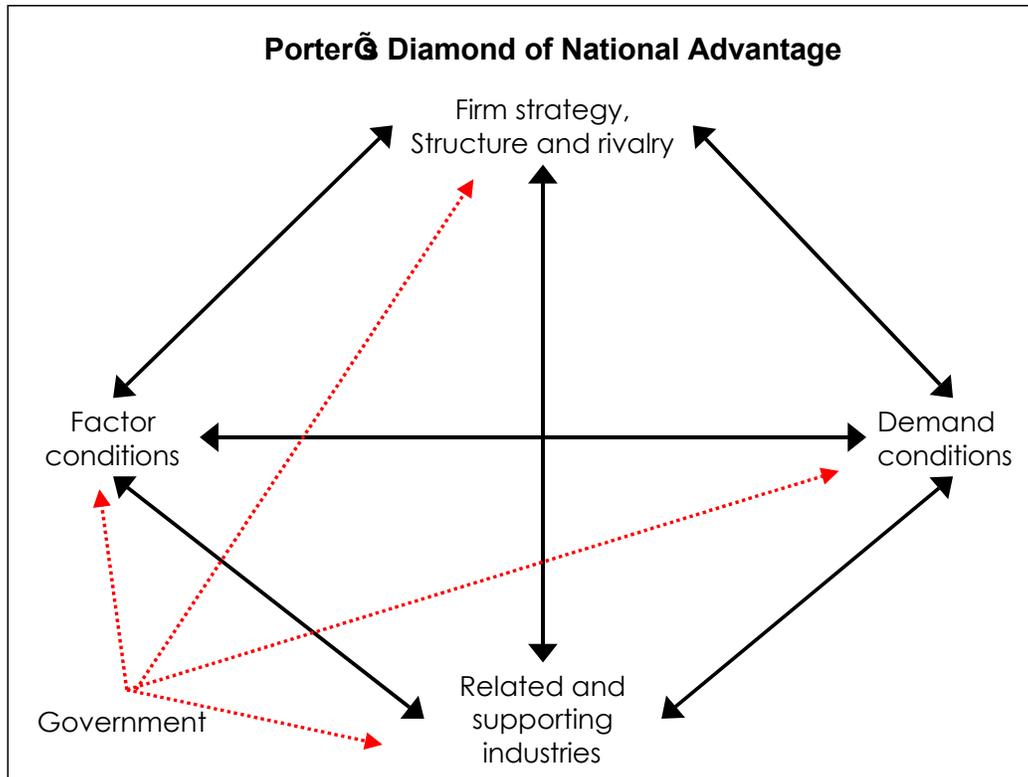


Figure 6. Porter's Diamond

The diagram distinguishes these four determinants, namely factor conditions, demand conditions, related and supporting industries and firm strategy, structure and rivalry. Porter believes that these determinants can be influenced in a proactive way by government.

9.2 Factor conditions

Porter differentiates between key and non-key factors are differentiated. Key factors of production can be grouped into skilled labour, capital and infrastructure and are created, not inherited. Non-key factors such as unskilled labour, capital and infrastructure can be obtained by any company and hence Porter argues that these factors do not generate any sustainable long term competitive advantage. The more specialized factors are generally scarce, require more venture capital and are more difficult to emulate.

The stock of factors at a given time is less important than the extent that they are upgraded and deployed.

Local disadvantages in factors of production force innovation. Adverse conditions such as labor shortages or scarce raw materials force firms to develop new methods, and this innovation often leads to a national comparative advantage.

9.3 Demand conditions

This aspect of the model describes the state of home demand for products and services produced in a country. Demand conditions have an impact on the speed and direction of innovation and the higher the demand from customers in an economy the quicker the pace of innovation. This forces companies to constantly reinvent and improve the quality of their products to remain competitive.

When the market for a particular product is larger locally than in foreign markets, the local firms devote more attention to that product than do foreign firms, leading to a competitive advantage when the local firms begin exporting the product.

A more demanding local market leads to national advantage.

A strong, trend-setting local market helps local firms anticipate global trends.

9.4 Firm strategy, structure and rivalry

Local conditions affect firm strategy. For example, German companies tend to be hierarchical. Italian companies tend to be smaller and are run more like extended families. Such strategy and structure helps to determine in which types of industries a nation's firms will excel.

Porter notes that despite all the differences and country peculiarities there is one characteristic that is shared by competitive economies, namely that there is an intense competition by national companies. He further states that from a static perspective, national champions may enjoy advantages of scale but the real world is dominated by dynamic conditions and it is direct competition that compels firms to work for increases in productivity and innovation.

In Porter's Five Forces model, low rivalry makes an industry attractive. While at a single point in time a firm prefers less rivalry, over the long run more local rivalry is better since it puts pressure on firms to innovate and improve. In fact, high local rivalry results in less global rivalry.

Local rivalry forces firms to move beyond basic advantages that the home country may enjoy, such as low factor costs.

9.5 Related and supporting industries

This determinant refers to the existence or non-existence of internationally competitive supplying industries and supporting industries such that the existence of a successful international industry may lead to advantages in other related or supporting industries. Porter argues that competitive supplying industries will encourage innovation further down the value chain. Essentially the spatial proximity of upstream or downstream industries facilitates the exchange of information and promotes the continuous exchange of ideas and innovations.

When local supporting industries are competitive, firms enjoy more cost effective and innovative inputs.

This effect is strengthened when the suppliers themselves are strong global competitors.

9.6 Government's Role

The role of government in the model is to:

- Encourage companies to raise their performance, for example by enforcing strict product standards
- Stimulate early demand for advanced products
- Focus on specialized factor creation
- Stimulate local rivalry by limiting direct cooperation and enforcing antitrust regulations

9.7 Application – review of existing research

Table 11: Assessment of research knowledge

Determinant	Assessment of research
Labour as a factor condition	Known 8/10. Labour is a critical factor – both quality and cost. Current cost is only viable and competitive if the industry addresses market niches (e.g. financial services and insurance segments, providing complex voice focused services), but this also requires well-educated and trained staff and both entry and management levels. Precise mix of skills (including experience in the case of management) required for identified markets reasonably well defined.

Determinant	Assessment of research
Capital as a factor condition	<p>Known 8/10. This industry requires a high capital investment, but significant returns are possible once critical mass is achieved. Making investments in operations that have not yet secured contracts is high risk. The level of risk that financiers are willing to accept is likely to only grow incrementally as confidence in the industry grows. This in turn requires that the industry cut its teeth on smaller contracts first – even if these are marginal. Success will lead to larger and more high value contracts that will have less financial risk.</p> <p>An alternative is inward investment from existing BPO firms that can channel business to SA based operations; the challenge here is introducing a measure of local ownership.</p>
Infrastructure as a factor condition	<p>Known 8/10. Also important enabler. Telecommunications is critical as it directly impacts cost competitiveness. Availability of offices space is important. Beyond this general economic infrastructure (transport, utilities) is as important as for any developed economy. Public transport of particular importance.</p>
Local demand	<p>Known 5/10. Local demand for BPO services is generally lacking. This may not be significant or limiting.</p>
International demand	<p>Known 5/10. Global demand is considerable and growing. Identifying precise industries, niches and countries of origin will be vital for the industry to grow. International promotion is also important to swing the spotlight onto the Western Cape as an option.</p>
Firm strategy	<p>Known 3/10. Hard to assess. Impressions are that generally firm strategy is somewhat ad hoc and reactive. Positioning need to be more focused and promoted.</p>
Firm structure	<p>Known 4/10. Less relevant in a young industry. Partnership with global BPO players may be an important way to get business. Local imperative for BEE of little concern to</p>

Determinant	Assessment of research
	overseas clients or investors.
Firm rivalry	Known 5/10. Seems healthy. Firm collaboration through industry bodies is growing, and is an important factor for unified and effective promotion and addressing needs with government.
Supporting industries	Known 7/10. Capable of keeping up with current demand. Standard apparently good.

In summary, though there is often a lack of sufficient detail, there are no significant gaps in the available information about the industry from a policy formation perspective.

10 Appendix 3: Other public sector support organisations

Below are listed the major public sector (or public sector funded) organisations providing sector support in the Western Cape region. This is not an exhaustive list, as there are many national and international organisations that ‘cover’ the Western Cape without specifically focusing on it.

10.1 The Department of Trade and Industry (DTI)¹²⁹

The DTI has overarching responsibility for most direct public sector support for the ICT industry and ICT enabled sectors, including the BPO sector. It seeks to do this through certain of its line departments and divisions, such as Trade and Investment South Africa (TISA), who administer the export support schemes; the Technology support schemes and the Export Marketing and Investment Assistance Scheme (EMIA) and other such programmes and projects. Many of its other shareholder interest companies such as the IDC, CSIR, NPI and SABS also have direct or indirect support activities. These are not discussed in any detail in this document.

The DTI has lacked a full time director for BPO for six months. Currently, after a spate of resignations, there is not a single individual working in the BPO department of TISA. Repeated attempts could not find one individual willing and able to comment on DTI support for the BPO industry.

¹²⁹ Source: www.dti.gov.za

10.2 South African Contact Centre Community (SACCCOM)

This is a recently formed national body, of which the regional industry associations are affiliates. It intends to provide the industry with a single platform from which to lobby for its various needs and to promote the country as a competitive BPO destination. *Calling the Cape* is represented at board level. Of critical importance is national marketing strategy facilitation by amongst other things presenting a coordinated national brand and web portal for investors. Other key issues it is to initial address are:

- Telkom pricing (Telkom is represented on the board!)
- Legislation
- Investment incentives, allowances and tax breaks
- Transformation
- Long term skills development
- Regulation of the industry

10.3 Wesgro

Wesgro is the official Trade and Investment Promotion Agency for the Western Cape Province of South Africa. It seeks to be the first point of contact for foreign importers, local exporters and investors wishing to take advantage of the business potential in the Western Cape. Wesgro works closely with key players in the Province, including the Provincial Government, business, labour, the City of Cape Town, District Municipalities and rural local authorities.

Its mission is:

- To market business opportunities in the Western Cape
- To retain and significantly increase foreign and domestic investment
- To increase exports from targeted sectors to key global markets
- To co-ordinate and integrate the marketing of the Western Cape's priority sectors in collaboration with our strategic partners
- To contribute to job creation and broad based black economic empowerment

Other activities include sector analysis and the provision of expert policy and marketing support to local authorities.

Unlike the national DTI or its subsidiaries, Wesgro has neither the budget nor resources to be able offer incentives. Instead, it has effectively operated as a network facilitation, research and opportunity linking organization.

Wesgro works closely with *Calling the Cape*, and provides it with office space and other resources.

10.4 The Cape IT Initiative (CITI)

The Cape IT Initiative (CITI) is a not-for-profit organisation focused on developing the ICT cluster in the Western Cape. It currently focuses on four core areas:

- Cluster development (events, networking & Cluster facilitation)
- IT Business Development (incubation and Entrepreneurial support)
- IT Skills Development
- IT Research & Policy

CITI's goal is to promote Cape Town as a global IT hub and gateway into Africa, thereby facilitating the creation of jobs and prosperity through IT. CITI has had some success in assisting local business development through entrepreneurial support programmes, and plays an important role in enabling ICT in the region, creating necessary linkages both nationally and internationally. Since ICT is a critical enabler of the BPO industry, it may have an important role to play. However, from the perspective of *Calling the Cape*, CITI has not hitherto performed any significant role in supporting BPO.

10.5 Cape Regional Chamber of Commerce

The Cape Chamber of Commerce provides a range of business support and promotion services to its members and others in the region, functioning primarily as a conduit for information important to business in the region. The Chamber does not have a specific focus on the BPO sector

As a membership organisation, the benefits of these services are often exclusive, and additional fees may be involved. The Chamber provides an important voice for organized business in political, policy and legislative matters, to government and in the media.

10.6 City of Cape Town

The City of Cape Town has proposed the following four principles in order to accelerate job creation and BEE in Cape Town's priority sectors and clusters. These are draft proposals and not the official policy of the City of Cape Town.¹³⁰

¹³⁰ Private Communication, Economic Development and Tourism, City of Cape Town

Table 12: City of Cape Town draft sector support principles

Principle	Sector support implications
<p>1. City of Cape Town must provide strategic leadership direction by confirming and supporting priority economic sectors</p>	<p>The City of Cape Town's Council has been elected to meet the needs of its citizens as effectively as possible. The public sector will communicate its vision and priorities that include the strategic direction that the local economy needs to move in order to meet the developmental and competitive challenges facing it.</p> <p>Council will:</p> <ul style="list-style-type: none"> ● Integrate its economic development strategy into the City's Integrated Development Plan ● Develop and implement partnership based programmes to implement its economic development strategy ● Monitor and evaluate the performance of the Cape Town economy (incl. strategic sectors) as well as Municipal funded special purpose economic development vehicles ● Facilitate the establishment of strategic and operational internal and external sector development advisory and coordination mechanisms
<p>2. City of Cape Town must provide an Enabling Business Environment through the provision and prioritization of basic services and infrastructure (including transport infrastructure, electricity, water) that meets the needs of priority sectors/ clusters</p>	<p>Council is responsible for ensuring that an environment for sustainable economic development is created.</p> <p>The priority needs of sectors, sub-sectors and clusters must inform the City's service delivery and infrastructure investment and budget strategies and priorities. Ideally, a three year plan will need to be developed.</p> <p>The City's service delivery will need to be evaluated in terms of effectiveness in meeting these needs.</p>
<p>3. Cape Town's priority sectors need to be supported by Private Sector Driven Sector Development Strategies which address business support needs, are performance monitored, and align with government priorities</p>	<p>Sector development strategies need to be developed and driven by private sector champions in order to obtain buy-in, be responsive to user identified needs, and become sustainable.</p> <p>The development of Sector development strategies must be facilitated by sector organisations and be based on a base-line sector analysis, a 5-10 year growth and development vision, and a strategy to achieve this vision.</p> <p>Sector support strategies and services need to be monitored against measurable performance indicators which indicate the impacts achieved.</p>
<p>4. Cape Town recognises the strategic economic importance of an efficient and</p>	<p>Logistical system constraints and inefficiencies which reduce the</p>

effective multi-modal (air, sea, rail, road) private and public transport and telecommunications logistics system that meets the needs of strategic sectors and clusters and allows the cost-efficient local and international movement of workers, freight, and data	competitiveness and growth of key sectors need to be identified through infrastructure and systems capacity audits and prioritised by the City in partnership with relevant role-players.
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The City's sector support strategy is the responsibility of the Economic Development & Tourism Directorate. Currently the City channels its BPO sector support through *Calling the Cape*.

The City of Cape Town's 2005/6 Integrated Development Plan has four primary strategies including Economic Growth and Job Creation. It specifically includes the BPO industry as a priority growth sector. The City has also motivated for 2005/6 funding to go towards facilitating the creation of a Call Centre Precinct, and an associated government land audit.

The City of Cape Town itself has several contact centres, which are affiliated with *Calling the Cape*.

10.7 Services SETA

The Skills Development Act¹³¹ encourages employers to invest in sufficient training for employees. This is seen as a means to both redress of skills inequities resulting from the apartheid regime, and to uplift skills across industry to a common standard.

The Act provides for the Minister of Labour to establish a number of Sector Education and Training Authorities (SETAs) each of which addresses the education and training requirements for a specific sector. In addition, the Act also introduces the concept of 'learnerships', which are negotiated contracts between employer and employee to ensure agreed-upon learning outcomes.

The function of the SETA is to determine what the training needs of the industry are, and to ensure the sector can support a specific SETA, financially and organisationally, which will deliver on the industry's needs.¹³² This is achieved through broad consultation with stakeholders in industry, business, labour, academia, communities and the government.

¹³¹ Act 97 of 1998

¹³² See the Department of Labour Skills Development Strategy, February 1999 in SAITIS: A Survey of the IT industry and related jobs and skills in South Africa

Companies are obliged to pay over a percentage of their salary bill to a SETA; specifically, the Act requires employers with a payroll in excess of R250 000 (or who deduct PAYE), to pay a Skills Development Levy (SDL) of 1% of gross payroll. This is collected by SARS and paid over to the relevant SETA. Additional sources of funds are also derived from national government budget allocations and donor agencies. Employers are then able to claim back a portion of the levy from their sector SETA by submitting a workplace skills plan that outlines the company training plan, beneficiaries of training and the method of the training and by implementing this workplace skills plan. The training to be undertaken in the plan must be undertaken by a South African Qualifications Authority (SAQA) accredited organisation.

This can then be reclaimed as a subsidy for accredited staff training.

One such SETA is the Services SETA, to which most BPO companies should logically belong. The Services SETA has accredited relevant training courses. However, many contact centre operations pay their Skills Development Levy to the Bank SETA as their parent companies belong to the financial services industry. However, the Bank SETA has no accredited courses suitable for BPO companies, and so these funds remain unclaimed. At the same time, the Services SETA has little money available to support training and skills development by BPO firms.

10.8 Other public sector support

There is a range of public sector organizations (who largely fall in to the DTI family) who provide support to local companies. These include the CSIR, The National Productivity Institute, The South African Bureau of Standards (SABS) and Ntsika. The services offered range from 'introduction to exporting' to technical specification and standards verification. There is no reported evidence that any local BPO firms had ever used these services. The importance of these organizations to the local BPO industry is therefore unclear, but appears neither direct nor strong.

Other not-for-gain organisations exist that support export activities (e.g. universities, the technology transfer offices at Universities and ITRISA, which is the International Trade Institute of Southern Africa). There is no reported evidence that there has been any impact by Universities and technikons on the local BPO sector (notwithstanding the provision of skills).

10.9 Assessment – impact of local sector support initiatives

Table 13: Assessment of direct government impacts

Government role – industry standards	No identified impact at the industry level. Skills standards defined if not fully distributed through the SITAs.
Government role – stimulate early demand	Limited role from own procurement. Major initiative has been establishment and funding of <i>Calling the Cape</i> , which has been successful at stimulating demand.
Government role – factor creation	Labour – see comments about skills Capital – no discernable impacts Infrastructure – overall economic infrastructure is of a good standard but there is considerable scope for improvement, especially with regard to public transport. National government policy with regard to telecommunications has inhibited the industry; recent liberalisation has improved the situation.
Government role – local rivalry	No discernable impact. Own procurement policies could be improved.

11 Appendix 4: Additional sources of information

The main report and papers used to develop this report are listed in section 2.3.

Other sources of written information cited in this report are:

Martin N Baily, Diana Farrell 'Exploding the Myths About Offshoring' McKinsey & Company April 2004

Vivek Agrawal, Dian Farrell and Jaana K Remes 'Offshoring and beyond' McKinsey Quarterly 2003

Ben Edwards 'A world of work' Economist Surveys 2004

Charles L Schultz 'Offshoring, Import Competition, and the Jobless Recovery' The Brookings Institution Policy Brief August 2004

Lael Brainard and Robert E Litan "'Offshoring" Servicing Jobs: Bane or Boom – and What to Do?' The Brookings Institution Policy Brief 132 April 2004

Charles Jonker 'SA holds its own in global call centre industry' Business Report November 2 2004

'Calling good English speakers' Business Report February 20 2004

Andrew Parker 'Two-Speed Europe: why 1 Million Jobs Will Move Offshore' Forrester Research Inc August 18 2004

'Big job-creation potential in call centre industry' Creamer media, downloaded from www.engineeringnews.co.za February 15 2005

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