

Business Process Outsourcing: A New Development Initiative for South Africa



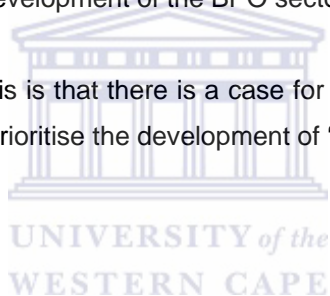
Mini research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Master of Social Development Degree from the School of Government. The other part of the requirement for this qualification was the completion of a programme of courses.

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Abstract

South African Economic Development strategy has in the previous 15 years, and even leading back as far as the late 1950s, followed the bias of conventional modernisation theory which traditionally equates economic development, and associated job creation, with industrialisation. However, in the Accelerated and Shared Growth Initiative for South Africa (ASGI-SA), the South African government's most recent Economic Development Strategy document, Business Process Outsourcing (BPO) and Tourism, both Service sectors, have been put forward as the priority sector development areas. This mini-thesis outlines the factors and evolving economic development theories, both global and national, which have contributed to this shift in strategy. This study pays detailed attention to the BPO sector by reviewing and establishing its capacity and potential to meaningfully contribute to economic growth and accelerated job creation, globally and, specifically in South Africa, in reference to the South African government's stated development objectives. 'Exportable' Services, and specifically the BPO sector, has only in recent years shown its potential as a significant contributor to economic development, and South Africa and other developing nations have little precedent and few guidelines as to how best develop the sector to achieve accelerated economic growth and job creation, thus, this study goes further by outlining possible strategic development issues for successful development of the BPO sector in South Africa.

The underlying message of this thesis is that there is a case for development strategists and planners to continue to investigate, pursue and prioritise the development of 'exportable' service sectors.



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Declaration

I, Joshin Raghubar, hereby declare that the thesis entitled "*Business Process Outsourcing: A New Development Initiative for South Africa*", is of my own work and that I have received no other assistance in completing the said work other than stated sources and citations. Furthermore, I declare that this mini-thesis has not been submitted at any other university, college or institution of higher learning for any degree or academic qualification.

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1. Introduction

1.1 Background to Research

South African Economic Development strategy has in the previous 15 years, and even leading back as far as the late 1950s, followed the bias of conventional modernisation theory which traditionally equates economic development, and associated job creation, with industrialisation. However, in the Accelerated and Shared Growth Initiative for South Africa (ASGI-SA), a recent South African government Economic Development Strategy document, Business Process Outsourcing (BPO) and Tourism, both Service sectors, have surprisingly been put forward as the priority sector development areas. This mini-thesis outlines the factors and shifting economic development theories, both global and national, which have contributed to this shift in strategy. This study pays detailed attention to the BPO sector by reviewing its capacity and potential to meaningfully contribute to economic growth and accelerated job creation, globally and in reference to the South African government's stated development objectives. 'Exportable' Services, and specifically the BPO sector, has only in recent years shown its potential as a significant contributor to economic development, and South Africa and other developing nations have little precedent and few guidelines as to how best develop the sector to achieve accelerated economic growth and job creation, thus, this study goes further by outlining possible strategic development issues for successful development of the BPO sector in South Africa.



Initially, development theorists, within an evolutionary framework, advocated that emerging or developing countries mimic the development path of successful developed economies, where industrialisation and development of the manufacturing sector played a central role. This leaning towards industrialisation and manufacturing was reinforced as development theorists looked at the sustained growth (from the late 1950's well into the 90's) of South Korea and other Asian Tigers, also termed Newly Industrialised Countries (NICS). Export-led industrialisation played a key role in these countries and development theorists, now within a Neo-Marxist framework, saw this as a model for other developing economies, including South Africa, to emulate (Gereffi, 1989). However, in recent years, due to various factors including increased globalisation, technological and telecommunications progress (Castells, 1996), the change in developing countries' factor of endowments, and significant cost and quality manufacturing competition from countries like China, evidence points to the declining importance of industrialisation in national economies and challenges development theorists to rethink development (Gereffi, 1989). The growing potential for 'exporting' services places the development of the Service Sector higher on the agenda of policy planners and development theorists.

This shift is supported by the evolution of New International Division of Labour Theory (NIDL) to a 'Newer' International Division of Labour Theory (NIDL2). NIDL explained the development of substantial manufacturing sectors in developing countries, moving them beyond merely being exporters of primary goods, by the confluence of three factors: the reduced importance of geographical location for production

due to technological progress; technological and organisational developments that enabled complex production tasks to be broken down into basic steps allowing unskilled workers to learn the steps quickly; and a limitless supply of cheap labour in developing countries (Hutchinson, 2004). However, NIDL asserted that developed countries would retain the skill-intensive tasks and developing countries would permanently be relegated to the periphery with only the labour-intensive tasks. In recent years, as developing countries continued to upgrade their human resources and technology continued its steady progression, we have seen skill-intensive tasks increasingly being outsourced to the periphery. This has given rise to the 'Newer' International Division of Labour Theory (NIDL2) where the core-periphery structure has been superseded and high-performing regions in both developed and developing countries carry out tasks of varying skill and technological intensity (Hutchinson, 2004).

The emergence of BPO in developing nations is a remarkable example of NIDL2 and the growing significance of 'Exportable Services' to economic development strategy. BPO's remarkable contribution to economic growth in India and certain other developing countries has certainly caught the attention of policy planners and development theorists the world over. BPO work, in 2004, accounted for 2.5% of India's GDP (Caldwell, 2004. P: 1), and it is estimated that the sector will employ between 900000 and 1000000 people in India by 2008 (Dossani and Kenney, 2003. P: 8). The 2003 UNCTAD E-Commerce and Development Report (UNCTAD, 2003. P: 56) states that 'from a development perspective, outsourcing has demonstrated its viability and success in India'.

The global BPO sector is estimated to grow between \$50bn and \$60bn by 2008, creating 3 million direct jobs worldwide with an estimated 2 million of these jobs going to 'far shore' destinations such as India and South Africa (McKinsey, 2005. P: 4). South Africa already has a small but burgeoning BPO sector that already places it in the second tier of major national BPO services providers, however, given the spectacular global growth projections and the associated surplus demand, this author argues that there continues to be a valuable opportunity to actively position and develop the South African sector to be a major beneficiary of this confluence of growth and demand, accelerating local economic growth and job creation. This assertion is supported in particular by a detailed study performed by McKinsey & Company, the leading management consulting firm, on the potential impact of the BPO sector in South Africa. This mini-thesis draws on the empirical work of the McKinsey study and summarises the associated findings. This mini-thesis, supported by the McKinsey study, argues that if some of the critical weaknesses can be addressed, and unique strengths developed, the South African BPO industry, in a coordinated effort with government and labour, can grow to capture a significant share of the international market demand, which will make a significant contribution to GDP in coming years and can translate into notable new direct and indirect jobs.

The significant positive impact of the BPO sector presents a case for development strategists and planners to continue to investigate, pursue and prioritise the development of 'exportable' service sectors.

1.2 Research problem

Traditionally, economic development has largely been equated with an industrialisation approach, where the development of a large manufacturing sector is seen as an essential step on the path to modernisation. However, as globalisation continues its rapid progress, and the skill-base of developing countries improves, focusing on the development of Services sectors that requires higher-value skills, such as BPO, may be a more relevant and suitable approach for developing countries like South Africa. If firstly it can be shown that BPO is a sector that has the potential to deliver economic growth and jobs, then how should the sector best be developed in South Africa in order to sufficiently contribute to meeting these development goals?

“Exportable’ Services, and specifically the BPO sector, has only in recent years shown its potential to significantly contribute to economic development, and South Africa and other developing nations have little precedent and few guidelines as to how best develop the sector to achieve accelerated economic growth and job creation.

This study is an opportunity to examine whether the active development of the Service sectors is a relevant and important approach, relative to the traditional manufacturing approach, in the modernisation and economic development efforts of today’s developing countries; and by focusing on the BPO sector in South Africa, identify strategies to best develop these ‘exportable’ services to achieve accelerated economic growth and job creation.



1.3 Research questions and objectives

There are four main research questions that guide this thesis, and these are:

1. Are Service sectors, particularly high-value services such as BPO, increasingly important to modernisation strategies for developing countries such as South Africa?
2. What is South African economic development policy as it pertains to sector development?
3. What are the strategies and factors that contributed to the successful development of the BPO sector in other developing countries such as India?
4. Can the BPO sector make a significant contribution to economic development in South Africa, if so, considering the current structure and endowments of the South African BPO sector, how could the sector in South Africa best be developed to achieve accelerated economic development and job creation?

It is hoped that this study will spark further debate and research as to the importance of Service Sectors in South Africa's economic development, and how BPO and other high-value Service sectors can be developed to achieve South Africa's economic development objectives.

The first research question poses the underlying enquiry of this entire study, and addressing this research question identifies a theoretical framework and context for the specific enquiry into the BPO sector and its development in South Africa. If it can be shown that there is a case for Services sectors, and specifically 'exportable' service sectors, to play an increasingly important role in modernisation and economic development strategies, then there is cause for development theorists to re-evaluate conventional theory that has traditionally equated economic development with industrialisation. This will also provide a platform for development strategists to focus further efforts into the development of 'exportable' service sectors. The first objective therefore is to provide a theoretical framework for understanding the increasing importance of Services sectors, particularly high-value services such as BPO, for developing countries such as South Africa.

The second research question seeks to understand the current South African policies and strategies for sector development; first of all establishing if specific sector development strategies form part of the overall national development strategy, and if so what are the specific focus areas and the specific approaches within them. This will enrich the formulation of the recommended development strategies proposed in this study, and also highlight any fundamental differences to the current approach. The second objective is therefore to review the South African economic development policy environment as it pertains to sector development,

The third research question seeks to identify the factors and best practises of other developing nations that have successfully grown the BPO sector to make a significant impact on national development. This study will specifically focus on India, as it has led the developing world in successfully growing its BPO sector to make a significant impact on its economic development. BPO work, in 2004, accounted for 2.5% of India's GDP (Caldwell, 2004. P: 1), and it is estimated that the sector will employ between 900000 and 1000000 people in India by 2008 (Dossani and Kenney, 2003. P: 8). The 2003 UNCTAD E-Commerce and Development Report (UNCTAD, 2003. P. 56) states that 'from a development perspective, outsourcing has demonstrated its viability and success in India'. The third objective of this thesis is therefore to review how the BPO sector has been developed successfully in other countries such as India.

This brings us to the fourth research question. If firstly it can be shown that BPO is a sector that has the potential to make a significant contribution to the delivery of economic growth and jobs in South Africa, then it will be useful to identify strategies to best develop the sector in South Africa in order to sufficiently contribute to meeting these development goals. Understanding how to best develop the BPO sector will also provide broader insight into the development of 'exportable' services. 'Exportable' Services, which includes the BPO sector, has only in recent years shown its potential to significantly contribute to economic development, and South Africa and other developing nations have little precedent and few guidelines as to how best develop the sector to achieve accelerated economic growth and job creation. The fourth objective of this thesis is therefore to establish whether the BPO sector can make a significant contribution to economic growth and job creation in South Africa, and secondly provide a basis for understanding how the BPO sector in South Africa may best be developed to achieve this accelerated economic development and job creation.

The research questions and corresponding research objectives are illustrated below:

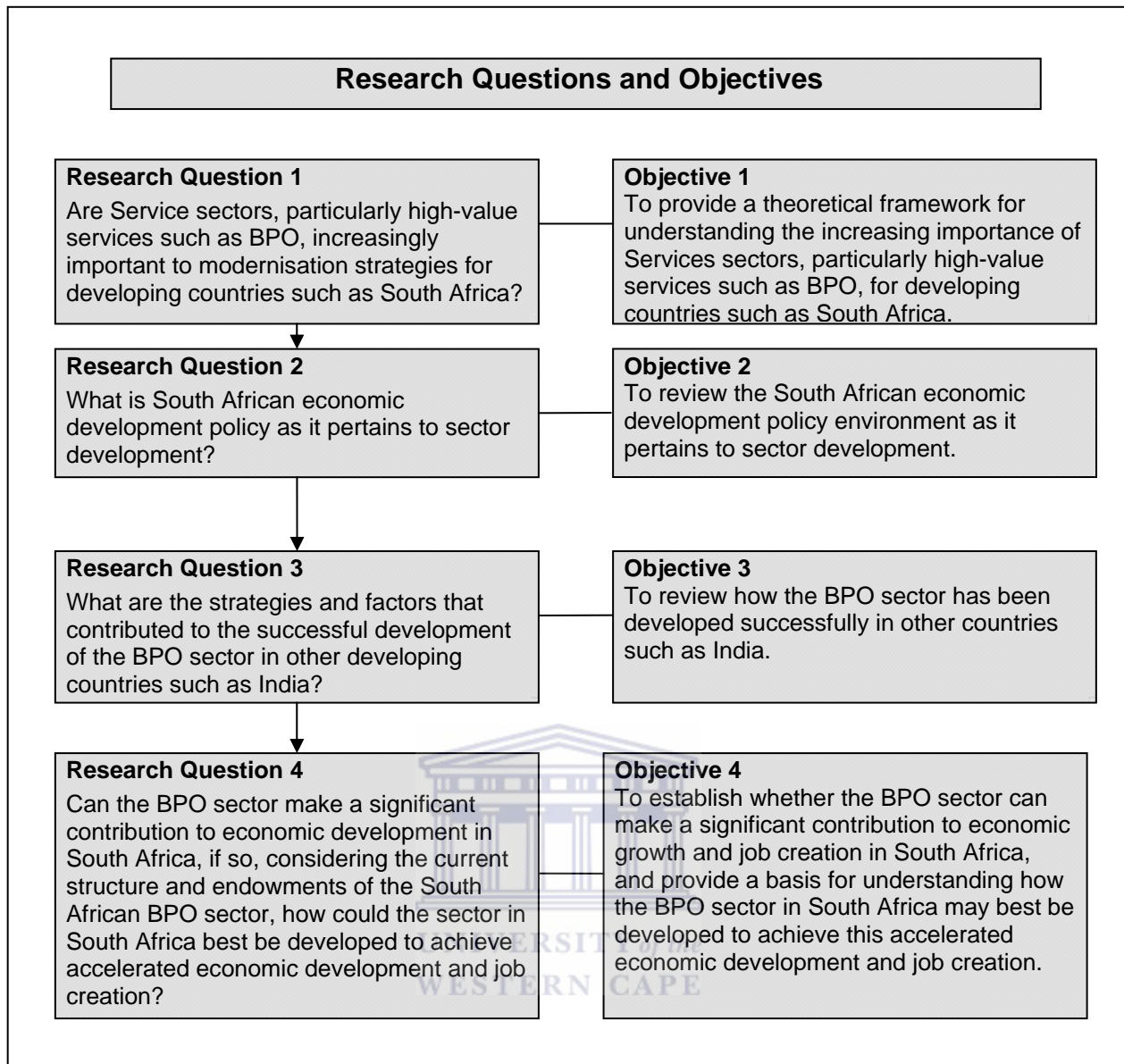


Figure 1.3: Research questions and objectives

1.4 Limitations to this Research

There are limitations to this research. The BPO Sector has only recently emerged as a development alternative, and is also a relatively new sector globally and in South Africa. Industry data and related development economic research is limited. Findings and associated recommendations for strategic development of the sector to meet the relevant development goals, based on the relevant literature and research, are made, however, testing these recommendations is beyond the scope of this research.

1.5 Practical value of this study

How will this thesis, and the achievement of its objectives, address the research problem? This study is an opportunity to examine whether the active development of the Service sectors are a relevant and important approach, relative to the traditional manufacturing approach, in the modernisation and economic development efforts of South Africa and more broadly of other modern day developing countries; and by focusing on the BPO sector in South Africa, identify strategies to best develop these 'exportable' services to achieve accelerated economic growth and job creation. The study will quantify the potential economic and job creation contribution of the BPO sector in South Africa, and accordingly set out practical recommendations for the sectors development that can be incorporated into development strategies by both public and private planners.

More broadly, this study will enable national planners to more effectively review the potential role of the Service sectors in development strategies, and, hopefully, spark further debate and research as to how BPO and other high-value Service sectors can be developed to achieve South Africa's economic development objectives.

2. Theoretical Framework

2.1 Chapter Introduction

The theoretical framework requires the consideration of economic development theories highlighting the development of the Services Sector, and particularly highly skilled services, and as an attractive and more relevant approach for today's developing economies, as opposed to the traditional industrialisation and manufacturing approach. This study will necessarily consider the development of the BPO sector and its potential to positively impact on economic development and employment creation in South Africa.

This chapter will discuss the New International Division of Labour theory, with a particular focus on Hutchinson's (2004) theories on the 'Newer' International Division of Labour; industrialisation theories as an approach to modernisation juxtaposed against the growing importance of Service Sectors; and theories on the economic impact and associated development of the BPO sector, particularly in South Africa.

2.2 The emergence of a 'Newer' International Division of Labour

Developing countries (the periphery) continue to aggressively move up the value 'production' chain by providing skilled and complex functions previously reserved for the workers of developed countries (core). This suggests a 'Newer' International Division of Labour Theory which *transcends* the core-periphery dichotomy as described by the New International Division of Labour Theory, which reserves sophisticated production tasks for developed countries and relegates simpler industrial production tasks to developing countries. Hutchinson (2004) presents a compelling challenge to some of the assumptions of Frobel, Heinrich & Kreyes's (1980) NIDL theory, and argues that a 'Newer' International Division of Labour (NIDL2) has emerged. NIDL2 points to an economic development path that is more relevant to certain emerging economies in today's globalised economic environment.

A detailed review of NIDL2 in this study, together with associated development theory, will provide the theoretical underpinnings for an understanding of the relevance of the BPO sector in relation to a successful economic development strategy for South Africa. This review of the BPO sector in relation to an economic development strategy for South Africa, will, in turn, also be a valuable contextualisation of NIDL2 theory itself.

2.2.1 New International Division of Labour Theory

The New International Division of Labour Theory (NIDL) was developed to explain the movement beyond basic production of primary goods by developing countries at the periphery and the establishment of substantial manufacturing sectors in these developing countries, particularly the Asian Tigers in the 1970s. NIDL theory became known through the work of Volker Fröbel and his associates in Germany who observed that the old division between core countries which produced manufactured goods and peripheral countries which produced primary goods, had been replaced by a new global division of labour with highly sophisticated production tasks (design, marketing, research) in one set of locations (core) and simpler industrial production based on standard technology and processes in another set of locations (periphery) (Hutchinson, 2004).

NIDL was made possible by the confluence of three factors: the reduced importance of geographical location for production due to technological progress; technological and organisational developments that enabled complex production tasks to be broken down into basic steps allowing unskilled workers to learn the steps quickly; and a limitless supply of cheap labour in developing countries (Hutchinson, 2004).

Fröbelians asserted that developed countries would retain the skill-intensive tasks and developing countries would permanently be relegated to the periphery with only the labour-intensive tasks. However, in recent years, as developing countries continued to upgrade their human resources and technology continued its steady progression, we have seen skill-intensive tasks increasingly being outsourced to the periphery. This has given rise to the *Newer* International Division of Labour Theory (NIDL2) where the core-periphery structure has been superseded and high-performing regions in both developed and developing countries carry out tasks of varying skill and technological intensity (Hutchinson, 2004).



2.2.2 Newer International Division of Labour Theory

NIDL2 has four main causes: the increasing importance of Transnational Companies (TNCs) and the extension and integration of their operations; ongoing technological advancement and adoption of this technology in developing countries; a changing legal and regulatory framework that continues to free the flow of goods, services, and capital (particularly investment capital); and an alteration in factor endowments in developing countries that has seen a dramatic increase in skilled labour that remains cheap (Hutchinson, 2004).

It is this alteration in factor endowments, particularly the rise of a large highly educated and skilled workforce in developing countries that is most significant. An old Chinese proverb says, "If you want one year of prosperity, grow grain. If you want ten years of prosperity, grow trees. If you want 100 years of prosperity, grow people." (Economist, 28, July, 2005. P: 42). Low-cost developing countries - not just China and India but also Mexico, Malaysia, Brazil, and others - are turning out large numbers of well-educated young people fully qualified to work in an information-based economy. In 2005, China produced about 3.3 million college graduates, India 3.1 million (all of them English-speaking), the U.S. just 1.3 million. In engineering, China's graduates numbered over 600000, India's 350000, and America's only

about 70000 (Colvin, 2005, P: 2). Asia has the greatest number of tertiary level students of over 21.5 million, and over 4.6 million students in the technical fields. In contrast Europe has 2.7 million technically trained students, and North America 2 million technically trained students (Hutchinson, 2004. P: 11). Turning to specific countries, it is clear that China and India, with 5.8 million and 5.6 million students respectively, have the largest absolute endowments of human capital. Just one of these countries rivals France, Germany, and the United Kingdom together for sheer labour power (Hutchinson, 2004). Although these are absolute numbers that ignore relative total population sizes, the differences are staggering. Furthermore, there is a growing concern among some Americans that the U.S. education system is not keeping pace with these emerging nations and, not only is not producing sufficient numbers of proficient students but is also not producing people with the relevant skills for a global economy. This has been illustrated by various studies, including one by the Organisation for Economic Co-operation and Development (OECD) show that U.S. high school students do not perform well in math or reading (Harwood, 2004. P: 5) as well as their peers in other nations despite the fact that the U.S. spent more than most OECD nations educating each child (Shlaes, 2004. P: 1). This is reflected in the fact that developing countries now have larger stocks of technically trained students than developed countries. In addition to the sheer volume of skilled people in certain developing countries, the competitiveness of developed countries is being further challenged by the low cost of this skilled labour in these developing countries. American computer programmers who made \$100000 a year or more are being fired because Indians and Chinese do the same work for one-fifth the cost or less (Colvin, 2005. P: 3). Thus, the global economic landscape has been significantly altered by the seemingly limitless supply of skilled and cheap labour from developing nations into the global labour pool, transcending and subverting the traditional core-periphery dichotomy.

One of the effects of globalisation is the increasing importance of TNCs. Over 65000 TNCs with over 850000 affiliates abroad (Shlaes, 2004. P: 1) account for two-thirds of international trade. Because of their size and economic weight, the decisions they make can significantly alter the flows of goods, services, financial capital and skilled workers, and in recent years TNCs, in addition to extending their operations in developing countries, have also increasingly integrated their operations in these regions meaning that skilled functions are no longer isolated in developed countries. Intel, for example, added 1000 new engineers in India and China in 2003 and 2004 (Lohr, 2004. P: 1). Walmart, the U.S. retail giant, is a significant manufacturing outsourcer to China and accounts for one eighth of all of China's exports to the US (Goodman, 2004. P: 2). In parallel with the extension and integration of TNC operations, we have also seen an increasingly liberalised policy environment, freeing up the flow of goods, services and financial capital, that makes investment and production networks more feasible. China alone received over \$300bn invested through the 1990's (Economist, 28, July, 2005. P: 42), and it still remains the world's largest recipient of Foreign Direct Investment (FDI), with contracted FDI, an indicator of future investment, soaring 39% in 2003 to \$115 billion (Economist, 28, July, 2005. P: 42).

It would appear that the key developing country players emerged or emerging in the NIDL2 are primarily a small number of Asian countries - the Asian Tigers followed by the Four Little Tigers and China, India and Turkey. In Latin America, the notable countries are Brazil and Mexico. Other countries such as South

Africa, Saudi Arabia, Argentina, and some Eastern European countries are important players in certain areas and seem on the border of incorporation into the NIDL2 (Hutchinson, 2004).

Thus, a series of mechanisms have profoundly altered the spatial organisation of the world economy. Technological progress has enabled TNCs to take full advantage of differences in labour costs and different locational mixes of factors of production. This outsourcing now takes place against a different economic backdrop, as developing countries have bigger stocks of skilled labour and can host higher-skilled tasks. In addition the freer movement of financial capital, goods and services is facilitated by a more liberal regulatory environment, allowing transnational production and investment networks to develop more effectively. These changing factors herald a *Newer International Division of Labour* comprising a range of both developed and developing locations superseding the core-periphery dichotomy. In this new order, some countries will ascend and others descend depending on their factor endowments and ability to negotiate an advantageous entry into the *Newer International Division of Labour* (Hutchinson, 2004).



2.3 Beyond Industrialisation

Conventional theory has traditionally equated economic development with industrialisation. Initially, development theorists, within an evolutionary framework, advocated that emerging or developing countries mimic the development path of successful developed economies, where industrialisation and development of the manufacturing sector played a central role. This leaning towards industrialisation and manufacturing was reinforced as development theorists looked at the sustained growth (from the late 1950's well into the 90's) of South Korea and other Asian Tigers, also termed Newly Industrialised Countries (NICs). Export-led industrialisation played a key role in these countries and development theorists, now within a Neo-Marxist framework, saw this as a model for other developing economies to emulate (Gereffi, 1989).

However, in recent years, due to various factors including increased globalisation, technological and telecommunications progress, the change in developing countries' factor of endowments, and significant cost and quality manufacturing competition from countries like China, evidence points to the declining importance of industrialisation in national economies and challenges development theorists to rethink development (Gerrefi, 1989). This can be applied to both developed and developing countries, and Daniels's (2000) and other's work on the growing export of services places the development of the Service Sector higher on the agenda of policy planners and development theorists.

This growth of exportable services and particularly sectors such as BPO has become increasingly significant. A 1999 study already revealed that these exportable services, through cross-border communications where the producer nor the consumer moves physically, as defined by the General Agreement on Trade in Services, made up the largest component of all forms of international trade in services (Hufbauer and Warren, 1999. P: 2).

The purpose of this section is twofold: i) a review of development thinking against the decreasing importance of industrialisation and the increasing importance of the service sector to both developed and developing countries; and ii) to demonstrate the growing significance of Exportable Services, and BPO, which falls within this category, to a country's trade, export, and economic development strategy.

2.3.1 The Increasing Importance of the Service Sector

Manuel Castells (1996) concluded that globalisation would naturally result in an informational economy driven by new forms of information and communications technology, which would produce a new form of corporate organisation called the networked enterprise (Castells, 1996). In the process, services, often delivered over different geographies, would play a larger role in world economies.

The service sector growth has been, for many years, on the increase while the manufacturing sectors have played a shrinking role in both developed and developing economies. In most economies today, services are the single largest contributor to economic growth and employment (Hufbauer and Warren, 1999. P: 1). Services account for more that 60% of world GDP and trade in services have been growing more rapidly than trade in merchandise since 1985 (India Budget, 2005. P: 1).

Since World War Two, general services have been the fastest growing part of the economy in developed countries. In the US, services have expanded from 11.7% of non-agricultural employment in 1952 to over 31.5% by 2002, with over 97% of jobs added in 2002 being in services (Dossani & Kenney, 2003. P: 13).

According to UNCTAD estimates, services businesses account for over 50% of all new foreign direct investment (Hufbauer and Warren, 1999. P: 4). In his paper Rethinking Development Theory, Gerrefi (1989), notes that as more and more countries of the world are becoming industrialised, industrialisation itself is losing its status as the ultimate hallmark of national development (Gerrefi, 1989. P: 1). He further asserts that 'industrialisation' is not longer synonymous with 'development' and certainly does not guarantee proximity to the core, as defined by World Systems Theory.

The profit margins and economic benefits of manufacturing have been increasingly under downward pressure, especially since the emergence of China and other low-cost manufacturing centres. Developed and developing countries alike, outside these zones of low-cost manufacturing supremacy, are not able to effectively compete, and have to develop from scratch or upgrade its economic mix towards technology and skills intensive tasks where more local value is added (Gerrefi, 1989).

2.3.2 The Growth of Exportable Services, BPO, and the Development Impact

In the pre-digital age services were characterised by the "uno actu principle" (Bhagwati, 1987. P: 550): They had to be produced and consumed at the same place and time. There are, of course, still many services for which the customer must go to the provider (e.g. tourism or public administrative services) or the producer seeks out the consumer such as for repairs or personal services (Deutsche Bank Research, 2004. P: 2). However, an increasing proportion of so-called "disembodied services" no longer requires personal contact between the provider and consumer (Henneberger, F & Ziegler, A, 2001. P: 2). This is paving the way for the global distribution of value chains and Business Processes in the services sector and given rise to a growing class of services that are 'exportable'.

The completion of a Business Process is a result of an entire chain of bureaucratic activities, and all of the actions represent a cost to a firm. It used to be that these processes were seen in totality and as a fixed cost, however, as the management discipline of Business Process Reengineering developed more

attention was given to reorganising these processes to be more efficient and cost-effective by decomposing, examining, and standardising activities necessary to complete a process (Dossani & Kenney, 2003). This was increasingly accompanied by digitisation of at least some portions of the entire process. This gave rise to the realisation that, enabled by information and communications technology, the provisions of services could be divided into components requiring different levels of skills and interactivity and that certain portions of these activities, which may or may not be skill-intensive, but required low-levels of face-to-face interactivity, could then be relocated offshore to destinations where it is cheaper and acceptably effective (Dossani & Kenney, 2003. P: 12). In today's digital world, any activity not requiring physical presence can be undertaken anywhere that is connected (Dossani & Kenney, 2003. P: 12).

While the globalisation of manufacturing is already well entrenched, with nearly every manufacturing country having part of its value chain located overseas (Gerrefi, 1994; Porter, 1990), the globalisation of services has only seen rapid advancement in the last 20 years. Decreasing telecommunications costs, the advancement and standardisation of information and digitising technology, the urgency to increase profitability by decreasing costs, and the abundance of suitable human resources in offshore locations have enabled and driven an acceleration in this globalisation process. The offshoring of business processes was merely an extension of that intranational outsourcing that was already occurring in developed countries, where firms moved the provision of certain services away from city business-centres to lower-cost towns. Once these shallow labour pools were tapped, it became an imperative for these firms to look offshore.

While, development theorists, from the early 1970s, correctly predicted that developed nations economy would evolve towards service-based economies, the incorrect implicit belief was that that only the lower-value manufacturing jobs would move to developing nations. However, the emergence of BPO and its remarkable contribution to economic growth in India and certain other developing countries has certainly caught the attention of policy planners and development theorists the world over. India has led the developing world in successfully growing its BPO sector to make a significant impact on its economic development. BPO work, in 2004, accounted for 2.5% of India's GDP (Caldwell, 2004. P: 1), and it is estimated that the sector will employ between 900000 and 1000000 people in India by 2008 (Dossani and Kenney, 2003. P: 8). More bullish estimates see this actually reaching 2 million jobs (Subramanyam, 2004. P: 56). A National Association of Software Service Companies (NASSCOM, 2004. P: 4) report states that every job in a BPO also generated an additional job in ancillary services. The 2003 UNCTAD E-Commerce and Development Report (UNCTAD, 2003. P: 56) states that 'from a development perspective, outsourcing has demonstrated its viability and success in India'.

2.4 Chapter Conclusion

The review of the relevant development theories and their evolution highlights the development of the Services Sector, and particularly highly-skilled services, and as an attractive and more relevant approach

for today's developing economies, as opposed to the traditional industrialisation and manufacturing approach.

As developing countries (the periphery) continue to aggressively move up the value 'production' chain by providing skilled and complex functions previously reserved for the workers of developed countries (core), a 'Newer' International Division of Labour Theory, which transcends the core-periphery dichotomy as described by the New International Division of Labour Theory, is emerging. This nuanced theoretical framework, coupled with the growing relative importance of the Service Sector, and particularly 'exportable' services, to economic value creation, provides the context or framework for understanding the growth of the BPO sector and its potential contribution to economic development.



3. Review of the Global BPO Market

3.1 Chapter Introduction

This chapter begins by providing a definition and overview of the BPO sector, its particular dynamics, country market players, size and make-up. This is followed by review of the global growth potential of sector. It concludes by a comprehensive review of the BPO sector in India, its reasons for success and its impact on economic growth and job creation in this developing nation.

3.2 Description of the BPO Sector

The rapid advancement of information technology, the internet, and the associated business applications, coupled with globalisation, has led to the growing internationalisation of Information Technology Enabled Services (ITES), which includes BPO. BPO or 'Offshoring' is the practice of outsourcing non-core services that, aided by communication technology, can be performed remotely, from corporations or governments in developed nations such as the US and the UK, to lower-cost service providers in developing nations.

Offshoring has predominantly been work performed over the phone or internet, such as IT and Call-centre services. However, researchers from UC Berkeley's Fisher Centre found 37 job categories that could easily move offshore, which include insurance claim processors, radiology technicians, and paralegals (Kirby et al, 2004). The 2003 UNCTAD E-Commerce and Development Report similarly identified over 60 types of services in 12 function areas (UNCTAD, 2003. P: 57). It is likely that BPO will continue to be any service that companies and entrepreneurs in developing countries can provide ably and more cheaply. As Nandan Nilekani, chief executive of Infosys Technologies, an Indian outsourcing company, declared at a recent World Economic Forum, "Everything you can send down a wire is up for grabs. (Lohr, 2004. P: 1)"

A Deutsche Bank study in 2004 categorised the offshoring probability of services and functions into High: Application Development, Programming, Maintenance of old systems, Help-Desk, Call centres; Medium: IT Infrastructure, Data/ computer centres, Network Administration, Web hosting, Server management; Low: R&D, System Architecture, Network/ data backup, and Integration of IT and business processes (Deutsche Bank Research, 2004. P: 10). However, since then higher-value and 'core' services have also begin to be outsourced. A 2007 PwC global survey found that 42% of companies surveyed would expand their current outsourcing activities into 'core-services' such as R&D (PwC, 2007. P: 23). CA, one of the largest global software makers, has recently announced that it has outsourced all the R&D and future

product development for part of its security portfolio to the Indian company HCL (Financial Times, Techblog, 2007). CA already has 1200 developers of its own in a Captive offshoring centre in India.

These services are either carried out by external providers (offshore outsourcing), or be provided from within the company itself (internal or captive offshoring), for instance by subsidiaries or company units abroad, or by joint ventures and strategic alliances. Indeed, captive offshoring accounts for two-thirds of total global outsourcing (Deutsche Bank Research, 2004. P: 4). The key characteristic of offshoring is that the services are rendered abroad. Normally the provider and client are located in different countries: India, as the major provider, and the United States, as the biggest taker, illustrate this mental image.

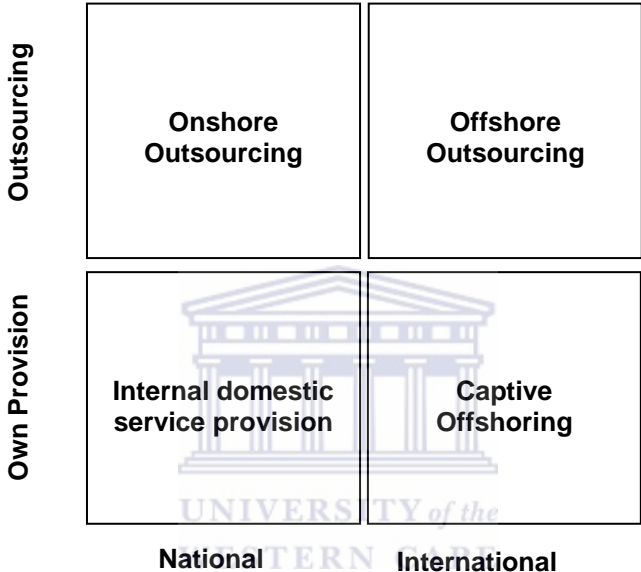


Fig 3.2.a Offshoring Types (Deutsche Bank Research, OECD, McKinsey, 2003. 2004, P: 3)

This is paving the way for the global distribution of value chains in the services sector, and for exploitation of the cost advantages at the most economical locations (Deutsche Bank Research, 2004).

However, costs are not the only reason for western companies to outsource processes to other countries. As in earlier periods of globalisation, they are driven by a variety of considerations (see Chart 1)

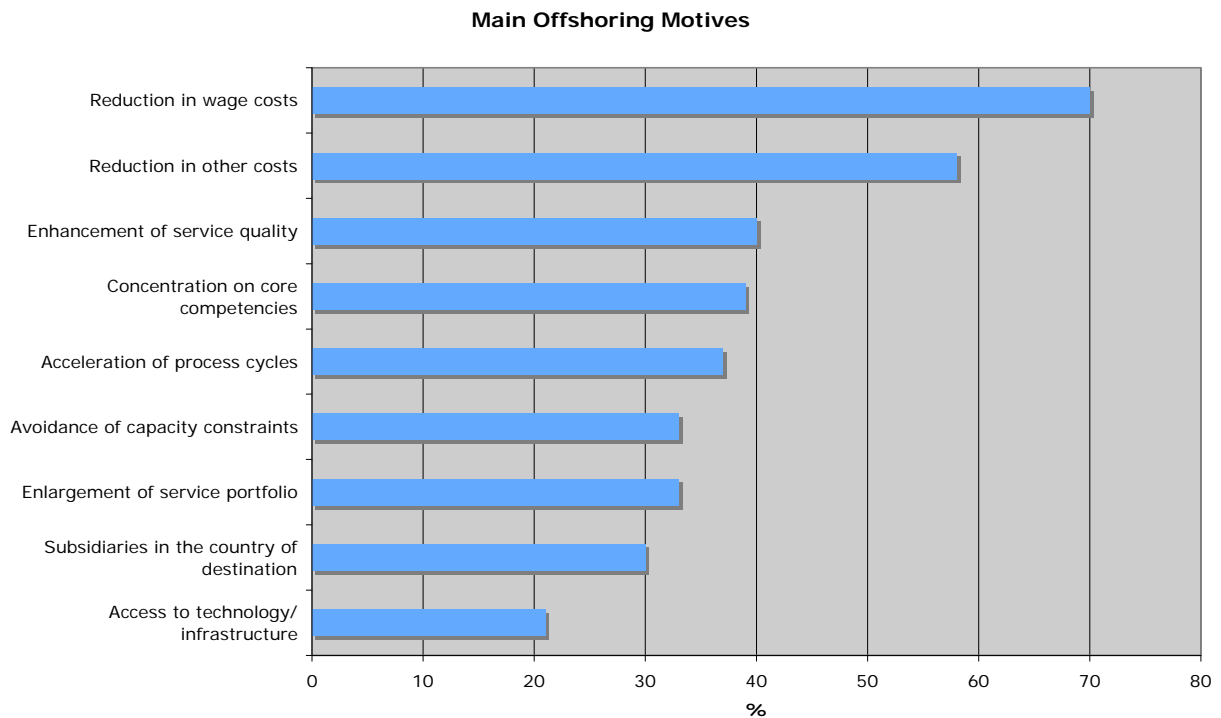


Fig 3.2.b Main Offshoring Motives (Deutsche Bank Research, 2004, P: 6)

Essentially, these can be summarized into four motivation groups, which are not mutually exclusive (Deutsche Bank Research, 2004).

- i. **Cost-based outsourcing** certainly has been the chief reason for offshoring with low-wage skilled workers making it attractive enough to offshore processes even when the increased monitoring and initiation costs caused by the distances involved are taken into account. Research by Deutsche Bank reveals that the hourly rate for a software developer in Germany is EUR 54 and in the US EUR 44. This compares with significantly lower costs of just EUR 14 in China (Deutsche Bank Research, 2004. P: 6). In the Czech Republic and India labour costs, at EUR 8 and 7 an hour respectively, are half less again (see chart). However, as offshoring entails specific additional costs, offshore labour costs, typically, make up only 15% to 50% of the total costs of a project, against 75% in the home country (Deutsche Bank Research, 2004. P: 6). Added to this are offshoring-related management and operating costs such as vendor management. All in all, the estimated cost savings work out at between 20% and 65%, although 20% to 30% is the realistic, and typical, figure. The most frequent and costly offshoring risks include the choice of provider, drawing up the contract, transferring processes abroad, the costs generated by downsizing the domestic workforce (redundancy arrangements and severance pay, etc.) and productivity losses resulting from cultural differences (Deutsche Bank Research, 2004. P: 6).

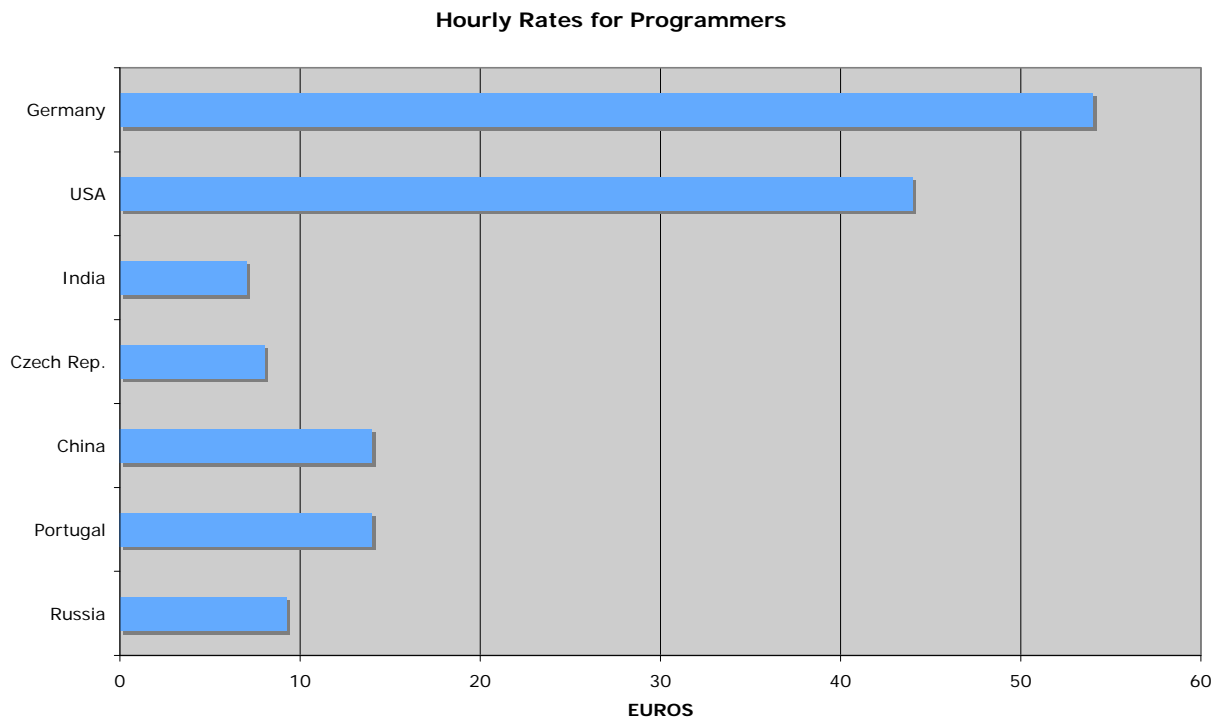


Figure 3.2.c Hourly Rate for Programmers (Deutsche Bank Research, 2004, P: 6)

- ii. If the necessary skilled staff cannot be found in the home country, production may be shifted for **procurement motives** to countries that possess the required specialists in abundance. Computer specialists and skilled engineering staff are in particularly strong demand. There are currently just over 5,000 IT graduates in Germany and the 25,000 in the USA that enter the labour market each year in contrast with 120,000 in India and as many as 250,000 in China (Deutsche Bank Research, 2004. P: 6). This shortage of skilled labour will intensify again in the medium term, not least owing to demographic trends.
- iii. One of the key motivators behind a commitment abroad is to **access new markets**. Populous, dynamic growth regions like India, the Philippines or China hold out substantial sales potential for multinational firms. To exploit this, a local presence is necessary. Some governments in the new markets even make it mandatory for foreign companies to build up local production and service facilities before they are allowed to sell their products and services there.
- iv. Finally, **locational quality** acts on the motivation to shift production facilities or services. A business-friendly institutional framework with liberal rules on labour dismissal, and subsidies and tax breaks can exert a pull effect on foreign companies. Restricted business scope, too much regulation or an excessively high tax load in the home country can act as push factors, driving production processes abroad.

The chief national recipient of offshoring work is India, followed by the Philippines and China. Second tier recipients include South Africa, Mauritius, Thailand, Dubai, Singapore, and selected Eastern European countries (Kennedy, 2004. P 4). Developed country centres like Ireland were perhaps the first offshoring

centre models. However, India today dominates the offshoring space and started aggressively developing its offshoring industry early on while other developing players only actively emerged post-millennium (see chart below). By 2004 India accounted for 65% of all global IT Offshoring and 45% of all global BPO Offshoring (India Budget, 2005. P: 2).

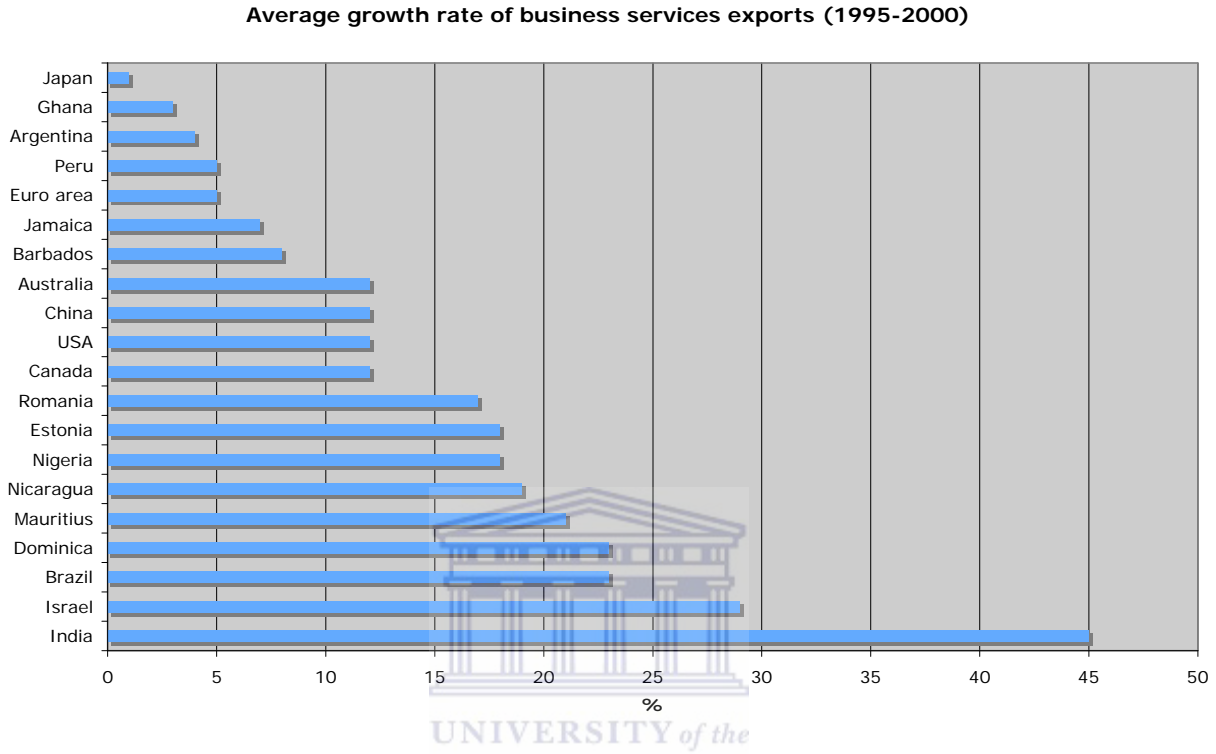


Figure 3.2.d Average Growth Rate of Business Service Exports (UNCTAD, 2002, P: 26)

	Stage 1: Infancy	Stage 2: Emerging	Stage 3: Escalating	Stage 4: Established
Asia-Pacific	Pakistan Rep. of Korea	Malaysia Thailand Vietnam	China Philippines	Australia India Singapore
Americas	Brazil Chile Venezuela	Jamaica	Mexico	Canada
Europe, Middle East & South Africa	Bulgaria Romania	Russian Fed. Ukraine	Czech Republic Hungary Poland South Africa	Ireland Israel UK

Table 3.2 Four-stage pattern in BPOO locations (DTZ Research, 2003, P: 22)

South Africa, as per the Table, is emerging as a Stage 3, or as referred to later in the mini-thesis, a Tier Two player. While Offshoring and BPO is already a large industry, it is set to remain a rapidly growing sector. It is estimated that only 10% of the potential global market has been tapped creating an attractive developing country opportunity (McKinsey, 2005. P: 5).

3.3 The Size and Growth Potential of the BPO Sector

While estimates vary from study to study, Offshoring and BPO is already a large global business. By 2004, Offshoring was already a \$35billion per annum business, growing at a rate of 30 to 40% annually, and increasing its share of the world's service sector by 1% annually (Caldwell, 2004. P: 1). Estimates of the BPO component of this range from \$10bn to \$11bn per annum in 2004 and are estimated to be between \$50bn to \$60bn by 2008 (McKinsey, 2005. P: 4). However, studies show that only 10% of the potential market is being addressed (McKinsey, 2005. P: 5). Another McKinsey study shows that the potential addressable market of global offshoring, beyond, 2008, was \$300bn with BPO making up approximately \$150bn of this (McKinsey, 2005. P: 3). Another study showed that the IT Enabled and Business Process Outsourcing services market, which includes BPO, is estimated to reach \$142billion in 2009 (NASSCOM, 2004. P: 3), and a Deloitte management consultancy estimates that about \$365bn of financial services expenses will be transferred to cheaper countries (Mills, 2004. P: 1) with India being the preferred destination. Regardless of these varying estimates, the growth projection is significant.

This dramatic growth in the outsourcing market is estimated to create an additional 3 million jobs worldwide by 2008, with 2 million of these jobs being created in developing countries, based on price performance of the location, service quality, and the available human resources (McKinsey, 2005. P: 5).

While the top or Tier One locations currently meeting this demand are India, the Philippines and China, these Tier One providers, due to supply-side constraints such as talent and infrastructure availability, performance issues, and an increasing requirements for multinational firms to develop globally diversified offshoring footprints, will not be able to meet all of this forecasted demand over the next two to three years, creating an opportunity for Tier Two providers such as South Africa, Thailand, Dubai, Mauritius, and Singapore to take-up this surplus demand pool which will create an estimated job pool between 200000 and 500000 jobs (McKinsey, 2005. P: 5).

The global growth of the offshoring market will create an opportunity for South Africa, if the local sector can be developed accordingly, to capture some of the demand, which in turn, can create thousands of jobs with multiplier benefits.

3.4 BPO and its Impact on Economic Growth and Employment

Creation – the Indian Example

The success of India's software and BPO industry on the global stage has captured the imagination of business and national development strategists the world-over. In the last decade, India has been by far the largest and most successful global offshore destination having a significant impact on India's economic development. The successful development of the sector in India can provide some valuable insights into the impact of this sector on development issues relevant to emerging countries, like South Africa, as well as useful lessons for successful development of the sector in these various countries.

This section will describe the make-up of the Indian BPO sector, its size and growth projections. It will then go on to discuss the factors that have led to the success of this sector; the associated impact on job creation and economic development in India; the potential global impact of the Indian sector on other emerging national players in BPO; and will conclude by drawing some lessons for these emerging national players, such as South Africa, for successful development of the sector in their respective countries.



3.4.1 Description, Size, and Growth Projections of the Indian BPO market

The combination of low labour costs, an abundance of skilled labour, project management skills, and technological sophistication make India a particularly attractive candidate for BPO (Dossani & Kenney, 2004). By 2004, India accounted for at least 65% of the global industry in offshore IT and 46% of the global BPO industry (McKinsey, 2005. P: 4). A UNCTAD Report estimates that India could even account for 80% of the global market (UNCTAD, 2003. P: 78). India was expected to earn \$13 billion from such services, which includes software development, for the fiscal year ending March 2004 (Srinivasan, 2004. P: 1). It is estimated that BPO contributes \$2.3 billion of this. Most of this work flows from the US with the UK, at 26%, being the next largest provider of BPO work (UNCTAD, 2003. P: 78). A director of Infosys, the large BPO service provider, conservatively estimates that BPO will generate \$20 billion for India by 2010 (Indiainfo.com, 2004. P. 1), while the UNCTAD E-Commerce and Development Report estimates that BPO will generate between \$21 billion and \$24 billion by 2008 (UNCTAD, 2003. P: 77). While still significant, this may prove to be far lower, as latest National Association of Software Service Companies (NASSCOM) reports show that BPO exports (excluding domestic demand) were US\$8.4bn in the 2006-2007 financial year, and are projected by NASSCOM to reach \$10.5bn-11bn in 2008 (NASSCOM, 2007. P: 3).

Exports ITES-BPO (USD million)

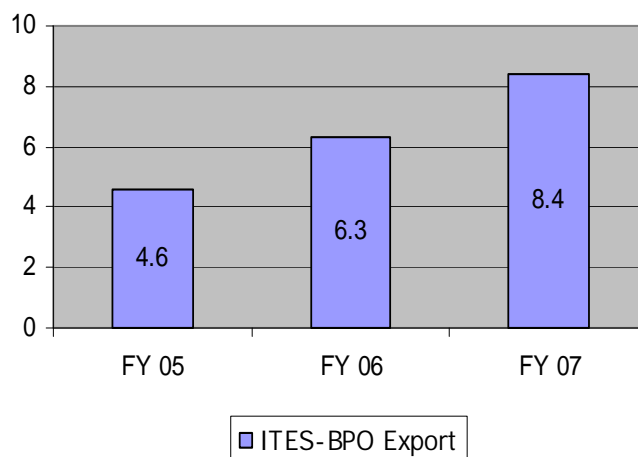


Figure 3.4.1 Indian Exports ITES-BPO (NASSCOM, 2007, P: 1)

The genesis of the growing BPO sector in India can be traced back to India's emergence in the mid-1980s as an offshore site for software production. By the late 1990s, India had become one of the world's leading suppliers of contract software programming due to its combination of skilled, low-cost manpower and project management skills (Dossani & Kenney, 2004. P: 5). This track record in satisfying international customers paved the way for MNCs to relocate Business Processes to India. MNCs like General Electric and American Express were BPO pioneers in India, and their activities were part of a learning and comfort-building process that created the foundations for the ensuing wave of offshoring (Dossani & Kenney, 2004. P: 5).

The initial wave of BPO came from the healthcare, banking, technology and insurance sectors with business processes such as call centres, data entry, document conversion, medical transcriptions, accounting, and claims processing being outsourced. These initial activities were highly routinised, however, over time more complex and high-value processes were outsourced. In time, processes linking the organisation with customers, suppliers or supporting production processes may be offshored. As an example, a BPO service provider that answered calls from potential clients of a loan service also began to prequalify clients for these loans. Clinical trials, gene testing, algorithm-development, supply chain management, and customer care are also potential candidates for offshoring (Dossani & Kenney, 2004. P: 7).

BPO service providers in India can be categorised into 8 types (Dossani & Kenney, 2004. P: 19):

- i. **Multinational Company (MNC) Captives.** These Captives are operations that service the needs of its Multinational Company (MNC) owner, and are the oldest BPO providers in India having emerged from MNCs that already had operations in India and saw the benefit of using their Indian operation to undertake activities formerly done in other countries. American Express, British Airways, and

General Electric were among the first MNCs to establish BPO Captives in India, and there have been scores since. General Electric has over 20000 employees in its Captive operations in India.

- ii. **Multinational Outsourcers.** These are multinational firms who are BPO service providers themselves. They have long established customers and have operated service facilities in many locations. Well known firms include EDS, IBM, Convergys, Accenture and others. These firms have been able to very quickly and aggressively set up and scale their Indian operations.
- iii. **MNC Specialists.** These are domain-specialist MNCs that perform labour-intensive speciality services. These services are wide-ranging but generally involve digitising analogue materials or converting information from one format to another. Examples include medical transcriptions, document conversion, cartoon animation and map digitisation.
- iv. **Non-resident Indian-promoted firms.** Among the first to identify the potential of outsourcing services to India were Indians living abroad. Many of the non-resident Indians establish businesses headquartered in their developed countries of residence that sourced work and then discharged it to their operations in India.
- v. **Indian Specialists.** Like their MNC counterparts these Indian owned firms perform labour-intensive speciality services. The challenge for these firms is to build up the domain expertise required.
- vi. **Indian Independents.** Like their MNC Outsourcer counterparts, these Indian owned and operated firms have been established for the sole purpose of offering BPO services to foreign clients. Many of these are venture-capital supported by investors hoping to ride the BPO outsourcing wave. Some of the independents offer a build-operate-transfer service to their MNC clients. The most successful Independents are now, like their MNC Outsourcer competition, also beginning to establish operations on other low-cost countries.
- vii. **Indian IT Industry Subsidiaries.** Many Indian IT companies have become global success stories. Firms such as HCL, Infosys, Satyam, TCS, and Wipro have become globally competitive and global brands. As an extension to their existing businesses, many of the have set up BPO subsidiaries or acquired BPO operations. With their capital, track record and relationships with international customers, they have become major players in the Indian BPO sector.
- viii. **Indian Non-IT Industry Subsidiaries.** Many other Indian firms have also entered the BPO market. While they have deep pockets, most of them have little experience servicing foreign clients or domain expertise.

3.4.2 Reasons for Success

India's success and leadership position in the global BPO market can largely be attributed to five main factors:

- i. **Abundant talent at low costs.** India's most compelling advantage is its abundance and low cost of skilled or semi-skilled labour, which can cost approximately 80% less than developed countries (UNCTAD, 2003) – "An Indian computer programmer making \$20,000 a year or less can replace an

American programmer making \$80,000 a year or more.” (Lohr, 2004. P: 1). Another study by Deutsche Bank found that on average a programmer in India can cost 7 Euros an hour compared to a programmer in the U.S. or Germany at 44 and 54 Euros respectively (Deutsche Bank, 2004. P: 6) (see Fig. 3.2.c). This differential is similar in other ‘offshorable’ vocations. A trained CPA in the U.S. typically earns \$75000 a year, while a similarly qualified accountant resident in India earns \$15000 a year (Dossani & Kenney, 2004. P: 13). The differential for less skilled workers is even greater, with the entry level Indian wage rate for call centre employees in metro areas is \$2400 a year (Dossani & Kenney, 2004. P: 13). NASSCOM statistics indicate that direct costs per employee are \$10354 compared to \$55598 in the US (Dossani & Kenney, 2004. P: 13). The abundance of resources in India is also in stark contrast to the shortage of skills in developed countries. There are currently over 5000 IT graduates in Germany and 25000 in the U.S. that enter the labour market each year in contrast with over 120000 per year in India. The figures are even more startling for those qualified to work in lesser skilled BPO environments. In contrast, despite concerted efforts by the German government and industry to boost supply, by the end of 2003, 30% of German ICT companies said they could not find sufficient skilled workers (Deutsche Bank, 2004. P: 6). This differential between the abundance of suitable human resources in certain developing countries and the shortage in developed countries is set to grow even larger.

- ii. **Development of suitable urban infrastructure.** While infrastructure in many parts of India is lacking, government and business have made a concerted effort to develop urban centres of excellence in the BPO sectors. This cluster development approach accounts for 85% of India’s IT and BPO exports stemming from just 13 urban clusters (Deutsche Bank Research, 2004. P: 7). However, given the industry growth projections a rapid expansion or development of new urban clusters will be required if the growth momentum is to be maintained (McKinsey, 2005).
- iii. **Operational and managerial excellence.** India’s BPO firms have developed a reputation of operational and managerial excellence, which has resulted in good quality output at low costs. Many firms have achieved productivity rates that match or even exceed those found in developed countries (Dossani & Kenny, 2004. P: 17). However, with sector growth, Indian firms will increasingly come under pressure to develop further managerial depth (McKinsey, 2005).
- iv. **Conducive business environment supported by appropriate policy interventions.** Large-scale reform in communications policy and its impact on related infrastructure, has been a longer-term driver of successful growth of the IT and BPO sectors (McKinsey, 2005. P: 3). Beginning in 1999, India has reformed its public monopoly telecommunications systems into a market-driven system, allowing private providers to enter the sector. These private providers were permitted to specialise, ranging from the provision of niche services, such as backbone and network management, to full-service integrated voice and data operations. As a result, India’s telecommunications network, mainly in the larger cities, has been provisioned with quality and cost levels approaching those of developed countries (Dossani & Kenney, 2004. P: 16). There has also been some labour reform that has supported the BPO sector. While the India government still offers some protection to local industry (and local workers) against international competition, employers in ITES and BPO have been exempt from labour rights restrictions regarding hours and overtime (Zainulbhai & Farrell, 2004. P: 1). This unrestrictive and flexible labour market has contributed to a buoyant job market in

this growing sector. In addition, government has also relaxed laws regulating foreign ownership and associated taxation in the sector. Unlike in industries such as retailing, agriculture and property, banking, insurance and telecommunications where foreign ownership is prohibited or limited to minority stakes, the Indian Government allows foreign ownership in the IT and BPO sector. It also creates a substantial incentive for foreign companies by waiving the 35% tax on corporate profits for foreign companies that move business process operations to India, even though some consider these incentives wasteful, as India would have almost certainly attracted these same investments even if they were taxed (Zainulbhai & Farrell, 2004. P: 1).

- v. **Positive impact of the growing Indian IT sector.** Regardless of the cost savings, firms in developed countries would only outsource to India if they were comfortable that there would be minimal disruption in the relocation and consistent quality of service. India's BPO sector benefited from the substantial track record already established by its successful software development industry. MNCs, such as General Electric and American Express that were already offshoring software development to India, were among the first to offshore the BPO requirements (Dossani & Kenney, 2004. P: 20).

Thus, key factors such as the low cost of labour combined with a large English-speaking workforce, proven skills in software development and IT related services, a suitable ICT infrastructure, supportive policy reforms, operational excellence helped make India an ideal destination for BPO.

3.4.3 Impact of the BPO Sector on Economic Development & Job Creation in India

India's offshore sector has proven to be a significant economic growth engine. The sector grew from US\$4bn in 2000 to over US\$12.8bn by 2004, accounting for 6% of the increase in GDP over this period. One study determined that outsource work accounted for over 2.5% of India GDP by 2004 (Caldwell, 2004. P: 1), and it is estimated to grow to 7% of GDP by 2008 (India Budget, 2006. P: 2), which means that it is expected to grow about three times faster than the overall Indian economic growth rate. According to the Centre for Monitoring Indian Economy, the offshore IT and BPO industries accounted for nearly 95% of the absolute growth in foreign exchange inflows associated with service industries between 2000 and 2004 (McKinsey, 2005. P: 3). While total services exports grew by 60% in that period, offshore ITES and BPO exports tripled in the same period. In 2004, India's share in world merchandise exports was 0.8% compared to its share in world commercial services which was 1.9% (India Budget, 2006. P: 1), and services, as a whole, accounted for 54.1% of GDP in 2005-2006 (India Budget, 2006. P: 1).

A 2004 Economic Times article stated "The leading Indian IT companies, the likes of TCS, Infosys and Wipro are rapidly overtaking the giants of Indian manufacturing such as Telco, Hindalco and L&T, when it comes to the number of people employed" (Indiainfo.com, 2004. P: 2). By 2004 the IT and BPO sectors directly employed nearly 700000 people and provided indirect employment to approximately 2.5 million

workers. It is estimated by some that the BPO sector will generate over two million direct jobs by 2008 (Subramanyam, 2004. P: 1), however, latest NASSCOM figures place direct employment by the BPO sector in 2007 at 553000 people. A NASSCOM report states that every job in a BPO also generated an additional job in ancillary services. Thus, there is also enormous potential for employment growth in the spin-off transport, food services, facility management and security services (Indiainfo.com, 2004). This growth in the workforce also means a growth in potential consumers for other industries and grows the market for multinational and local businesses alike.

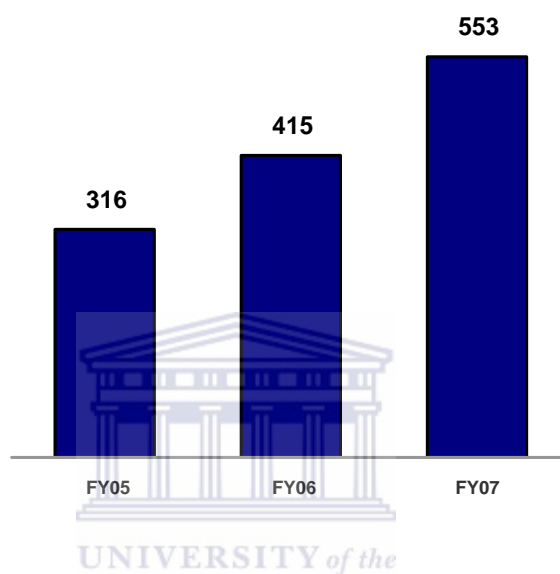


Figure 3.4.3 Employees ITES-BPO in India (in '000) (NASSCOM, 2007, P: 1)

Opportunities and jobs for women further the cause for development, and the type of employment that BPO creates provides greater opportunities for women. Lower skilled jobs like call centre work and data entry have allowed greater female participation. 49% of Wipro's workforce is women, and ICICI OneSource, another leading Indian BPO provider, has women constituting 60% of its employees (UNCTAD, 2003. P: 67).

BPO in India has resulted in considerable FDI. It is estimated that by 2008, US\$4-5bn of FDI to India will be attributed to the BPO sector, which is more than that raised by the entire Indian economy in 1998 (McKinsey, 2005. P: 4). While foreign companies outsource services to providers in India, some also build and operate their own BPO centres. Many MNCs such as Accenture, EDS, and IBM all operate outsource centres in India. These three companies were employed between 5,000 and 6,500 people in India by 2004.

BPO is considered a 'clean' industry and has even had a positive impact on the environment in which the centres are located. Large corporate campuses with manicured lawns and highly developed infrastructure are in stark contrast to the poverty in many Indian urban centres. There has also been a positive impact on the surrounding urban environment with regard to infrastructure and transport. The locations of BPO

hubs have caused the areas between Bangalore, Hyderabad and Chennai, Gurgaon and Noida, Mumbai and Pune, to be known as the 'golden triangle' (Indiainfo.com, 2004. P: 2). Thus, in contrast to the often-negative effects of the manufacturing and other primary industries, BPO seems to have a minimal and even positive effect on the environment.

BPO in India has and will continue to make a significant contribution to economic growth, foreign exchange earnings and employment. BPO has impacted positively on the employment of women, levels of FDI, infrastructure development and sustainable integration into the global economy.

3.4.4 Impact of India's Success on other Emerging Nation BPO Sectors

India's success has a positive impact on the prospect of other countries hoping to position themselves as attractive BPO locations. Firms from developed countries are certainly more comfortable with offshoring, and there is even an increasing requirement for companies to develop globally diversified offshoring footprints.

The rapid increase in global demand for BPO services will not entirely be able to be met by Tier One providers such as India. Due to the anticipated supply-side bottlenecks such as talent and infrastructure availability, as well this requirement for globally diversified offshoring footprints (McKinsey, 2005. P: 7), there is an opportunity for many Tier Two providers such as South Africa, Mauritius and Thailand to benefit (McKinsey, 2005. P: 7). Successful Indian BPO firms are rapidly expanding their operations to other developing countries. Infosys, a leading Indian firm, spent US\$250mn this year buying a Polish call centre, and is actively building a network of offices from Mexico to Eastern Europe to China to provide an 'anytime, anywhere' solution to its clients (Ramesh, 2007. P: 1). Tata, Wipro and other Indian firms are doing the same. These firms are also recruiting and training talent from other developing countries. Tata, for instance, has recruited in South Africa and has sent these trainees to its training facilities in India. It is hoped, by this author that they return to operations in South Africa. If this phenomenon is positively viewed, India is exporting managerial and entrepreneurial talent to other emerging nations such as South Africa, as well as providing valuable skills to the local workforce.

The proven impact of the BPO sector on India's economy and development has also primed development planners and governments in other developing countries to providing more favourable policy and infrastructure environments to the BPO sector.

3.4.5 Lessons for Other Emerging BPO Nations

Beyond indicating that developing service sectors such as BPO can significantly contribute to national economic development, the Indian success story has a number of broad lessons for countries wishing to effectively grow their BPO industries. Firstly, it is critical to invest in developing the appropriate human capital, which is available at the right price, both in regard to skills and abundance. Education and training efforts must focus on producing suitably skilled people for the BPO sector. Secondly, policy interventions to deregulate the telecommunications sector in order to lower prices; boost quality and specialisation are necessary. Other policy interventions designed specifically to attract BPO may also be useful. It is also an imperative to develop the appropriate urban infrastructure to support the sectors growth, and India's centres of excellence indicate that a concerted effort to develop BPO clusters should be made. As in India, first attracting MNCs to set up their own captive centres can provide the impetus for the sector to develop and gain critical mass. Lastly, India, through industry bodies such as NASSCOM, made a coordinated effort to market and grow the BPO sector. Any country wanting to gain a slice of the lucrative global BPO market should make a similar approach.

3.5 Chapter Conclusion

As the successful development of service sectors and particularly exportable services become increasingly important to a nation's competitiveness, BPO presents a valuable and effective opportunity for developing countries, such as South Africa, to grow the economy, earn foreign exchange, and create jobs. Demand for BPO services is certainly significant and growing, and is becoming more sophisticated and nuanced. Many countries, both developed and developing are actively positioning themselves as attractive BPO destinations. While the sectors in Tier One providers such as India and China are thriving, there is also a valuable opportunity for developing countries to position themselves as Tier Two providers to meet the surplus global demand.

India's successful BPO sector and its considerable contribution to India's economy and development, is an important case study for any emerging nation planning its development path in today's globalised environment. India's success proves the development case for BPO and has some useful lessons for other national pretenders.

4. Overview of the South African Economy and Development Strategies

4.1 Chapter Introduction

South Africa, with its apartheid legacy, shares the dynamics of both developed and developing nation economies. It has unique endowments and shortfalls, with associated challenges for sustainable and inclusive economic growth. Labour-intensive manufacturing sectors have been in decline, while service sectors are increasingly important to the economy, pointing to unique challenges and opportunities for South Africa to enhance economic growth in a manner that also creates jobs. As South African development policy has evolved since 1994, the opportunities presented by the BPO sector have increasingly come in focus and now form a notable component of the development strategy.

There are two parts to this chapter. In the first part, the size, market-up, and development challenges of the South Africa economy are reviewed. In part two, a closer look is given to South Africa's evolving development strategy and the recent focus on BPO.

4.2 The Size and Make-up of the South African Economy

South Africa has often been described as a two-tiered economy – one rivalling developed economies with a sophisticated financial market, industrial and service sectors; and the other where the majority of South Africans find themselves excluded from the economic mainstream, mainly of them unemployed and a significant number living below the poverty line.

4.2.1 Size and Growth

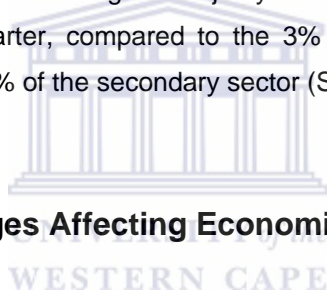
South Africa is a medium-sized economy, with a gross domestic product of R1 741bn (Stats SA, 2007. P: 1) and a population of 47 million (Investec, 2007. P: 1). Whilst GDP per capita measurements place South Africa in the middle-income category, its very high level of income inequality means a large percentage of the population live in poverty. Whilst the economy is in its longest upward phase of the business cycle, the unemployment rate is close to 25% (closer to 40% if one uses the expanded definition) and growth has only averaged a modest 2.9% pa over the last 10 years (Investec, 2007. P: 1). However, growth has accelerated in recent years reaching approximately 4.9% in 2006 (National Treasury, 2007. P: 1). The South African National Treasury forecasts growth of 5.1% per year from 2007

to 2009 (National Treasury, 2007. P: 1). South Africa runs a trade deficit and a modest budget surplus of 0.6% in 2007-2008 (National Treasury, 2007. P: 1), which is notable considering the development priorities of the country.

South African banking regulations rank with the best in the world. The sector has long been rated among the top 10 globally. The Johannesburg Stock Exchange Limited is the 18th largest exchange in the world by market capitalisation (www.southafrica.info, 2007).

4.2.2 Sector Make-up

The economy's major strengths include its physical and economic infrastructure, natural mineral and metal resources, a growing manufacturing sector, and strong growth potential in the tourism, higher value-added manufacturing and service industries (www.southafrica.info, 2007). 2007 third quarter figures from Statistics South Africa report that the economy grew 4.7% in the quarter, with services (Financial, real estate, and business services) contributing the majority of this growth (Stats SA, 2007. P: 1). Tertiary sectors grew by 6.7% over the quarter, compared to the 3% of the primary sector (despite rampant commodity price increases), and 0.6% of the secondary sector (Stats SA, 2007. P: 1).



4.2.3 Development Challenges Affecting Economic Growth

Despite these strengths and recent increased economic growth, there is still widespread unemployment, poverty, and obvious inequality in South Africa. According to the latest UNDP Report on South Africa, the number of people living below the national poverty line marginally declined from 51.1% in 1995 to 48.5% in 2002 (UNDP, 2003. P: 41). However, given the population growth over the last decade, this means that the number of people below the poverty line increased from 20.2 million to 29.1 million in 2002. Furthermore the UNDP Report shows that the poverty gap has also worsened to 18% in 2002 (UNDP, 2003. P: 43). Specifically it shows the number of people living with less than \$1 per day growing from 9.45% in 1995 to 10.5% in 2002, and the number of people living with less than \$2 per day growing from 6.2% in 1995 to 9.6% in 2002 (UNDP, 2003. P: 41).

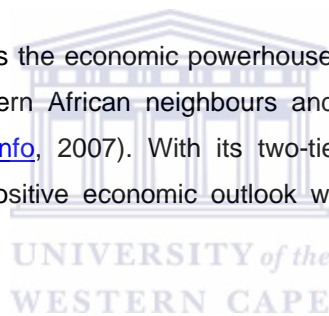
One of the key political, economic and social objectives over the past ten years has been the reduction of inequality in South Africa. Thus, it is particularly notable that the UNDP Reports shows that inequality, determined by the Gini Coefficient, has in fact increased since 1995 from 0.596 to 0.635 in 2001 (UNDP, 2003. P: 43). The government's view on the inequality trend is different. It includes its social spending as income in the conventional Gini coefficient calculation, which results in an improving Gini coefficient or a reduction in inequality. The government calculates the pre-transfer Gini coefficient in 2000 as 0.59, but

argues that the 'real' Gini coefficient, which includes social spending, is 0.35 (PCAS, 2003. P: 91). This inclusion of social spending results in a Gini coefficient reduction of 41% (PCAS, 2003. P: 91).

There is still the enormous problem of unemployment in South Africa. The unemployment rate has increased significantly over the past nine years with the strict definition unemployment figure at 4.3 million in 2002 and the expanded figure at 8.4 million. The official unemployment rate is approximately 25%, and the unemployment rate, according to the UNDP Report which uses the expanded definition, increased from 17.7% in 1996 to 42.1% in 2001 (UNDP, 2003. P: 20). While the government points out that 1600633 net new jobs have been created, the 4% annual growth of the economically active population outstripped the average 2% economic growth rate over the period resulting in the huge increase in unemployment (PCAS, 2003. P: 94).

The South African economy is being and will continue to be adversely affected by the impact of HIV/AIDS and ongoing crime. While positive efforts are now being made to address these areas, some estimates are that HIV/AIDS will cost as much as 17% in GDP by 2010.

Despite these issues, South Africa is the economic powerhouse of Africa with a gross domestic product (GDP) four times that of its southern African neighbours and comprising around 25% of the entire continent's GDP (www.southafrica.info, 2007). With its two-tier economy dynamics, its development challenge will be to combine its positive economic outlook with efforts that promote more rapid job creation and inclusiveness.



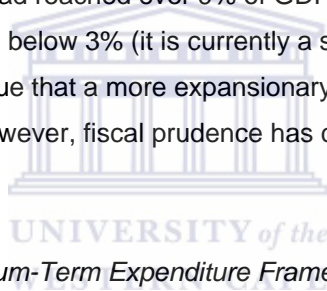
4.3 A Review of Economic Development Policy, Objectives and Time-frames

4.3.1 GEARing towards the Developmental State

In 1994, while there was a functioning economy, the post apartheid government inherited a bankrupt state and enormous imbalances due to the distortions of the apartheid system. Government managers immediately set about the task of macro-economic stabilisation with an austere approach to monetary and fiscal policy. Government worked towards a lower budget deficit, lower national debt-to-GDP ratio, and lower debt-servicing burden (Bruggemans, 2007). Government also aimed for a lower tax burden, increased tax base, low inflation, lower nominal interest rates and healthy external finances (Bruggemans, 2007).

There were some attempts at privatisation and deregulation although strong opposition from Government's partners in the Labour movement often muted these. Critics from the left labelled the government's policy position as being of the neo-liberal Washington Consensus construct. There were of course considerable efforts by government to redress some of the structural imbalances of apartheid. The Black Economic Empowerment (BEE) policy, through its various and often ambiguous tenets, aimed to force open the economy to black participation; and government actively if not always effectively extended basic service provision to those previously under serviced, as well as expanded the social safety net through further grants.

In 1996, government introduced its Growth, Employment and Redistribution (GEAR) policy framework. The policy set government the ambitious goals of achieving sustained annual real GDP growth of 6% or more by the year 2000 while creating 400,000 new jobs each year (CIA, 2007. P: 1). The policy aimed to increase investment, especially Foreign Direct Investment, to help achieve these ambitious goals; and demonstrated the government's commitment to open markets, privatisation and a favourable investment climate. Trade liberalisation also progressed substantially since the early 1990s. Average import tariffs declined from 30% in 1990 to 14.3% in 1999 (CIA, 2007. P: 1). One of GEAR's key pillars was the reduction of the fiscal deficit, which had reached over 9% of GDP during the 1993/4 fiscal year (CIA, 2007. P: 1). The deficit has remained below 3% (it is currently a surplus) since the implementation of the reforms (CIA, 2007. P: 1). Critics argue that a more expansionary budget is desperately needed to stimulate pro-poor development; however, fiscal prudence has certainly improved South Africa's fiscal health.



Budgetary reforms such as the Medium-Term Expenditure Framework and the Public Finance Management Act - which aims at better reporting, auditing, and increased accountability - and the structural changes to its monetary policy framework, including inflation targeting, have created transparency and predictability (CIA, 2007. P: 1).

While the targeted FDI was not always explicitly channelled towards specific sectors, noticeable government efforts were made to promote manufacturing and industrial development. The Coega project and industrial zone in the Eastern Cape is an example of active efforts to develop the industrial sector and attract FDI accordingly.

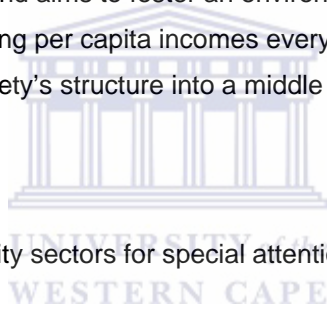
GEAR's outcomes have been mixed. While it brought greater financial discipline and macroeconomic stability, it largely failed to deliver in key areas (CIA, 2007). Formal employment continued to decrease. Despite the ongoing efforts of BEE and signs of an emerging black middle class, the country's wealth remains unevenly distributed along racial lines (CIA, 2007). The desperately needed FDI also remained elusive, and consequently the ambitious economic growth targets were never realised (CIA, 2007. P: 1). The policy came under increased pressure when growth slumped to a dismal 0.5% in 1998 (CIA, 2007. P: 1).

Until 2000, government's broad approach seemed to be to maintain fiscal and monetary prudence, embrace the free market, and restructure and liberalise where possible. This belief seemed to be that there would be long-term benefits, which would trickle down to the poor eventually. Short-term pain would be inevitable.

However, by 2000, social and political restlessness increased. Supported by global economic tailwinds and commodity price increases, capital account inflows, and better than expected taxation revenue collection, government began to moderately increase spending to promote faster growth and poverty alleviation. There remained a focus on long term benefits, however the short-term pain could be somewhat alleviated by increased welfare and social spending. There are now approximately 12 million welfare recipients as compared to 3 million in 2000 (Bruggemans, 2007. P: 2).

This increasing developmental approach focused on greatly improving the supply-side capacity, which is necessary to be able to achieve sustained growth over 5% per annum. Government's strategic plan, launched in mid-2005 by the Deputy-President of the country, is called Accelerated and Shared Growth Initiative – South Africa (ASGI-SA), and aims to foster an environment that sees 6% annual growth doubling GDP every 12 years, doubling per capita incomes every 14 years, growing formal employment by 3-4% annually, and changing society's structure into a middle class condition within 10-20 years from now (Bruggemans, 2007. P: 2).

ASGI-SA identifies several high priority sectors for special attention. BPO is one of them.



4.3.2 Review of ASGI-SA and the focus on BPO

The South African government in July 2005 launched the Accelerated and Shared Growth Initiative for South Africa (ASGI-SA) with direct oversight from the Deputy President. It's primary aim is to foster and a growing and inclusive economic environment that will halve unemployment and poverty by 2014, by identifying certain binding constraints on the economy, and making specific interventions in key areas that will enable unfettered inclusive economic growth.

ASGI-SA targets an average annual GDP growth rate of 4.5% or higher between 2005 and 2009, and at least 6% from 2010 to 2014 (Mlambo-Ngcuka, 2006. P: 2). It's stated vision of South Africa's development path is a:

vigorous and inclusive economy where production, products and services are diverse, more value is added to products and services, costs of production and distribution are reduced, labour is readily

absorbed into sustainable employment, and new businesses are encourage to proliferate and expand (Mlambo-Ngcuka, 2006: P.2)

ASGI-SA's formulation, begins with the realisation that South Africa's growth up to that point and even today has not coincided with a larger growth of exports over imports resulting in a substantial and persistent trade deficit; and that this growth has bypassed a significant part of the population who are largely excluded from the mainstream economy.

It identifies a set of six binding constraints that require focused responses (Mlambo-Ngcuka, 2006. P: 2):

- i. **The volatility and level of the currency.** Currency volatility and an overvalued Rand have been issues for economic planners and particularly manufacturers and exporters. Another area where macro-economic policies can be improved is in government expenditure management and capital investment where some government agencies consistently under-spend their budget while other consistently exceed theirs.
- ii. **The cost, efficiency and capacity of the national logistics system.** Due to certain backlogs in infrastructure investment and forward planning, in some cases market structures that do not encourage competition, the prices of conveying goods and services over large distances are relatively higher than they ought to be (Mlambo-Ngcuka, 2006. P: 3).
- iii. **Shortage of suitable skilled labour amplified by the cost effects on labour of apartheid spatial patterns.** South Africa's education system, and its apartheid legacy, is not effective in producing the quantity of appropriately skilled professionals, managers, and artisans required for a fast growing economy. In addition the price of labour is pushed up by the fact that many live long distances from where they work (Mlambo-Ngcuka, 2006. P: 3).
- iv. **Barriers to entry, limits to competition and limited new investment opportunities.** The South African economy remains relatively concentrated. This is especially true in upstream production sectors such as iron and steel, paper and chemicals, and key inputs such as telecommunications and energy. In some cases this has a negative impact on downstream production or service industry development (Mlambo-Ngcuka, 2006. P: 3).
- v. **Regulatory environment and the burden on small and medium businesses.** The contribution of small, medium, and micro businesses to GDP and employment has been mediocre. Tax administration, municipal regulation labour law administration, and certain regulation unnecessarily hamper the development of these businesses (Mlambo-Ngcuka, 2006. P: 3).
- vi. **Deficiencies in state organisation, capacity and leadership.** Certain weaknesses in the structure and capacity of state institutions that provide economic services, coupled with indecisive leadership in policy development have also hamstrung growth (Mlambo-Ngcuka, 2006. P: 3).

To address and counter these binding constraints, ASGI-SA formulates responses and specific interventions in six key areas (Mlambo-Ngcuka, 2006. P: 4):

- i. **Infrastructure Investment.** Government has significantly ramped up spending on infrastructure with a planned growth rate of between 15% and 20% of the capital budget per year (Mlambo-Ngcuka, 2006). Government and public enterprise investment for the period between April 2005 and March 2008 is estimated to be R370bn (Mlambo-Ngcuka, 2006. P: 4). Department of Trade and Industry figures place this closer to R415bn beyond 2008 (www.southfrica.info, 2007). Key areas of expenditure, from government's perspective, are provincial and local roads, bulk water infrastructure and water supply networks, energy generation and distribution, housing, schools and clinics, business centres, sports facilities, and multipurpose government centres, including police stations, courts, and correctional facilities (Mlambo-Ngcuka, 2006. P: 4). Electronic communications infrastructure development, which is critical to the BPO sector, is also considered essential. ASGI-SA plans to rapidly grow South Africa's broadband network; aggressively reduce telephony costs; complete submarine cable projects, SEACOM and the East African Submarine System that will provide competitive and reliable internal broadband access; and the provision of subsidies to encourage the establishment of telecommunications and labour intensive business in poor areas. Government has also launched Infraco, which will be a state-owned telecommunications provider, providing wholesale broadband capacity to other telecommunications providers (www.southafrica.info, 2007). A range of large-scale infrastructure projects have been identified in each province, that would have an impact on accelerating and sharing growth, and some of these are already underway. A key rallying force for rapid infrastructure development is South Africa's hosting of the 2010 FIFA World Cup, which will have a significant impact stadium and public transport infrastructure. In the latest Medium Term Economic Framework, national government's contribution to the 2010 FIFA World Cup is currently R17.4bn split between stadiums and transport infrastructure (Stats SA, 2007). Other strategic interventions include further development of the country's research and development infrastructure, and further efforts to boost public-private-partnerships in the development and maintenance of public infrastructure (Mlambo-Ngcuka, 2006. P: 4).
- ii. **Targeting specific sectors with growth potential (Sector investment strategies).** ASGI-SA identifies specific areas for special priority attentions with specific sector strategies. The commonality between the sectors is that they are labour intensive, rapidly growing sectors worldwide, suited to South African circumstances, and open to opportunities for Broad Based Black Economic Empowerment, and small business development. BPO, Tourism, and Biofuels (including agriculture and agro-processing) are considered the three key sectors (Mlambo-Ngcuka, 2006. P: 6), followed by:
- a. Chemicals;
 - b. Metals beneficiation;
 - c. Creative industries (Crafts, Film & T.V. Content, and Music)
 - d. Clothing and Textiles
 - e. Durable consumer goods; and
 - f. Wood, pulp, and paper

- iii. **Skills Development and Education initiatives.** The shortcomings of the education and training system to produce sufficient people with the appropriate skills must be addressed if South Africa is to meet its economic growth targets. South Africa's education system, with its apartheid legacy, is not currently effective in producing the quantity of appropriately skilled professionals, managers, and artisans required for a fast growing economy. Government has embarked on some key measures to address these challenges such in the education sphere such as the QUID UP programme aimed at achieving high levels of literacy and numeracy in the lowest grade; the Dinaledi programme aimed at doubling maths and science high school graduates to 50000 by 2008; an upgraded career guidance programme; and an upgrading of the Further Education and Training colleges, and the extension of the Adult Basic and Education Training programme (Mlambo-Ngcuka, 2006. P: 7). Key interventions in the skills sphere include the Employment Services system which aims to close the gap between potential employers and employers; Phase 2 of the National Skills Development Strategy; the development of a scarce skills database based directly on the needs of over 100 projects included in ASGI-SA; the identification of 'retired experts' and deployment of experience professional and managers to local governments to improve project development implementation and maintenance capabilities; and youth volunteer programmes, managed by the Umsobomvu Youth Fund, aimed at developing a range of key skills (Mlambo-Ngcuka, 2006. P: 7). A key intervention of ASGI-SA, is the Joint Initiative for Priority Skills Acquisition (JIPSA) which is a high-level structure led by a committee of key government Ministers, business leaders, trade unionists, and education and training providers or experts. JIPSA's task is to identify skills that are urgently needed and develop quick and effective solutions accordingly. These may include special training programmes such as fast track development programmes in partnership with other countries who currently have these skills; special interventions to bring retirees, and South Africans and Africans currently working out of South Africa, back into the domestic workforce; and actively bringing in appropriately skilled immigrants where necessary (Mlambo-Ngcuka, 2006. P: 7).
- iv. **Small business development to bridge the gap between the informal and formal economies.** ASGI-SA outlines some specific approaches to bridging the gap between the first and second economies in South Africa. Broadly these are increasing access to finance for small, medium, and micro-businesses through a variety of government agencies and mechanisms that encourage participation by private sector institutions, coupled with support services, especially targeted at bringing women and youth into the economic mainstream; directly designing government procurement and indirectly encouraging private sector procurement to support small black-owned businesses; reform of the regulatory environment to better support small business; further expanding the Expanded Public Works Programme to provide short-term employment and limited skills to those otherwise unable to gain employment; and a set of interventions, such as the formalisation of land tenure for rural dwellers, that try to realise the value of dead assets such as livestock, land, houses, indigenous skills and knowledge that have intrinsic but unrealised value (Mlambo-Ngcuka, 2006. P: 8). Finally, steps will also be taken to leverage the activities in the specific sector strategies to impact on integrating the second and first economies. An example that pertains particularly to the BPO sector is that government is committed to ensure that at least 5

BPO operations are established in poor areas, which currently have relatively little economic activity (Mlambo-Ngcuka, 2006. P: 8).

- v. **Addressing Public Administration issues.** A range of interventions have to be formulated to try to address the lack of capacity in certain state institutions and local governments that provide economic services, unnecessary bureaucracy, and the sometimes indecisive leadership in policy development. These include a programme to deploy experienced professionals and managers to local governments; mechanisms to continuously evaluate growth bottlenecks in the economy and the possible negative growth impact of certain regulation; a review of the effectiveness and efficiency of development finance institutions such as the Industrial Development Corporation (IDC), the Land Bank, the Development Bank of South Africa (DBSA), and the National Development Agency (NDA); mechanisms to address bureaucratic delays affecting potential investors; and reforming the framework for the planning and management of land use, both at national and local government levels, such as speeding up the Environmental Impact Assessment system and various zoning processes (Mlambo-Ngcuka, 2006. P: 11).
- vi. **Macro-economic initiatives.** While ASGI-SA states macro-economic interventions will be made, it is rather vague of the specificity and mechanics of the interventions. The intention of interventions in this arena are to reduce the volatility and overvaluation of the Rand; to foster sustained and shared growth through coordinated fiscal and monetary policy, while working within an inflation targeting regime; to send out the appropriate economic signals through improved budgeting in government, which has thus far tended to underestimate revenue and overestimate expenditure, thereby appearing more expansionary than it is; and finally to improve expenditure management particularly when it pertains to capital investment (Mlambo-Ngcuka, 2006. P: 11).

It is notable that the two lead sectors, BPO and Tourism, specifically targeted for development (the Biofuels sector support has recently been scaled down), as they are the best opportunities for shared and accelerated growth are both Service sectors, and importantly, in the context of this mini-thesis, that BPO is one of them. As such, a range of government bodies and private sector players are now making a coordinated effort to growth the BPO sector.

4.3.3 BPO Sector-Specific Policy Interventions

Under the auspices of ASGI-SA, the Department of Trade and Industry's (DTI) industrial policy framework has recently been drafted to include a Business Process Outsourcing and Offshoring Sector Support Strategy. This BPO Sector Support Programme was formulated as a coordinated effort between government and industry, through the Business Trust, and aims to develop South Africa into a Tier 2 BPO centre by 2009. If this can be achieved studies show that the sector can contribute up to R8bn in GDP (BPO2SA, 2007. P: 2). This plan will focus on (BPO2SA, 2007. P: 2):

- i. Supporting the effective marketing of South Africa as a competitive BPO location;
- ii. Developing and deepening the pool of internationally competitive talent;

- iii. Creating an enabling environment of incentives and infrastructure to support the sector;
- iv. Improving the quality of the South African offering; and
- v. Strengthening the industry body capable of mobilising and representing the key stakeholders

The key output to date was the launch in March 2007 of the BPO Government Assistance and Support (GAS) Programme aimed at attracting substantial investment to the sector through support interventions that include marketing, easier entry into South Africa for both new and expanding BPO operations, skills development, simplifying administrative procedures, and other investment incentives (BPO2SA, 2007. P: 1). They key tenets of the GAS programme are (BPO2SA, 2007. P: 2):

- i. **A Strategic Marketing Initiative.** The initiative addresses both targeted and broad-based marketing. The targeted marketing focuses on attracting and securing selected high-impact foreign investors, who will in turn create a groundswell of other investor interest, and the broad-based marketing encompasses the supporting of government and industry initiatives, to raise South Africa's BPO global profile, with the aim of securing a dominant Tier 2 position (BPO2SA, 2007. P: 2).
- ii. **A Talent Development Initiative.** A Work Readiness Programme, known as "Monyetla", is an initiative between the Department of Trade and Industry and the Department of Labour, and aims to take unemployed matriculants or graduates through a process of learning work-readiness skills. Monyetla is in its pilot phase and aims to train 1000 learners at a cost of R15000 each. The Training and Skills Support Grant has also been launched and is directed towards the cost of providing company specific training up to a maximum of R12000 per agent. The incentive grant is over and above the assistance obtained through the Sector Education and Training Authorities (SETAs) and is a complement to the BPO Investment Support Grant (BPO2SA, 2007. P: 2).
- iii. **The BPO Investment Support Grant.** This 5 year, R1bn incentive scheme is designed to attract BPO investment that creates employment opportunities. The grant is provided depending on the value of qualifying investment cost and employment creation, and ranges between R37000 and R60000 per contact centre seat. It is offered to local and foreign investors establishing projects that aim primarily to serve offshore clients (BPO2SA, 2007. P: 1). While the scheme was initially criticised for not achieving immediate success in the initial few months after its launch in March 2007 (Le Roux, 2007. P: 1), a notable American BPO company, Teletech, announced in November 2007, that it will invest in setting up and managing a 1300 seat operation in Cape Town through this specific GAS scheme (Khumalo, 2007. P: 1). Teletech is a global BPO provider, which employs over 50000 people in 18 countries. This centre is already under construction and aims to be operational in 2008. It is the scheme's first success (Khumalo, 2007. P: 1).
- iv. **BPO Centres for Designated Areas.** The initiative emerged from ASGI-SA's aim to bridge the gap between the first and second economies, and to locate contact centres in more depressed areas, in order to spread the opportunity and shift the focus away from active regions. As a regional development support measure, the programme aims to provide a support facility for those operators who may wish to locate in the designated areas, by assisting them to secure appropriate

infrastructure and business services, to derive value from locating in the identified areas (BPO2SA, 2007. P: 1). In November 2007 DTI tender procedures have already begun, under this GAS scheme, inviting municipalities to submit proposals to host BPO centres, and inviting private BPO operators to submit proposals to host BPO centres in Designated Areas.

Other government departments have also been mobilised in the BPO sector development strategy. The Department of Communications has recently brokered an agreement with Telkom, the government-owned telecommunications monopoly, to specifically reduce costs for BPO providers. As the high telecommunications cost is one of the key disadvantages to the local BPO sector, this agreement, coupled with the recent relaxing of the monopoly due to the licensing of new market entrants, will be important in accelerating growth in the sector.

4.4 Chapter Conclusion

To date, economic growth in South Africa, has largely bypassed the majority of South Africans who lack the skills and opportunities to access the mainstream economy. Economic growth, since 1994, has also been relatively muted compared to other developing countries although there has been some increased gains in recent years. In order to accelerate growth and relieve supply-side bottleneck constraints, development policy has evolved from relatively hands-off macro-economic policies to added initiatives that play a more developmental hands-on role. As service sectors have both locally and internationally been playing larger economic roles, key service sectors have been specifically identified in South Africa that can contribute to shared and accelerated growth. BPO has been singled out as one of these key sectors and is receiving focused attention from development policy makers who have formulated a comprehensive sector development strategy to grow South Africa into a globally competitive BPO Tier 2 provider.

5. BPO in South Africa

5.1 Chapter Introduction

Business Process Outsourcing is a major global trend and, as an industry, has proven itself to have the potential to be significant and inclusive economic value generator. South Africa has an emerging BPO industry, with the foundations and potential to develop into a competitive global player, capturing a significant share of the international market demand, which in turn, can translate into notable new direct and indirect jobs and the considerable economic contribution to GDP. While the potential for growth exists, a focused and coordinated effort is required by government, labour and industry to successfully develop the sector.

The chapter sets out by reviewing the size and make-up of the South African BPO industry as it stands and goes on to evaluate its growth potential based on various scenarios of global growth forecasts and other variables. A review of the endowments and weaknesses of the existing South African BPO industry, then points the way to shaping the appropriate and distinctive value proposition for the sector relative to global competitors, and for proposed strategic initiatives to develop the industry successfully in order to access the economic and development opportunity.



5.2 The Size and Make-up of the BPO sector in South Africa

Although South Africa is a late entrant on the competitive BPO arena, the industry has grown rapidly in recent years. A McKinsey study shows that in 2004, excluding Captives, which make up the bulk of the industry and only serve in-house company needs, there were approximately 70 BPO service providers serving both local and offshore clients, with almost 4500 agents serving offshore customers and 5000 serving local customers (McKinsey, 2006. P: 3).

The industry is concentrated in contact centres and back-office processing, and concentrated geographically in Johannesburg and the Western Cape (Cape Town), with Durban and Coega as emerging centres (McKinsey, 2006. P: 3). The 14 top service providers account for over 70% of agents employed (McKinsey, 2006. P: 3).

Core BPO Activities in South Africa

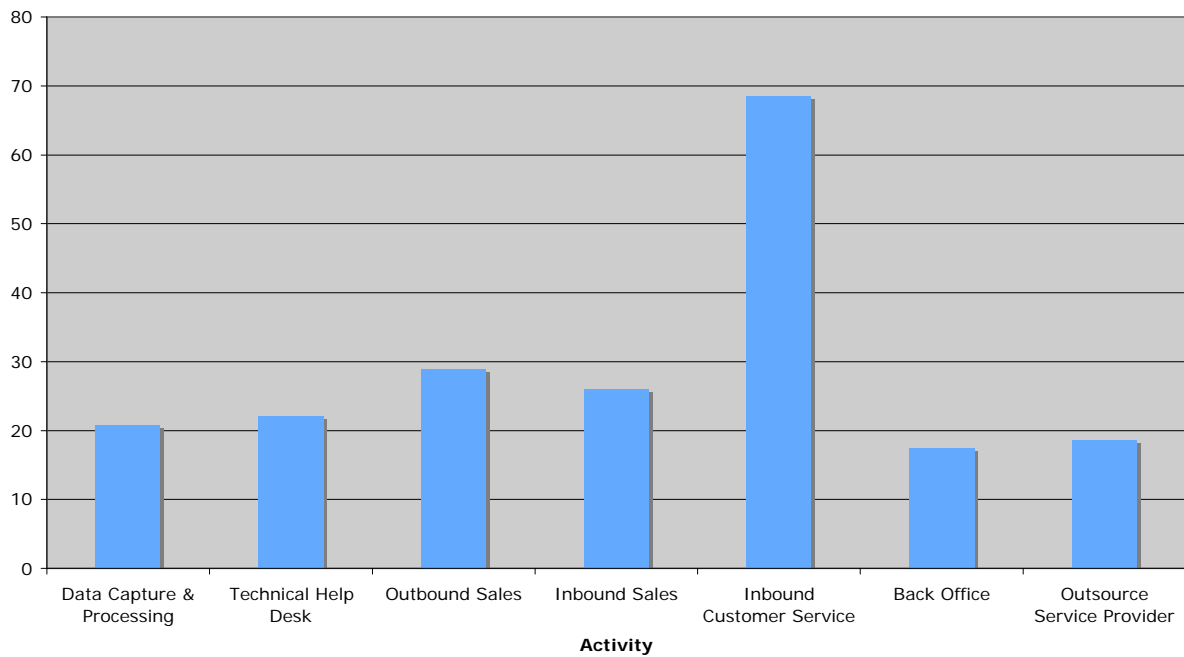


Figure 5.2 Core BPO Activities in South Africa (Mochiko, C3Africa Research, 2007, P: 18)

2006 data from a study focused on the Cape Town BPO industry show that the number of full-time agents has grown by 41% since 2003, and the industry employs 22156 people compared to 8000 in the same period. This translates to consistent annual industry growth of over 30% over the three-year period (Deloitte, 2007. P: 8). The number of companies serving offshore clients has grown to 26 from 12 in 2004 (Deloitte, 2007. P: 8). In this period the industry has grown to become a significant contributor to the provincial economy with the sector total economic impact being between R2.5bn to R3.3bn per annum, which is as much as 2.4% of the Gross Regional Product for the Western Cape and 3% of the total number of people formerly employed in the Cape Town metro area (Deloitte, 2007. P: 8).

In recent years, several well-known multinationals, both Captives and Outsource Providers, have opened operations in South Africa such as IBM, Teletch, Carphone Warehouse, and Lufthansa, while some local outsource companies in the sector have developed into sizeable market players such as Dialogue, which is listed on the Johannesburg Stock Exchange, and Merchant, a subsidiary of technology firm Dimension Data.

In South Africa, it is now estimated, including Captives, there are over 80000 people working in just call-centres providing a range of services including human resource services, customer care, accounting, administration, and debt collection (Mochiko, 2007. P: 1).

5.3 Growth Potential of the BPO Sector in South Africa – growth and job creation

To determine the growth potential of the South African BPO sector and the associated impact on job creation and economic growth, it is useful to review the detailed study done by McKinsey & Company, on behalf of the Business Trust, non-profit industry body. This study has subsequently played a critical role in shaping the government's sector development strategy.

The growth, job creation, and economic contribution estimates are based on a scenario-driven growth-forecast model, anchored in expectations for the global industry's growth, and assumptions about South Africa's ability to capture a share of that growth (McKinsey, 2005). Growing global demand for BPO services will outstrip the supply from Tier 1 countries such as India, China, and the Philippines. The opportunity for South Africa to compete in the global BPO market lies in this surplus unmet-demand mainly from the English-speaking US and UK markets (McKinsey, 2005), and its ability to develop its offering as an attractive Tier 2 location accordingly.



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Figure 5.3.a Global Growth projections for BPO (McKinsey, 2005, p: 4)

Key features of this global market and the growth projections are:

- i. Predicted growth to between US\$50bn and US\$60bn by 2008, and between 40% and 50% of the growth will be in financial service and insurance industries (McKinsey, 2005. P: 4).
- ii. This dramatic growth in the outsourcing market is estimated to create an additional 3 million jobs worldwide by 2008, with 2 million of these jobs being created in developing countries, based on price performance of the location, service quality, and the available human resources (McKinsey, 2005. P: 5).
- iii. While the top or Tier 1 locations currently meeting this demand are India, the Philippines and China, these Tier 1 providers, due to supply-side constraints such as talent and infrastructure availability, performance issues, and an increasing requirements for multinational firms to develop globally diversified offshoring footprints, will not be able to meet all of this forecasted demand over the next two to three years, creating an opportunity for Tier 2 providers such as South Africa, Thailand, Dubai, Mauritius, and Singapore to take-up this surplus demand pool which will create an estimated job pool between 200000 and 500000 jobs (McKinsey, 2005. P: 5).



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Figure 5.3.b Banking & Insurance Industry Contribution to Global BPO Growth (McKinsey, 2005, P: 5)

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Figure 5.3.c Surplus Demand Opportunity for Tier 2 Country Providers (McKinsey, 2005, P: 6)

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In this context of global growth and unmet demand from Tier 1 countries, there are a number of variables that influence the extent to which South Africa can grow its BPO sector. Some are within South Africa's control and some are not, and include the extent of demand surplus available to Tier 2 players; South Africa's relative cost competitiveness; and the extent to which South Africa can present a compelling and distinctive value proposition for BPO in Financial Services and Insurance, its two best positioned industries (McKinsey, 2005. P: 9). On the basis of these variables, three growth scenarios have been formulated in the McKinsey study. In the low road scenario, South Africa fails to successfully develop the sector further and remains a Fringe player; in the middle road, South Africa develops to being an established Tier 2 country provider; and in the high road, South Africa successfully becomes one of the more successful Tier 2 providers. Based on the forecasted market opportunity in each of these scenarios, it is possible to derive the number of direct jobs created, and using a standard multiplier of 3, derive the number additional number of indirect jobs generated (McKinsey, 2006. P: 7).

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Figure 5.3.d Growth Scenarios For South African BPO Sector (McKinsey, 2005, P: 7)

5.3.1 Growth Scenario One – Fringe Player

In this low road or 'do-nothing' scenario, 4000 to 5000 direct jobs can still be created with a further 15000 to 16000 indirect jobs being generated. This will result in a cumulative foreign direct investment of US\$28-32mn by 2008 (McKinsey, 2005). This scenario is based on the following factors occurring (McKinsey, 2005. P: 7):

- i. South Africa misses the opportunity to service the demand from the US and United Kingdom by failing to establish and market a distinctive value proposition.
- ii. Continental European demand for BPO services does not materialise, and Tier 1 centres such as India and China successfully address their supply constraints, thus, a demand surplus of only 10% is generated.
- iii. South Africa's cost competitiveness does not improve, with other emerging Tier 2 providers presenting a more distinctive offering than South Africa.

5.3.2 Growth Scenario Two – Viable Tier Two Location

In this middle-road scenario, 65000 to 70000 jobs (16000 to 18000 direct) can be created, resulting in cumulative FDI by 2008 of US\$106-120mn, and a total South African BPO industry of US\$0.6bn

(McKinsey, 2005. P: 7). This scenario, which is reasonably achievable, is based on the following factors occurring (McKinsey, 2005. P: 7):

- i. South Africa develops and successfully presents its value proposition and becomes one of the five to six preferred Tier 2 locations for BPO.
- ii. The demand surplus available to Tier 2 countries rises to 27% as Tier 1 countries only partially address their supply-side constraints.
- iii. South Africa improves its cost competitiveness by 15% through a combination of telecom regulations and other efforts, resulting in a larger share of the surplus locating to South Africa.

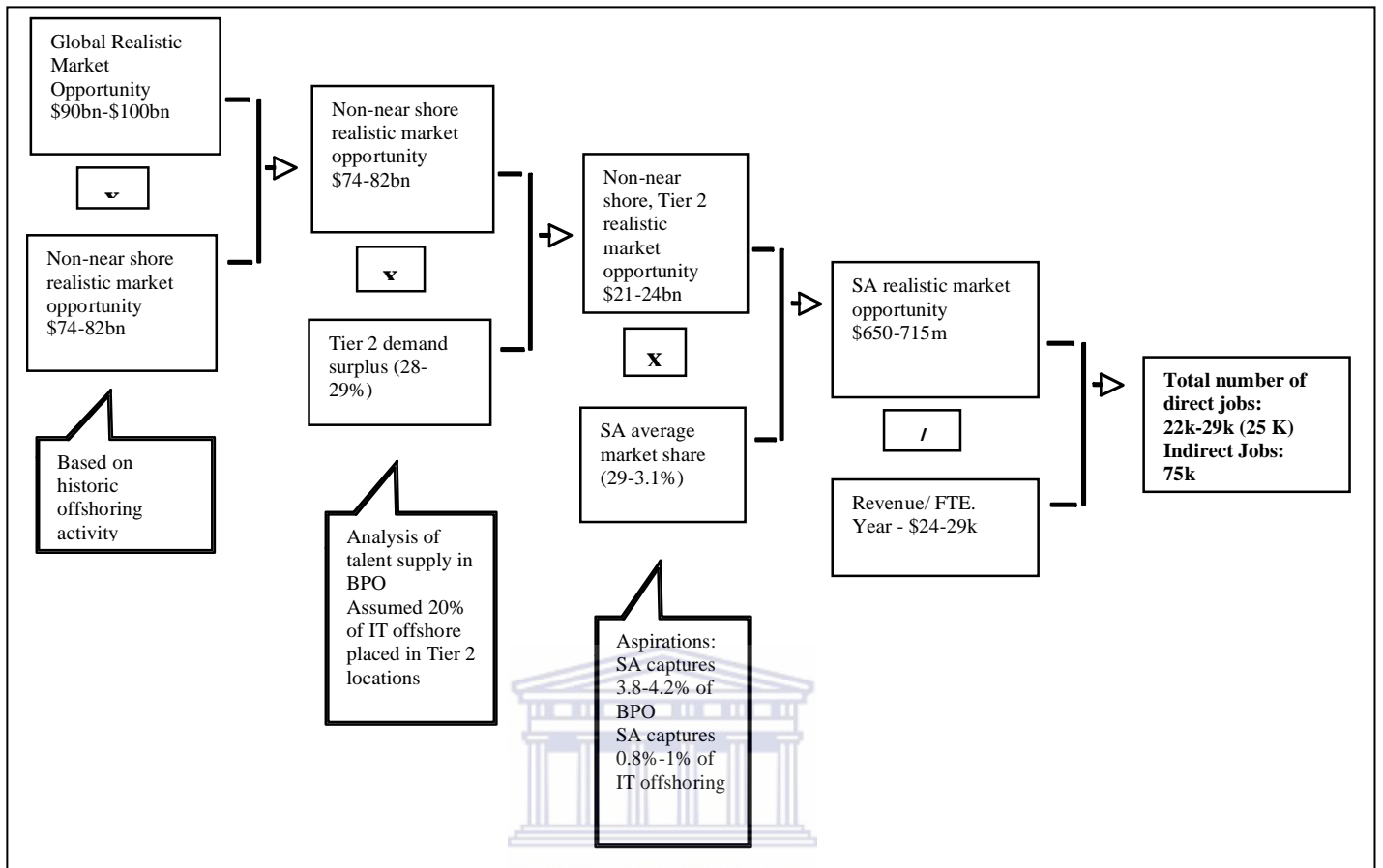
5.3.3 Growth Scenario Three – Premier Tier Two Player

In this high-road scenario, between 140000 and 160000 job are created (35000-40000 direct jobs), leading to cumulative FDI of between US\$265mn and US\$285mn by 2008, and a total South African BPO industry of US\$1.2bn (McKinsey, 2005. P: 8). This scenario is possible although it will require substantial effort, and is based on the following factors occurring (McKinsey, 2005. P: 8):

- i. South Africa develops and successfully presents its value proposition and becomes one of the five to six preferred Tier 2 locations for BPO.
- ii. European demand materialises at 50% of its forecasted rate, and Tier 1 countries fail to address their supply-side constraints. This results in the demand surplus rising to 35%.
- iii. South Africa is able to attract a disproportionately large share of the surplus demand from the Financial Services and Insurance sectors, based on a compelling and unique value proposition in these areas.
- iv. South Africa improves its cost competitiveness by 25% through a combination of telecom regulations and developing lower cost, higher quality labour pools, resulting in a larger share of the surplus locating to South Africa.

5.3.4 The Likely Scenario for South Africa

A likely scenario for South Africa, if concerted efforts are made, is one that falls somewhere between the middle-road and the high-road, which would see South Africa creating a US\$0.8bn industry by 2008, attracting cumulative FDI of up to US\$175m, translating (see Figure 5.3.4.a) into 25000 new direct jobs, and using a standard multiplier of 3, up to 75000 additional indirect jobs (McKinsey, 2005. P: 8). Indirect jobs are for people providing support to the BPO industry and to the employees of the BPO industry.



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Note: FTE (Full Time Employee)

Figure 5.3.4.a Potential Job Creation from South Africa BPO sector (McKinsey, 2005, P: 2)

Practically this would require South Africa to attract five to seven multinational company Captives of 10000 to 2000 each, five to seven third party vendors of similar size, between 20 and 30 smaller investments and expansion of existing companies by between 150% and 200% (McKinsey, 2005. P: 8).

Based on the revenue generated by the South African BPO industry by the additional 25000 direct jobs, and the economic multiplier for the effect of indirect economic activity resulting from direct revenue (which would take into account the marginal propensity to consume, marginal propensity to import, and the average tax rate) (See Figure 5.3.4.b), the BPO industry could contribute up to R8.8bn to GDP by 2009 (McKinsey, 2006. P: 2).

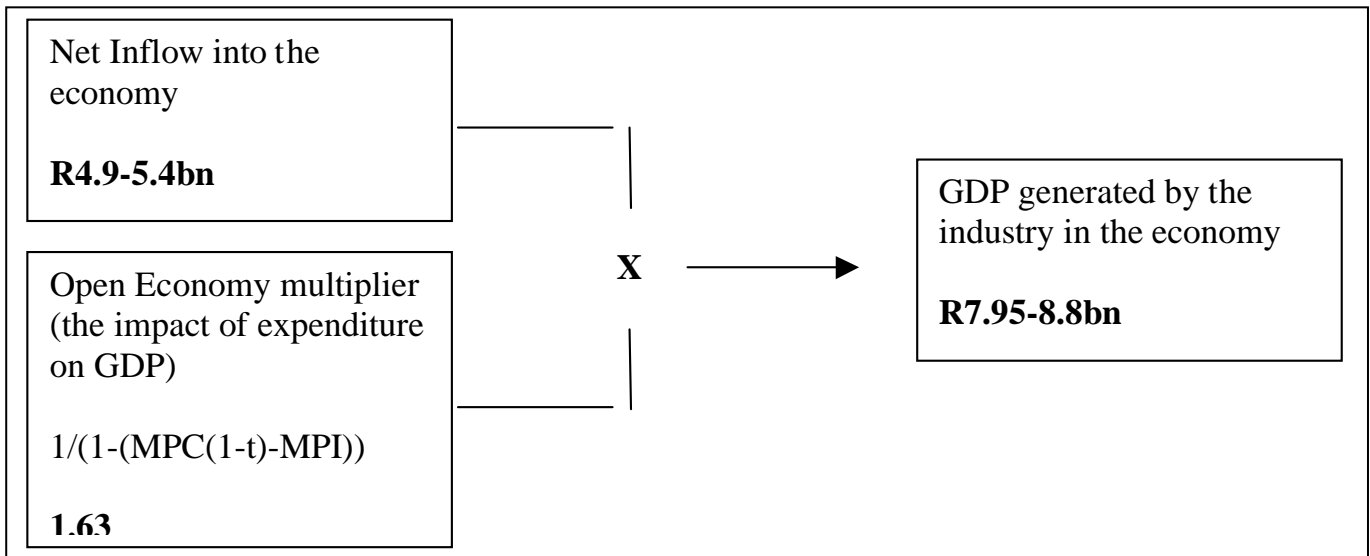
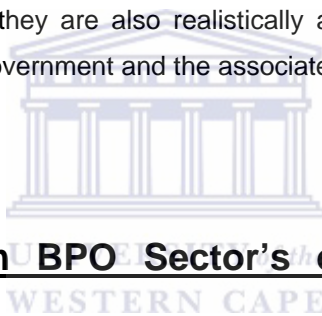


Figure 5.3.4.b Potential Contribution of South Africa BPO sector to GDP in 2009 (McKinsey, 2005, P: 3)

While these targets are ambitious, they are also realistically achievable, and judging from the recent coordinated efforts of industry and government and the associated successes, South Africa is certainly on track.



5.4 The South African BPO Sector's existing Endowments and Shortfalls

5.4.1 Endowments

South Africa and its emerging BPO sector is endowed with numerous qualities that allow it to develop a compelling value proposition as a preferred destination for BPO. Its cultural and language familiarity, particularly from the US and UK, and its quality of life, with the availability of social infrastructure such as residential facilities, make it an attractive location (McKinsey, 2005. P: 12).

It is also an environment with political and economic stability, international connectivity, high quality business infrastructure and availability of basic information technology services infrastructure.

South Africa also has unique advantage in two key high-growth industry sectors, which it can develop its BPO offering on:

- i. **Insurance:** South Africa has a world-class mature industry with many large, experienced players and a scalable insurance infrastructure. This industry contains a skilled labour pool with key qualifications, such as actuarial, being commonly available (McKinsey, 2005. P: 9).

- ii. **Banking:** South Africa has a sophisticated financial service environment and a well-regulated banking environment, which is compliant with international regulations. There are world-class technological platforms already in place (McKinsey, 2005. P: 9).

SECTOR	SOUTH AFRICA	INDIA
Insurance <ul style="list-style-type: none"> • Actuarial Services • Asset-liability matching • NAV calculation • Redemption & outflows processing • Inbound customer call centre 	<ul style="list-style-type: none"> • Product sophistication, with insurance products generating more the \$2bn & introduced the same time as the UK • World class firms – with total market cap exceeding \$50bn & writing premiums larger than 10% of South Africa’s GDP • International qualifications & well regulated environment 	<ul style="list-style-type: none"> • Industry only recently liberalised (since 1999) • Low life insurance penetration, with little product knowledge by general population • Lack of adequate knowledge of the business by agents & few high-quality training opportunities
Banking <ul style="list-style-type: none"> • Credit & Fraud Risk Modeling • Asset Management Administration • Credit Card processing • Collections • Inbound customer call centre 	<ul style="list-style-type: none"> • Large, world-class banks, with total market cap greater than \$75bn & operations in developed and developing world • Strong credit culture with almost US\$4bn annual income per product from consumer finance • Strong domestic regulatory authorities, complying to international regulations such as Basel II 	<ul style="list-style-type: none"> • Highly nationalised banking sector • Absence of credit bureaus & credit culture • Low conformance to Basel II • Proficiency in financial services & business English restricted to urban areas

Table 5.4.1. South Africa’s Advantages over India in Financial Services (McKinsey, 2005, P: 9)

South Africa can shape the compelling value proposition it requires in order to be a successful Tier 2 destination, based on its current strengths.

The McKinsey study advocates that this value proposition be based on 3 pillars, as well as unequivocal support and prioritisation from government (McKinsey, 2005. P: 10):

- i. **Pillar One – A Solid Foundation.** South Africa’s existing strengths – quality of life, political and economic stability, international connectivity, high quality business infrastructure, reliable telecoms and power – and its current ability to meet the minimum hurdle in terms of cost competitiveness

(even though it is not nearly the lowest-cost destination), of at least a 30% to 40% cost reduction relative to the UK and US, give it the right to lay claim to being an attractive destination for BPO.

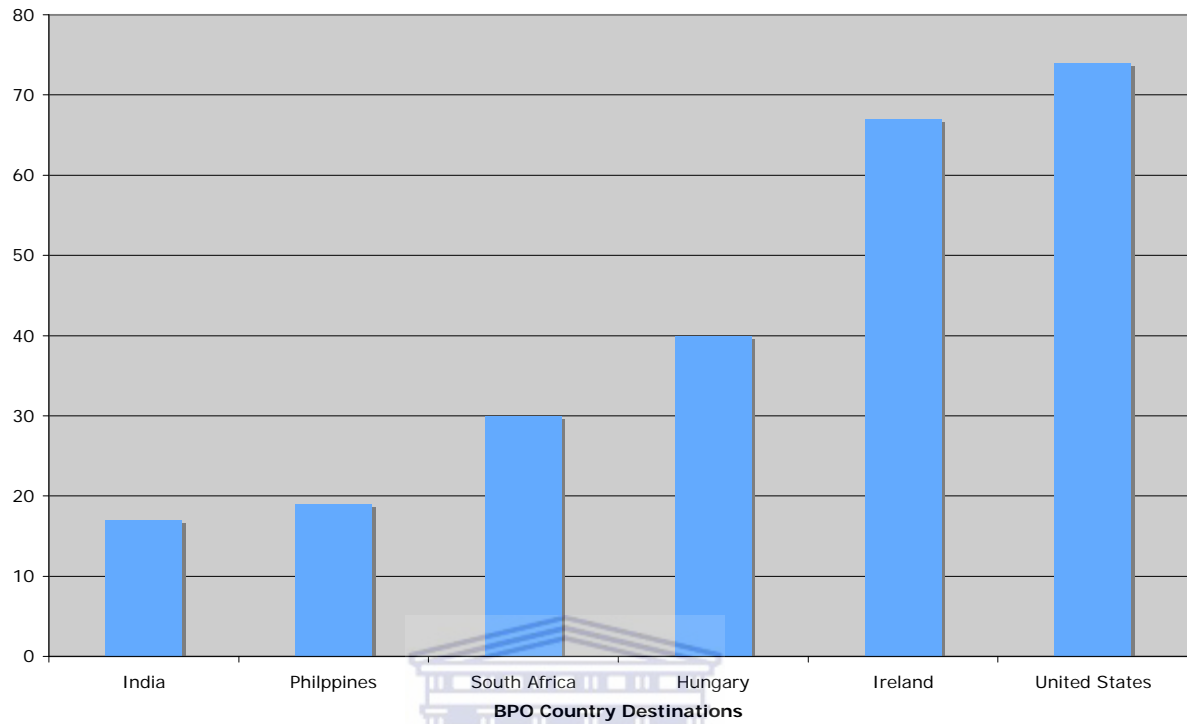


Figure 5.4.1.a Cost Comparison of BPO Operations (McKinsey, 2005, P: 7)

- ii. **Pillar Two – Structural distinctiveness.** South Africa can build a value proposition around quality and service provision. Its cultural & language familiarity with Western countries are a distinct advantage in this regard, and its strength in high-value specialist areas such as Insurance and Banking is also notable. It's limited but proven track record, compared to other BPO providers, in proving high-value service to leading offshore clients, also adds to this positioning of quality and service provision (at a suitable price).

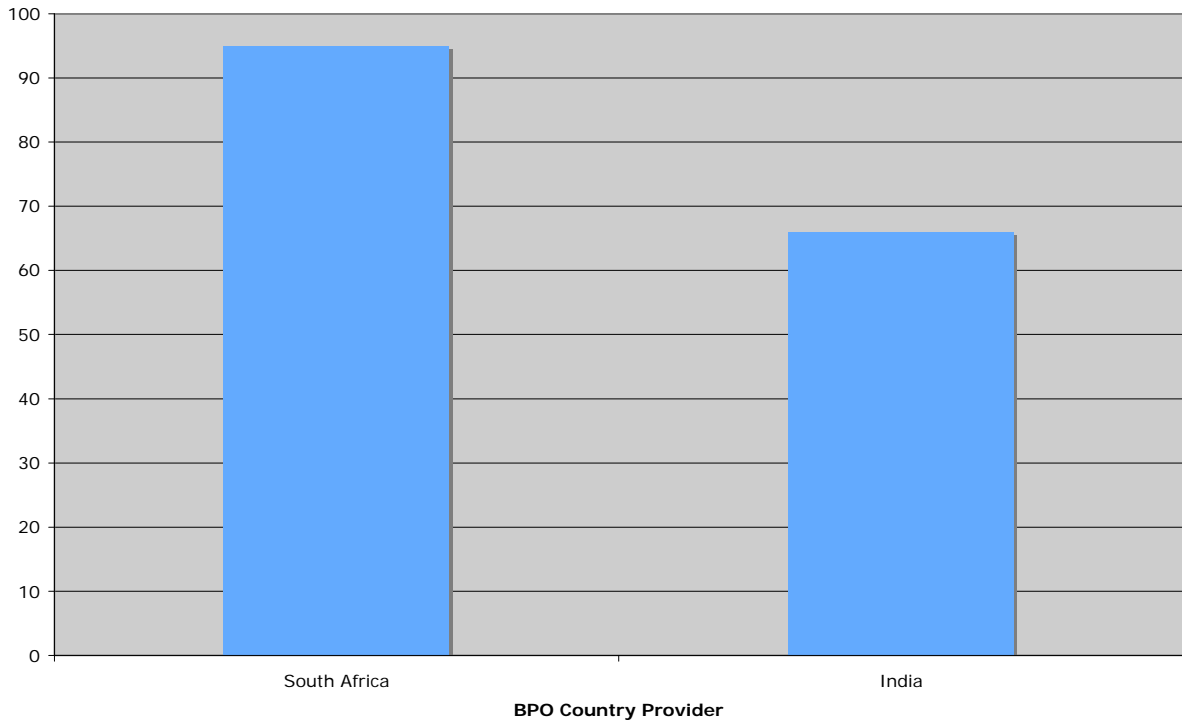


Figure 5.4.1.b Service Quality Comparisons (McKinsey, 2005, P: 8)

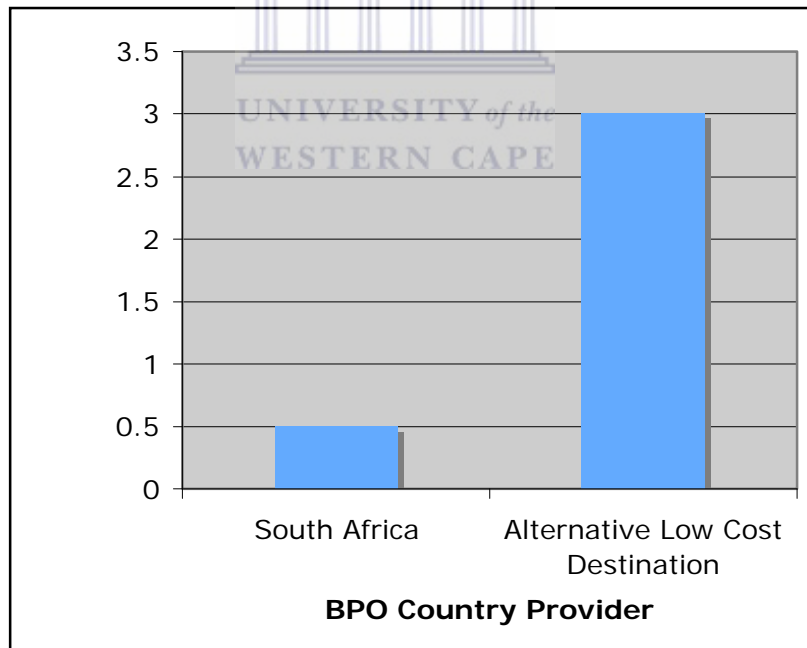


Figure 5.4.1.c Comparison of Performance against Service Level Agreements (www.bpesa.org.za, 2007, P: 2)

- iii. **Pillar Three – Public Sector Commitment to Cost Improvement.** While South Africa’s value proposition is based around quality service provision, cost competitiveness will always remain a key dimension in the BPO arena. It is critical to continue to improve cost reductions by facilitating

enhanced competitiveness in the telecoms arena, and actively developing and broadening the talent pool. Government has recently begun to actively support this sector and economic incentives for companies to offset some of their operational cost disadvantages in the short and medium term are necessary,

South Africa's strengths provide a good foundation to develop a unique value proposition as a preferred Tier 2 BPO destination; however, there are also real and perceived obstacles that require attention.

5.4.2 Weaknesses and Shortfalls in the South African BPO sector

From a potential investors perspective, there are a number of notable deterrents to offshoring to South Africa. These include (McKinsey, 2005. P: 13):

- i. Inadequate cost competitiveness compared to preferred locations such as India and China, due to high labour rates and high telecoms costs.
- ii. Indications of talent shortages particularly at management level are becoming apparent, and shortages at agent level may develop as the industry grows.
- iii. The unfavourable regulatory framework with regard to labour inflexibility; the lack of financial and non-financial incentives compared to those provided by competing nations (although this is now beginning to change with the launch of new incentives by the DTI); and set-up assistance where it is quicker to complete set-up requirements and company registrations in competing countries.
- iv. Marketing and development of the BPO sector has, until recently, been fragmented and uncoordinated, within industry participants and especially as a coordinated effort between government and private sector.
- v. A small third party vendor (or Outsource provider) landscape, where there are only three to five large players with experience of migrating international businesses, compared to the 30-40 in the Philippines and the more than 250 in India.
- vi. Personal security risk perceptions, which are high with high crime and HIV/AIDS levels in South Africa.

5.5 Proposed Strategic Initiatives for Development of the BPO Sector in South Africa

Studies outline a set of five key strategic initiatives to successfully develop the South African BPO sector into a competitive Tier 2 player, and access the associated development and economic opportunities (McKinsey, 2005. P: 13):

- i. **Focused Strategic Marketing Initiatives.** A coordinated effort by both industry and government must be made to develop and communicate a consistent and coherent message, targeted and tailored for priority audiences, which is supported by the ability to deliver on these promises. This

would entail crafting a compelling value proposition and associated message that differentiates South Africa on the basis of quality and service provision in selected high-value growth industries such as banking and insurance, and positioning South Africa as the supplier of choice across the value chain within these industries (McKinsey, 2005. P: 14). The marketing effort, supported by tailored incentive and support packages, should focus on targeting 30-40 key potential clients with the intent of successfully attracting at least three to four multinational Captives, and again at least three to four large third party vendors, which will act as high-profile catalysts or champions of South African BPO centre growth (McKinsey, 2005. P: 14). Efforts should be made to capitalise on and extend existing relationships with leading multinationals, with decentralised back-office operations, which have strong presences in South Africa or the African continent, to consider BPO in South Africa (McKinsey, 2005. P: 14).

- ii. **Comprehensive Talent Development.** A coordinated effort, again by private sector and government, must focus on training, certification, and promotion for the BPO industry, in order to develop an available agent pool of between 40000 and 60000 a year, and a competent middle-management pool (McKinsey, 2005. P: 14).
- iii. **Favourable regulatory framework and investor support.** South Africa's BPO industry will benefit from a regulatory environment that results in further labour flexibility and cost competitiveness across the telecoms value chain. Formulating a BPO sector strategy and the associated incentive packages, as has been done by government in partnership with industry, is a positive step, and this needs to be supported by further incentives that motivate providers to reduce the cost of operations by 20-30% from current levels, and by ad hoc incentives specifically designed to secure high-profile investors (McKinsey, 2005. P: 14). Improved set-up assistance is also required to be competitive to that provided in other BPO destinations.
- iv. **Strengthening governance and quality assurance within the industry.** As new company market entrants aggressively pursue opportunities in the BPO industry there will be a risk that quality and service provision is eroded. It is critical that a strong industry body formulate and enforce a standard of quality assurance. It has been seen in the experiences of other BPO destinations that significant investments in training and attracting experienced international talent can develop the local industry (McKinsey, 2005. P: 14).
- v. **Building programme management capability and longer-term institutional arrangements for the industry.** Continuing efforts must be made to develop a programme management office and strong industry bodies (at national and regional levels) to champion the industry and coordinate the provision of marketing, talent development and knowledge services to industry players (McKinsey, 2005. P: 14). South Africa has already made headway in this regard with a newly established national industry body and active regional organisations in Gauteng, the Western Cape, Eastern Cape, and KwaZulu-Natal. A high degree of coordination and partnership between government, industry and labour will be required to successfully develop South Africa into a success Tier 2 provider that results in shared and accelerated growth.

In order to spread the economic wealth and stimulus benefits, and facilitate shared growth, should also, in a transparent manner, allocate or channel inbound BPO investment to various regions where appropriate.

5.6 Chapter Conclusion

South Africa's emerging BPO industry is already on global radar screens, and has the capacity and foundations to position itself competitively in the context of global growth in demand for BPO services, and develop into a competitive global Tier 2 player. If it addresses some critical weaknesses and builds on its unique strengths, the South African BPO industry, in a coordinated effort with government and labour, can grow to capture a significant share of the international market demand, which will make a significant contribution to GDP in upcoming years and can translate into notable new direct and indirect jobs. This will contribute to South Africa's stated development aims of shared and accelerated growth.



6. Conclusion

Through a specific enquiry into the BPO sector and its economic and development impact, this study set out to understand if Service Sectors, particularly high-value services such as BPO, are increasingly relevant to economic development strategies for developing countries, and specifically South Africa. As this study shows through the enquiry into the BPO sector, there is clearly a case for Services sectors, and specifically 'exportable' service sectors, to play an increasingly important role in modernisation and economic development strategies, and there are grounds for development strategists and planners to focus further efforts into the development of 'exportable' service sectors. Specifically, in South Africa, there is a valuable opportunity, through a focused and coordinated national effort, to aggressively promote, grow, and support the BPO industry, which can result in achieving the twin development objectives of both economic value creation and job creation.

The review of the relevant development theories and its evolution highlights the development of the Services Sector, and particularly highly-skilled services, as an attractive and more relevant approach for today's developing economies, as opposed to the traditional industrialisation and manufacturing approach. Initially, development theorists, within an evolutionary framework, advocated that emerging or developing countries mimic the development path of successful developed economies, where industrialisation and development of the manufacturing sector played a central role. This leaning towards industrialisation and manufacturing was reinforced as development theorists looked at the sustained growth (from the late 1950's well into the 90's) of South Korea and other Asian Tigers, also termed Newly Industrialised Countries (NICs). Export-led industrialisation played a key role in these countries and development theorists, now within a Neo-Marxist framework, saw this as a model for other developing economies, including South Africa, to emulate (Gereffi, 1989). However, in recent years, due to various factors including increased globalisation, technological and telecommunications progress (Castells, 1996), the change in developing countries' factor of endowments, and significant cost and quality manufacturing competition from countries like China, evidence points to the declining importance of industrialisation in national economies and challenges development theorists to rethink development (Gereffi, 1989). The growing potential for 'exporting' services places the development of the Service Sector higher on the agenda of policy planners and development theorists.

This shift is supported by the evolution of New International Division of Labour Theory (NIDL) to a 'Newer' International Division of Labour Theory (NIDL2). NIDL explained the development of substantial manufacturing sectors in developing countries, moving them beyond merely being exporters of primary goods, by the confluence of three factors: the reduced importance of geographical location for production due to technological progress; technological and organisational developments that enabled complex production tasks to be broken down into basic steps allowing unskilled workers to learn the steps quickly; and a limitless supply of cheap labour in developing countries (Hutchinson, 2004). However, NIDL asserted that developed countries would retain the skill-intensive tasks and developing countries would permanently be relegated to the periphery with only the labour-intensive tasks. In recent years, as developing countries continued to upgrade their human resources and technology continued its steady

progression, we have seen skill-intensive tasks increasingly being outsourced to the periphery. This has given rise to the 'Newer' International Division of Labour Theory (NIDL2) where the core-periphery structure has been superseded and high-performing regions in both developed and developing countries carry out tasks of varying skill and technological intensity (Hutchinson, 2004).

The emergence of BPO in developing nations is a remarkable example of NIDL2 and the growing significance of 'Exportable Services' to economic development strategy. BPO's remarkable contribution to economic growth in India and certain other developing countries has certainly caught the attention of policy planners and development theorists the world over. BPO work, in 2004, accounted for 2.5% of India's GDP (Caldwell, 2004. P: 1), and it is estimated that the sector will employ between 900000 and 1000000 people in India by 2008 (Dossani and Kenney, 2003. P: 8). The 2003 UNCTAD E-Commerce and Development Report (UNCTAD, 2003. P: 56) states that 'from a development perspective, outsourcing has demonstrated its viability and success in India'. India's successful BPO sector and its considerable contribution to India's economy and development, is an important case study for any emerging nation planning its development path in today's globalised environment. India's success proves the development case for BPO and has some useful lessons for other national pretenders.

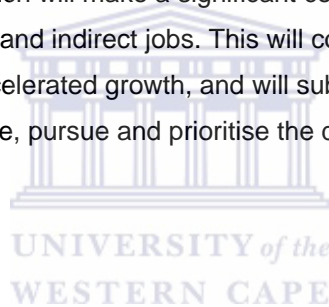
To date, economic growth in South Africa, has largely bypassed the majority of South Africans who lack the skills and opportunities to access the mainstream economy. Economic growth, since 1994, has also been relatively muted compared to other developing countries although there has been some increased gains in recent years. In order to accelerate growth and relieve supply-side bottleneck constraints, development policy has evolved from relatively hands-off macro-economic policies to added initiatives, such as those outlined in the ASGI-SA strategy, that play a more developmental hands-on role. As service sectors have, both locally and internationally, been playing larger economic roles, key service sectors have been specifically identified in South Africa that can contribute to shared and accelerated growth. BPO has been singled out as one of these key sectors and is receiving focused attention from development policy makers who have formulated a comprehensive sector development strategy to grow South Africa into a globally competitive BPO Tier Two provider.

The global BPO sector is estimated to grow between \$50bn and \$60bn by 2008, creating 3 million direct jobs worldwide with an estimated 2 million of these jobs going to 'far shore' destinations such as India and South Africa (McKinsey, 2005. P: 4). BPO presents a valuable and effective opportunity for developing countries to grow the economy, earn foreign exchange, and create jobs. Demand for BPO services is certainly significant and growing, and is becoming more sophisticated and nuanced. Many countries, both developed and developing are actively positioning themselves as attractive BPO destinations. While the sectors in Tier One providers such as India and China are thriving, there is also a valuable opportunity for developing countries to position themselves as Tier Two providers to meet the surplus global demand. South Africa already has a small but burgeoning BPO sector that already places it in the second tier of major national BPO services providers, however, given the spectacular global growth projections and the associated surplus demand, there continues to be a valuable opportunity to actively position and develop

the South African sector to be a major beneficiary of this confluence of growth and demand, accelerating local economic growth and job creation.

South Africa's emerging BPO industry is already on global radar screens, and has the capacity and foundations to position itself competitively in the context of global growth in demand for BPO services, and further develop into a competitive global Tier Two player. If concerted efforts are made, South Africa can create a US\$0.8bn BPO industry by 2008, attracting cumulative FDI of up to US\$175m, and creating 100000 new jobs (McKinsey, 2005. P: 2). This requires a coordinated effort by all the national players to craft and communicate a compelling value proposition and associated message that differentiates South Africa on the basis of quality and service provision in selected high-value growth industries such as banking and insurance, positioning South Africa as the supplier of choice across the value chain within these industries (McKinsey, 2005).

If it addresses some critical weaknesses and builds on its unique strengths, the South African BPO industry, in a coordinated effort with government and labour, can grow to capture a significant share of the international market demand, which will make a significant contribution to GDP in upcoming years and can translate into notable new direct and indirect jobs. This will contribute to South Africa's stated development aims of shared and accelerated growth, and will substantiate further efforts for development strategists and planners to investigate, pursue and prioritise the development of other 'exportable' service sectors.



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Appendix 1 - Definitions

These are the definitions of key terms used within this thesis. (Please note that other researchers in other contexts may define these terms differently.)

BPO:	This is the abbreviation for Business Process Outsourcing. Business Process is the broad term for the myriad of white-collar processes that any bureaucratic entity undertakes in servicing its employees, vendors, and customers. Business Processes include human resources, accounting, auditing, customer care, telemarketing, tax preparation, claims processing, document management, and many other chores necessary for firm functioning. The completion of a Business Process is the result of an entire chain of bureaucratic activities. All of these actions represent a cost to the firm (Dossani and Kenney, 2003. P: 9). Efficient organisation of these processes can achieve significant savings, and these processes have become increasingly digitised. The electronic digitisation of a business process, improving communication technologies and the Internet increasingly permits changing its geography of provision. Outsourcing refers to the movement of the provision of services and the associated jobs from within an organisation, by the organisation, to outside third party providers, who can usually provide these services more cost effectively and efficiently. Outsourcing and Offshoring will be used interchangeably for the purpose of this study.
Captives:	Captives are operations that only service the in-house needs of its multinational company owners.
ITES:	This is the abbreviation for Information Technology Enabled Services and may, for the purposes of this study, be used interchangeably with BPO.
Offshoring:	Offshoring is the movement of the provision of various 'white-collar' services, and the associated jobs, from developed countries to low cost, usually highly educated, developing regions. The jobs, by association, refer to any service that can, aided by communications technology, be performed remotely. Offshoring can either be from a firm to third-party providers or by firms to their own facilities set-up in developing countries. Outsourcing and Offshoring will be used interchangeably for the purpose of this study.
Outsourcing:	Outsourcing refers to the movement of the provision of services and the associated jobs from within an organisation, by the organisation, to outside third party providers, who can usually provide these services more cost effectively and efficiently. Outsourcing and Offshoring will be used interchangeably for the purpose of this study.

Third Party Vendors:	These are multinational firms who are BPO service providers themselves. They may have long established customers and have operated service facilities in many locations. They are sometimes referred to as Outsourcers or Multinational Outsourcers.
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