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06/06/09

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SACCCOM

**PRESENTATION TO THE
PARLIAMENTARY PORTFOLIO COMMITTEE ON
COMMUNICATIONS**

OLD ASSEMBLY CHAMBER, CAPE TOWN

9th OF JUNE 2006

Founder Members:

• _____

Associate Member:

1. INTRODUCTION

- 1.1. The South African Contact Centre Community ("SACCCOM") would like to thank the Portfolio Committee on Communications ("the Portfolio Committee") for giving it the opportunity to make this written submission and to subsequently make oral presentation.
- 1.2. SACCCOM was founded in 2004 as the national co-ordination body for the Business Process Outsourcing industry ("BPO"), whose vision is to represent a strong and sustainable industry in South Africa that contributes significantly to national job and wealth creation.
- 1.3. SACCCOM will, in relation to the BPO, act for, on behalf of and in the interests of its collective membership to develop and co-ordinate strategy, policy and supporting initiatives, including developing partnerships with government and other stakeholders, designed to:
 - 1.3.1. build and maintain national profile and credibility under the SACCCOM brand;
 - 1.3.2. market, position and promote South Africa as an attractive destination for investment;
 - 1.3.3. drive and co-ordinate national initiatives to develop a pool of appropriately skilled talent;
 - 1.3.4. promote and support sustainable transformation within the industry;
 - 1.3.5. grow the industry base across all regions of South Africa, on a geographically equitable basis;
 - 1.3.6. promote and support the emerging small and medium enterprise ("SME") sector; and/or
 - 1.3.7. promote, foster and recognise service excellence.
- 1.4. Currently SACCCOM's stakeholders and/or constituency, as represented by the existing and prospective members whom it represents and to whom it provides services, is comprised of or may be classified as follows:

- 1.4.1. *Foreign direct investors:* Overseas entities that are client users of captive and/or outsourced services provided from South Africa.
- 1.4.2. *Corporate entities:* Domestic corporate entities that are client users of captive and/or outsourced services provided from South Africa, grouped by industry sector, as follows:
- Automotive and Manufacturing;
 - Financial Services;
 - Healthcare;
 - IT, Electronics, Broadcasting and Telecommunications;
 - Retail, Entertainment and Hospitality; and
 - Travel and Transport
- 1.4.3. *Public service entities:* Domestic public service entities that are client users of captive and/or outsourced services provided from South Africa, grouped by activity, as follows:
- Public Services: Agency (national, provincial or municipal, as appropriate); and
 - Public Services: Government (national, provincial or municipal, as appropriate).
- 1.4.3.1. *Service providers:* Nationally active industry service providers, grouped by activity, as follows:
- Providers of outsourced services;
 - Providers of human resources-related support services to the industry (e.g. staffing solutions, training); and
 - Providers of other support services to the industry (e.g. consultancy, technology, research).
- 1.4.4. *Regional associations:* Regionally-focused industry associations.

2. THE BUSINESS PROCESS OUTSOURCING AND OFF-SHORING (BPO&O) OPPORTUNITY FOR SOUTH AFRICA¹

2.1. The Business Process outsourcing and off-shoring industry

- 2.1.1. Business process outsourcing and off-shoring ("BPO&O") is a major global activity which has been proven to have a significant positive impact on employment and economic wealth creation in developing countries that have the required skills, cost advantage and infrastructure.
- 2.1.2. Contracting external agents to perform certain business functions is not new, but collaboration between companies and external service providers (who are off-site and increasingly off-shore) has increased rapidly with the universal use of email and the availability of high bandwidth and web-based connections.
- 2.1.3. This has given birth to a rapidly expanding BPO sector which forms part of the greater services industry but which is not formally classified. It is made up of eight sub-sectors namely:
 - 2.1.3.1. IT and Technical Services;
 - 2.1.3.2. Call Centre Functions;
 - 2.1.3.3. Financial Accounting and Administration;
 - 2.1.3.4. Human Resource Functions;
 - 2.1.3.5. Data Conversion, Entry and Scanning;
 - 2.1.3.6. Administration and Maintenance;
 - 2.1.3.7. Insurance Industry Functions; and
 - 2.1.3.8. Website Design and Development².

¹ **Outsourcing** occurs when a company uses a third party to carry out certain of its business processes and **Off-shoring** occurs when these activities are performed in a foreign location.

² Dti BPO&O Sector Development Strategy, Chapter 1, p.7

2.2. BPO is acting as a trigger for job creation and community development in developing countries

2.2.1. Because of the channel through which the service is delivered (telephone, email and internet) the service can be provided from anywhere in the world where there is adequate infrastructure and skills at competitive costs. Developing countries like India and the Philippines have benefited significantly from this trend and will continue to do so. India forecasts 1 million new jobs from BPO by 2008. Others, like China, will also capitalise on this growing market.

2.3. BPO has the potential to make a significant contribution to accelerating and sharing growth in South Africa.

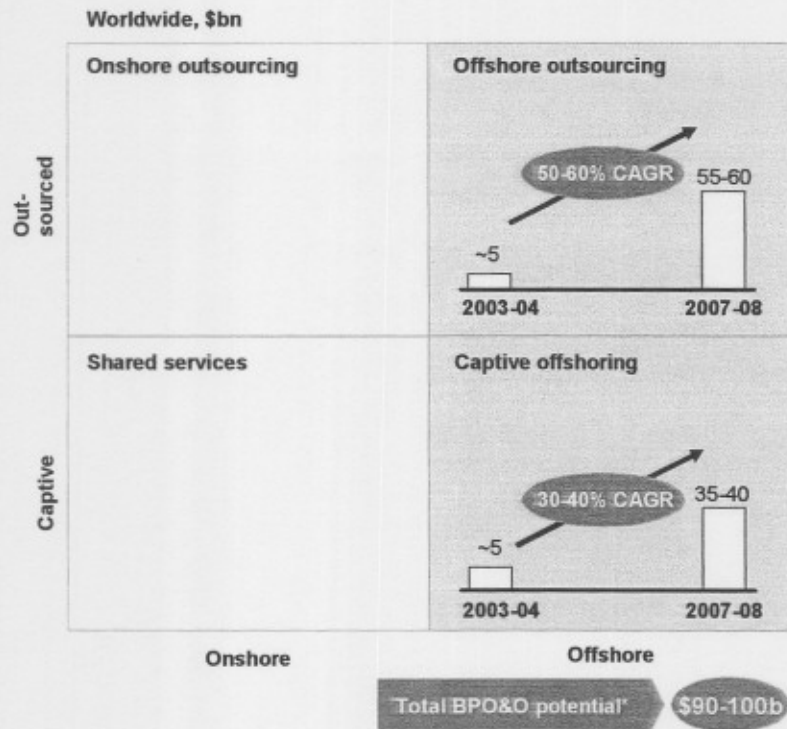
2.3.1. The Department of Trade and Industry commissioned work in 2002 as a basis for a Customised Sector Programme and the development of sector support strategies. At about the same time the private sector participated in a research programme on the potential of the BPO sector. These studies showed rapid growth in this sector world wide, its potential for a positive impact on developing countries and the opportunity for creating 100 000 jobs in South Africa over the next five years³.

2.3.2. The global BPO&O industry is set to grow by 50% p.a. (resulting in growth of between \$90bn and \$100bn U.S.) for the next 4-5 years, and as a result a window of opportunity exists for South Africa to realise significant value by developing this sector of the economy (see Exhibit 1).

³ Dti BPO&O Sector Development Strategy, Chapter 1, p.7

EXHIBIT 1: THE TRADITIONAL ENGLISH BPO&O MARKET (U.S AND UK) COULD GROW TO \$90-100b BY 2008

□ Growth opportunity for SA



'While the total BPO&O market potential is around \$150b by 2008, only 40% of the opportunity will be captured by 2008'

Evalueserve (offshoring consulting firm)

'Gartner estimates that the BPO market will grow to \$173b by 2007, of which 14% of the delivery will be from offshore centres'

Gartner global offshore sourcing predictions, June 2004

* Including IT offshoring of \$40 bn
Source: Team analysis

2.3.3. The sector has the potential to create 100 000 new jobs in South Africa (25 000 direct and 75 000 indirect)⁴ and contribute up to R7.9bn⁵ in Gross Domestic Produce ("GDP") to the economy by 2009. (See Exhibit 2).

⁴ Using indirect job multiplier of 3, comparative multipliers are: Financial Services - 2.3, gambling - 3.1, Trade, catering and accommodation - 4.9 and Motor Vehicle - 6.3. (Source: IDC, Paper on Trade and industrial policy for the service sector)

⁵ Using a GDP multiplier of 1.63, which is calculated based on economic models for determining the GDP multiplier

EXHIBIT 2: SA CAN CAPTURE PART OF THE BPO&O MARKET, CREATING 100 000 NEW JOBS

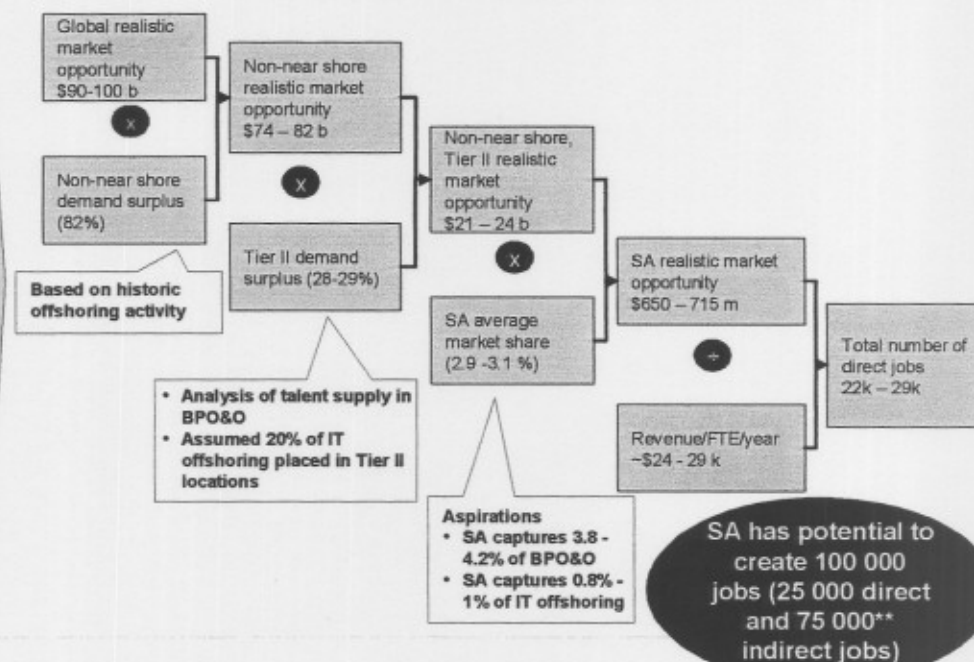
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ESTIMATE

Approach

- Calculated realistic market opportunity in BPO&O industry for 2008
- Determined demand that will be placed on price performance (non near shore demand)
- Evaluated supply from Tier I locations to determine demand surplus that will need to be met by Tier II locations
- Quantified realistic SA market opportunity using scenarios based on the % of Tier II demand that South Africa can capture in various industry verticals
- Calculated number of jobs that could be created using a range of revenues/ FTE

Job creation opportunity in BPO&O



* Direct jobs are people employed in BPO&O centres, Indirect jobs are for people providing support to BPO&O industry and to employees in BPO&O industry

** An indirect job multiplier of 3 has been used (for each direct job 3 indirect jobs will be created)

Source: Team analysis

1

2.3.4. This has the potential to impact significantly on rural as well as urban communities. The current cost of telecommunications, however, linked to the lack of incentives for operators in this sector, means that we run the risk of not realising this job creation potential.

2.3.5. In addition there would be a number of positive side-effects including:

- Social benefits as a result of improved quality of life due to development and increased employment within the local economy;
- Knowledge enhancement as a result of the increase in the pool of highly skilled labour and the capacity of public and private training providers to service the industry;
- Enhanced image of the "South Africa brand" by promoting the country as a leading player in the knowledge economy; and

- Infrastructure improvement arising from improvements in information technology and related services and utilities.

2.3.6. The Accelerated and Shared Growth Initiative of South Africa (ASGI-SA) has identified BPO&O as one of the priority sectors for accelerated growth initiatives. President Thabo Mbeki also emphasised this during his "State of the Nation" address at the opening of Parliament on the 3rd February 2006.

2.4. SA is in a good starting position to capitalise on this opportunity

2.4.1. South Africa's strengths include:

- Strong capability in the highest growth sectors of financial services and insurance;
- English language capability;
- Stability;
- Quality of life;
- An attractive business environment;
- A small but growing BPO industry; and
- Cultural affinity with key markets in the United Kingdom and United States of America, being the industry's primary market.

2.4.2. This is evidenced in the value of new business some of the operators are signing as of late. IBM SA, an operator in the industry, is set to sign new business deals worth \$385 million this year. IBM SA expects to fortify its position in SA and favourably position the group for the next six to seven years. Merchants, a subsidiary of Dimension Data, has recruited and trained over 5 000 previously unemployed PDIs who were successfully deployed and placed on some of their international contracts over the past few years.

2.4.3. Although South Africa has a large and growing domestic BPO market with strong human resource skills, cultural appeal as well as high growth industry sectors (i.e. insurance and financial services sectors) to exploit this potential opportunity, it has been unsuccessful in attracting much needed investment from European and American multinationals. This failure is in stark contrast to the rapid development of BPO&O industries in India and the Philippines. Both these countries have managed to establish rapidly growing BPO industries which in turn have

significantly contributed to growth, development and job creation within India and the Philippines.

2.4.4. One of the factors which SACCCOM has identified as a disincentive to attracting international investment into South Africa's BPO&O industry is the high cost of telecommunications. As telecommunications is core to the operation of a successful BPO&O industry, the high cost of telecommunications has made it simply impossible for South Africa to compete with countries such as India and the Philippines who are able to provide this input to investors at significantly lower prices than South Africa is able to offer.

2.4.5. Of particular concern to SACCCOM is the high cost of international telecommunication services as these costs have a direct bearing on South Africa's inability to attract foreign investment into the South African BPO&O sector. Over the past two years, the industry has lost major international opportunities which could be directly attributed to the high costs of the telecommunications. This is still continuing.

3. CHALLENGES THAT NEED TO BE ADDRESSED

3.1. In order to capitalise on the opportunity, as presented by the BPO&O industry, of creating new jobs and generating sustainable economic growth over the next three to five years, South Africa must move fast to meet a number of critical challenges. This can be done by first addressing a number of key strategic challenges that stand in the way of achieving the potential for job creation and economic growth, such as:

3.1.1. High telecommunications costs;

3.1.2. Higher cost of operations than key competitors driven primarily by labour and telecommunications;

3.1.3. Negative perceptions of operational risks;

3.1.4. Relative difficulty in setting up new operations in South Africa;

3.1.5. Challenges with some enabling regulations;

3.1.6. A limited vendor landscape (very few major anchor clients);

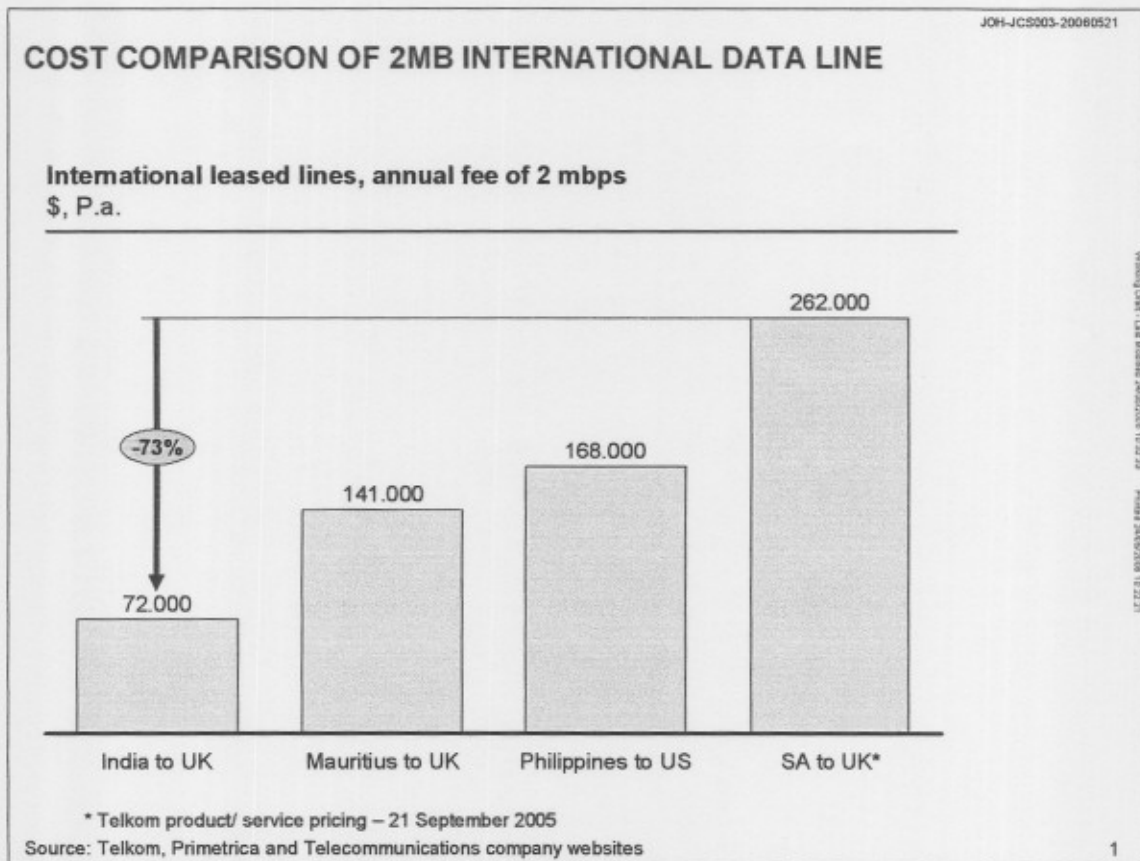
3.1.7. An uncompetitive and comparatively expensive technology infrastructure; and

3.1.8. An ineffective marketing effort.

4. TELECOMMUNICATION COSTS AND ISSUES TO BE ADDRESSED

4.1. The telecommunications cost differential between operations in South African and other offshore locations like India and the Philippines amount to R23m per annum for a 1000 seat BPO&O centre and account for about 20% of the total cost gap between these countries. This cost gap in telecommunications costs for a 1000 seat BPO&O centre is driven by differences in costs of:

4.1.1. Leasing a 2mb international line which is approximately \$186 000⁶ per annum per line in South Africa as opposed to \$72 000 per annum in India or \$168 000 per annum in the Philippines.



⁶ Based on Telkom offering for call centres

- 4.1.2. Calling costs in South Africa of approximately \$2.6m. These costs are not incurred in India and the Philippines as 2mb international lines are used for both voice and data. In South Africa while it is possible for companies to use 2mb lines for both voice and data, most South African operators prefer to use Telkom's per minute calling package due to lack of scale. As an illustration, labour is 70% of call centre costs for local call centres. This changes only 30% to when international calls are involved due to high international call costs.

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ESTIMATE

THE MAJOR DRIVERS OF THE \$3 M TELECOM COST DIFFERENTIAL ARE LEASE LINE (LOCAL AND INTERNATIONAL) AND CALLING COSTS

\$ p.a. for 1000 seat BPO&O centre

	SA*	India	Philippines
Number of 2 mb lines	5	9	9
Cost per line	\$262,000	\$72,000	\$168,000
Lease line costs	\$1,310,000	\$648,000	\$1,512,000
Calling costs per minute	0.05	0**	0**
Calling costs	\$2,659,000**	0**	0**
Total telco costs***	\$3,969,000 (R27,187,650)	\$648,000 (R4,438,800)	\$1,512,000 (R10,357,200)

While SA requires few international lease lines due to Telkom's end to end solution the higher calling costs make SA more expensive than India and Philippines

* Based on Telkom offering for call centres, with companies opting for end to end solution with per minute calling costs
 ** Calling costs are for Telkom's end to end VoIP offering. In India and Philippines BPO&O operators use lease line for
 *** Exchange rate of \$1:R6.85
 Source: Team analysis

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5. LABOUR COST COMPARISON

- 5.1. South Africa also has a higher labour cost than our main competitors. This is aggravated by the fact that the demand for skills outstrips the supply.

6. ADDITIONAL ISSUES TO BE ADDRESSED

- 6.1. Telecommunications services and availability are only limited to a single service provider. Investors on the other hand need at least two companies that can provide end to end solution and install their own fibre into their premises to create full redundancy.
- 6.2. Lack of Service Level Agreements, at the moment there are no companies that provide end-to-end SLAs, with Telkom only offering SLA for half the circuit.
- 6.3. This makes investment in South Africa extremely risky for major investors and is a deal breaker for most.

7. THE BPO&O SECTOR SUPPORT PROGRAMME

- 7.1. To address these challenges, government and business have agreed to work together, so that:
 - 7.1.1. The Department of Trade and Industry (the dti) has held a number of industry consultations which have received positive responses;
 - 7.1.2. The President's Big Business Working Group agreed that business and government should work together to exploit the window of opportunity that will be available to South Africa over the next 3 years and asked the Business Trust to help organise the concerted action that will be required; and
 - 7.1.3. The Business Trust agreed to support the development of the BPO sector in partnership with the dti, and approved over R100m in funding to facilitate the implementation of a business plan developed under the guidance of a leadership group of business leaders and senior officials.
- 7.2. A BPO&O Sector Support Facility (BPO&O SSF) has been established by the Business Trust and the dti supported by SACCCOM. Teams of experts with experience in BPO strategy, marketing, incentive development, training, organisation and management have been employed to take the programme through its initial start up phase which runs from September 2005 to end of June 2006. In the start up phase the programme has focused on 5 work streams in order to:

- 7.2.1. Support the effective marketing of South Africa as a competitive Business Process Outsourcing location;
- 7.2.2. Create an enabling environment of incentives and infrastructure to support the sector;
- 7.2.3. Develop and deepen the pool of internationally competitive talent;
- 7.2.4. Support the industry body to restructure and mobilise itself to represent all key stakeholders; and
- 7.2.5. Control the quality of the South African offering.

8. RECOMMENDATIONS/WAY FORWARD

- 8.1. Reducing telecommunications costs could be achieved through the introduction of greater competition. Progress on deregulation and the implementation of recommendations from the telecommunications colloquium working group has been slow to date.
- 8.2. In addition to creating a regulatory framework which is conducive to competition, there are other cost components which SACCCOM would like the Portfolio Committee to note, namely:
 - 8.2.1. High cost of international bandwidth – In a recent study of the South Africa Foundation of April 2005 entitled "Telecommunications Prices in South Africa", a comparative study was done in respect of the pricing of international services. In the South African Foundation survey, South Africa priced its domestic and international bandwidth at a significantly higher price than the 11 (eleven) other countries surveyed, including middle income developing countries.
 - 8.2.2. Access to the undersea cables – One of the main reasons for the high costs of international telecommunication services is the monopoly which Telkom exercises over the landing rights and access to the undersea cable. It is imperative that other operators be granted access to the undersea cable at wholesale rates and on the same terms and conditions as Telkom. Regulations which robustly regulate access to the undersea cable are urgently needed as such regulations will inevitably precipitate a reduction in international bandwidth costs.

8.2.3. Manner in which international private leased circuits are made available by Telkom – The cost associated with leasing international private circuits ("IPLS") from Telkom are prohibitive. This is due to the fact that these facilities are made available by Telkom to other telecommunication service licensees at retail rather than wholesale rates. The leasing of telecommunications facilities must be strictly regulated and controlled by ICASA.

8.2.4. Door to door connectivity – All other global operators are able to offer their customers 'door to door' international connectivity, yet Telkom will only provide a service up to its points of presence in the United States of America and Europe. This means that South African entities that use Telkom's international services are required to enter into separate contracts with foreign domestic providers. This in turn increases the cost of doing business and reduces business efficacy.

8.2.5. Benefits of reduced bandwidth costs – SACCCOM believes that it will be most helpful if an exploratory debate could take place on the socio-economic effects of affordable bandwidth within the South African economy. It is expected that such a debate will enable policy makers to clearly identify the extent of such benefits and to then formulate appropriate policy for the realisation of same.

8.3. Furthermore, a major overhaul of competitive conditions in the sector is likely to take time and may result in South Africa missing the current window of opportunity to create jobs in the BPO&O sector.

9. CONCLUSION

9.1. SACCCOM would once again like to thank the Portfolio Committee for the opportunity to make these oral submissions and trust that they will assist the Portfolio Committee in its deliberations. SACCCOM would also like to point out that should it be able to be of any further assistance to the Portfolio Committee regarding this submission, it shall gladly avail itself.