



READY TO COMPETE

**SOUTH AFRICA'S BPO CAPABILITIES IN
THE FINANCIAL SERVICES SECTOR**

Executive Summary



Research commissioned through a partnership



The Department of Trade and Industry represents the Government in the Partnership and participates in the BPO Sector Support Programme through its Strategic Competitiveness Unit, situated in the Enterprise and Economic Development Division (EIDD).

<http://www.dti.gov.za/>



The Business Trust Business Process Outsourcing Support Programme has been established to enable actors in the public and private sectors to work together to establish South Africa as a preferred location for Business Process Outsourcing as a means of creating 100,000 jobs and thereby reducing unemployment and poverty.

<http://www.btrust.org.za/>



Business Process enabling South Africa is the national coordinating body representing the interests of the Business Process Outsourcing & Offshoring sector in South Africa. The organisation represents the industry and has 4 regional arms in Gauteng, the Western Cape, KwaZulu-Natal and the Eastern Cape.

<http://www.bpesa.org.za/>

Everest Group and Letsema Consulting were commissioned to conduct the research on behalf of the Partnership



ALIVE WITH POSSIBILITIES

A. Introduction and context

South Africa is emerging as an important destination for BPO. The service provider industry¹ in South Africa has achieved credible scale in BPO, currently employing ~30,000 people. Also, the industry has been growing rapidly at a rate of 33% per year.

South Africa's BPO program objectives include creating 100,000 direct and indirect offshore jobs by 2009. The program has achieved significant success to date. Several public and private sector initiatives have been put in place to attract more offshore BPO business to South Africa.

This report presents a deep, fact-based view of South Africa's current BPO capabilities and potential for growth in the Financial Services sector. In doing so, the report highlights South Africa's key differentiators with respect to other offshore destinations and the key risks and tradeoffs that investors need to consider.

As a starting point, the report outlines the significant growth potential in offshore Financial Services BPO and the opportunity for South Africa to participate in this growth phenomenon.

B. Global opportunity in offshore Financial Services BPO

The Financial Services (FS) sector continues to be the largest adopter of the offshoring model, accounting for ~45% for the global offshoring industry. The estimated current market size for offshore Financial Services BPO is ~US\$10 billion. Most leading global Financial Services majors have offshored significantly across a wide range of functions.

However, there is still significant growth potential for offshore Financial Services BPO. The estimated addressable opportunity is ~US\$250 billion, approximately 25 times the current market size. Growth opportunities exist across multiple functional areas, including both front-office and back-office work.

The recent financial crisis could have a short-term negative impact on FS companies' offshoring plans. However, in the medium-to-long term, these companies will look to offshoring to manage cost pressures. Hence, the medium-to-long-term growth outlook for offshore Financial Services BPO is robust.

As Financial Services majors grow their offshore footprint, they are looking beyond the leading offshore destinations (e.g. India, Philippines). This presents opportunities for South Africa to grab an increasing share of the global offshore Financial Services BPO market. South Africa has established a good starting point in Financial Services BPO, as described in the following section.

¹ Service providers includes third-party suppliers and offshore captives. Third-party suppliers include both global and local (i.e. South African) suppliers

C. Current service provider landscape for Financial Services BPO in South Africa

This report examines the service provider landscape for Financial Services BPO in South Africa from the following perspectives: scale of operations, delivery maturity, type of value delivered and client geographies served.

C1. Scale of operations

Service providers (suppliers and offshore captives) in South Africa have established credible scale in Financial Services BPO, employing ~11,000 people. While this scale is smaller compared to traditional offshore destinations (e.g. India, Philippines), it is comparable to the emerging offshore destinations such as Romania, Malaysia and the Czech Republic. In addition to the service providers, there are multiple, large-scale domestic Financial Services captives in South Africa. These domestic Financial Services captives employ ~65,000-75,000 people.

C2. Delivery maturity in Financial Services (FS) BPO

The following factors evidence the fact that service providers possess credible delivery maturity in FS BPO:

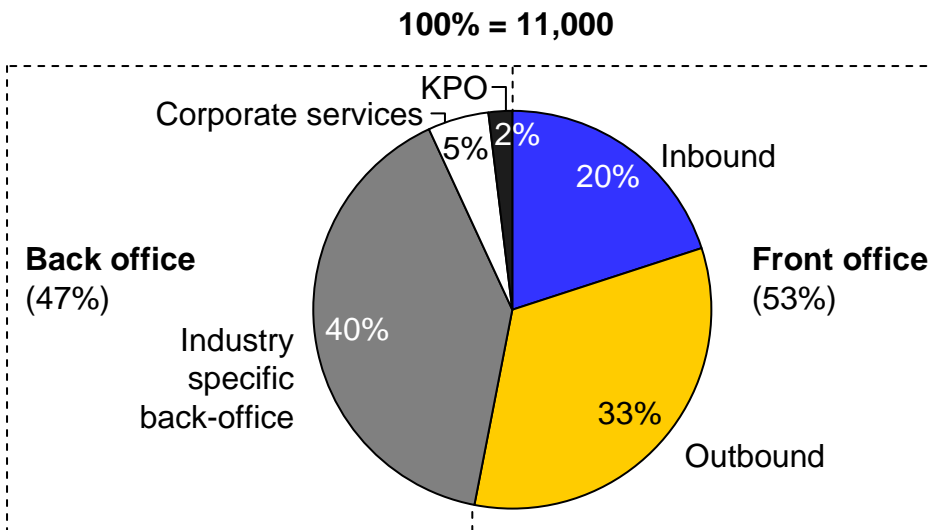
Significant client experience: Service providers currently serve ~240 FS clients across FS sub-verticals (retail banking, insurance, and asset management)

Breadth of process capabilities: While front-office capability is a key strength (~6000 employees across inbound and outbound functions), significant back-office work also exists (~5000 employees) as indicated in the chart below (**Chart 1**)

Chart 1: FS BPO Employee split across types of BPO functions

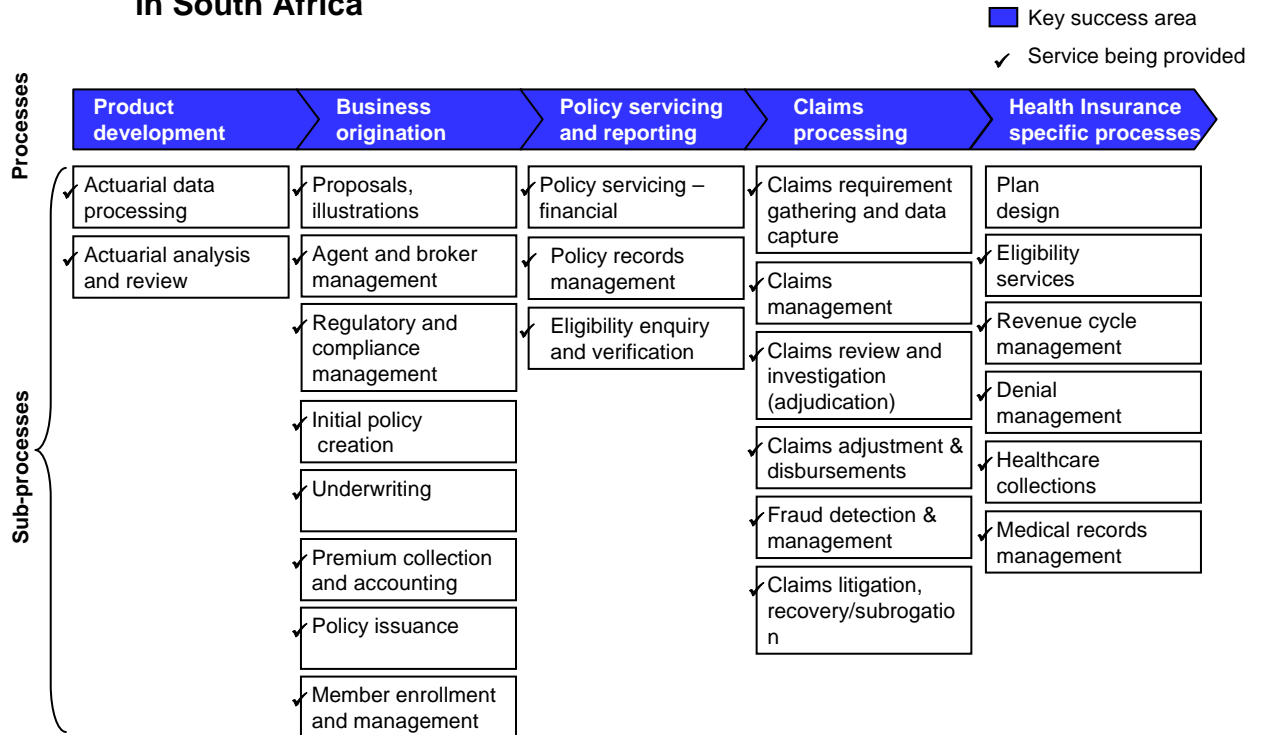
FS BPO employee split by BPO functions

Number of employees



Service providers support almost all outsource-able front-office processes (including inbound customer service, outbound sales and collections processes). In addition, service providers support ~75% of outsource-able FS back-office processes. Specifically, insurance back-office processes are a key strength, with service providers supporting nearly all (~95%) outsource-able processes.. **Chart 2** indicates the breadth of activity in the insurance back-office space.

Chart 2: Insurance-specific back-office processes supported by service providers in South Africa



C3. Value delivered beyond labor arbitrage:

The service provider industry continues to deliver robust cost benefits and is meeting clients’ quality and service level expectations. In addition, the industry is evolving to deliver business benefits beyond labor arbitrage in multiple ways, such as:

- Leveraging technology to drive process transformation
- Delivering a higher quality of service compared to the baseline (e.g. improved First Call Resolution, Customer Satisfaction, reduced Turnaround Time)
- Using strong domain skills to support sophisticated financial products and complex processes

C4. Client geography focus

While the focus to date has been on the domestic market, offshore activity is also emerging, with ~2,900 offshore jobs in Financial Services BPO. Back-office services constitute almost 50 percent of all offshore jobs. There are examples of early successes in offshore delivery of complex, high-end services, such as investment administration and actuarial modeling.

D. Potential for growth in Financial Services BPO

Although current offshore activity is nascent (~2,900 jobs), there is significant potential for growth. Four key drivers are:

1. Large experienced talent pool with service delivery and domain skills in the domestic Financial Services industry
2. Sizeable talent pool with specialized skills (e.g. actuaries)
3. Narrowing of operating cost differences between South Africa and other low-cost offshore locations
4. Availability of scalable, high quality English skills, at a low cost

These factors are described below:

D1. Large experienced talent pool with service delivery and domain skills in the domestic Financial Services industry

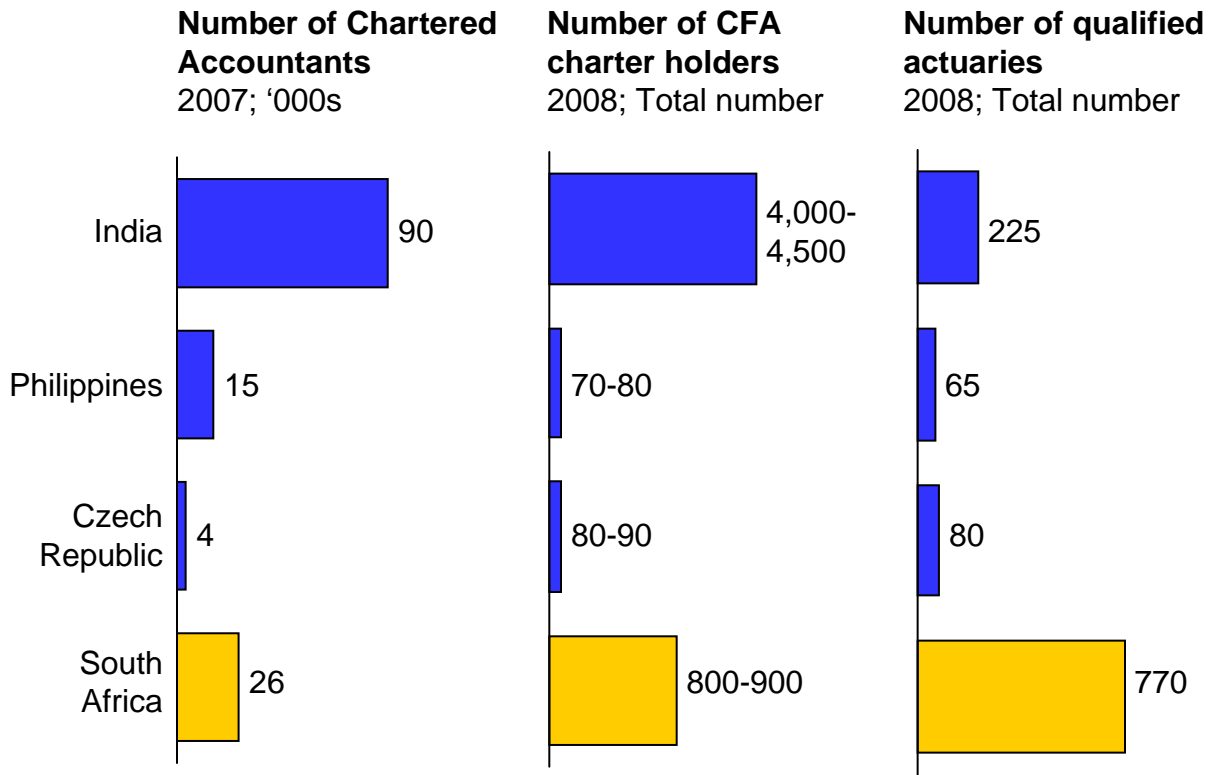
Service delivery skills: Domestic Financial Services captives have built significant scale. Many of these captives have achieved individual scale in excess of 4000 employees, with the domestic captive industry employing ~65,000-75,000 people overall. While these are captive entities, they are effectively being run like outsourced operations (e.g. through defined service level agreements with the parent companies). In addition, these captives have demonstrated distinctive capabilities, especially in the areas of process improvement, efficiency and six-sigma.

Domain skills: Products and regulations in South Africa's domestic Financial Services sector are similar to developed markets (e.g. UK) and are more advanced relative to most other offshore destinations. Therefore, the talent pool in South Africa's domestic Financial Services sector has strengths in terms of its knowledge and experience in working with advanced products and regulations. Also, the domestic sector has significant technology experience to draw upon. Historically, it has had a strong orientation towards technology adoption; a number of successful implementations (e.g. cellphone banking) evidence this orientation.

D2. Sizeable pool of specialized skills in the market

South Africa has a sizeable pool of specialized Financial Services skills such as actuaries and certified analysts. While the scale of these skills are not the largest in every domain relative to other offshore destinations, there are clearly certain pockets of meaningful scale. For example, South Africa has ~4 times the number of actuaries in India, as indicated in **Chart 3**. The presence of specialized skills positively positions South Africa to deliver complex Financial Services BPO processes.

Chart 3: Comparison of scale of niche skills in South Africa relative to other offshore destinations



D3. Narrowing of the operating cost differences between South Africa and other offshore destinations

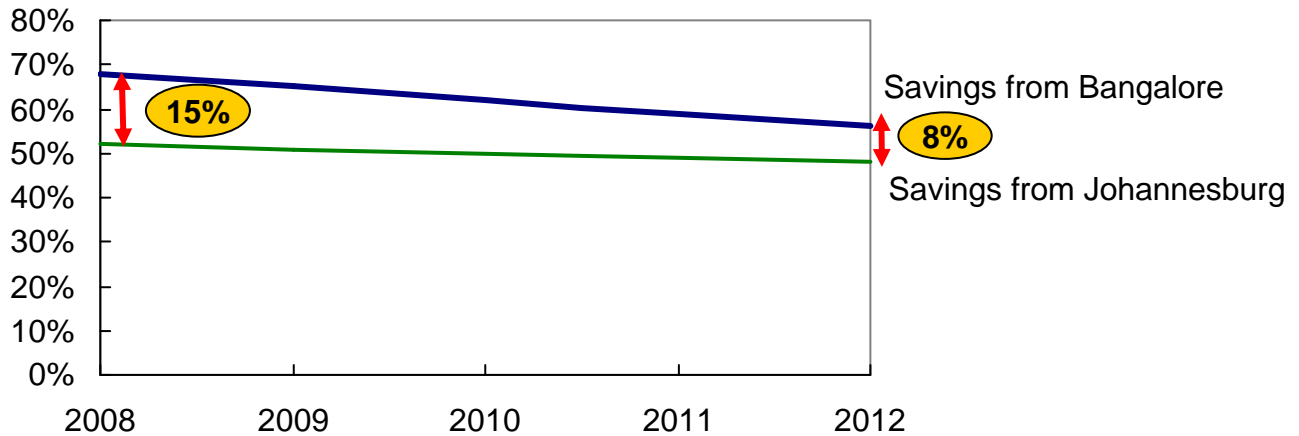
Current arbitrage potential from South Africa relative to western markets (e.g. U.S., UK) is quite significant, with a savings potential of ~50-60 percent on an operating cost basis. While South Africa is not the lowest cost destination, the savings gap with other low-cost destinations is narrowing. Two factors drive the narrowing savings gap. First, while most currencies largely appreciated over the past 3 years (2005-08), the South African currency depreciated. Second, inflation levels in South Africa are lower than in other low-cost destinations. **Chart 4** indicates the extent to which the savings gap has been narrowing for the front-office (customer service) function.

Chart 4: Comparison of savings gap between South Africa and India

MARKET AVERAGES FOR CUSTOMER SERVICE

Savings gap between South Africa and India relative to U.S. (Tier 2 locations)

Percentage



Given underlying drivers of this relative cost movement (i.e. inflation, currency), it is likely that this gap could reduce further going forward. Also, even at current cost levels, the savings gap is even smaller when considering the impact of lower attrition in South Africa.

D4. Availability of scalable, high quality English skills

While South Africa lacks the scale of university graduates like other populous countries, high-school graduates in South Africa (as in other developed countries) prove effective in BPO operations. The estimated total entry-level talent pool for BPO in South Africa (including high-school graduates) is ~470,000 annually. In addition to scale, the talent pool in South Africa has strong English language proficiency and cultural affinity with western geographies, especially the UK.

While there is strong potential for growth, investors need to be aware of certain risks in South Africa and make appropriate investments to deal with them. These key risks have been described below.

E. Key risks and structural factors

While South Africa has clear advantages in terms of its robust physical infrastructure (e.g. roads) and expatriate quality of life, there are some real concerns around telecommunications, crime and the prevalence of HIV/AIDS.

Steps are being taken to improve telecommunications infrastructure and to reduce costs. Telecommunications tariffs have dropped by ~47% year on year over the last four years. Also, proposals are currently being discussed to enhance bandwidth and to further reduce tariffs.

Most companies manage risks related to crime and HIV/AIDS by making targeted investments. Examples include implementing security infrastructure to prevent and deter external crime, financially supporting structured initiatives (e.g. Business Against Crime), and investing in training and AIDS awareness together with treatment programs to deal with HIV/AIDS.

F. Roles that South Africa can play for investors

The global sourcing location landscape is evolving and investors have multiple global location options today (~150 cities). As global investors expand their offshore location footprint in this environment, they increasingly think about a global supply chain and, in that context, the roles which each location should play in the broader global delivery network.

Given South Africa's differentiators, investors can leverage South Africa for multiple roles in Financial Services BPO as described below:

F1. Offshore destination for high-quality English language front-office

The presence of a large talent pool (~470,000 annually) with good quality English skills, accent and cultural affinity with international geographies position South Africa well for this role. Also, South Africa offers significant savings potential. On an operating cost basis, South Africa is 50-60 percent cheaper than leading international destinations (U.S., UK). The savings gap between South Africa and other low-cost destinations (e.g. India) is narrowing and is likely to reduce further going forward.

F2. Offshore destination for complex back-office work

South Africa has key strengths in terms of its large experienced talent pool with relevant service delivery and domain skills in the domestic Financial Services sector. In addition, South Africa has clear advantages in certain niches such as actuaries. Savings potential from South Africa for complex FS back-office work is already on par with other low-cost destinations for certain types of processes (e.g. actuarial modeling) and the savings gap is narrowing for others (e.g. fund administration).

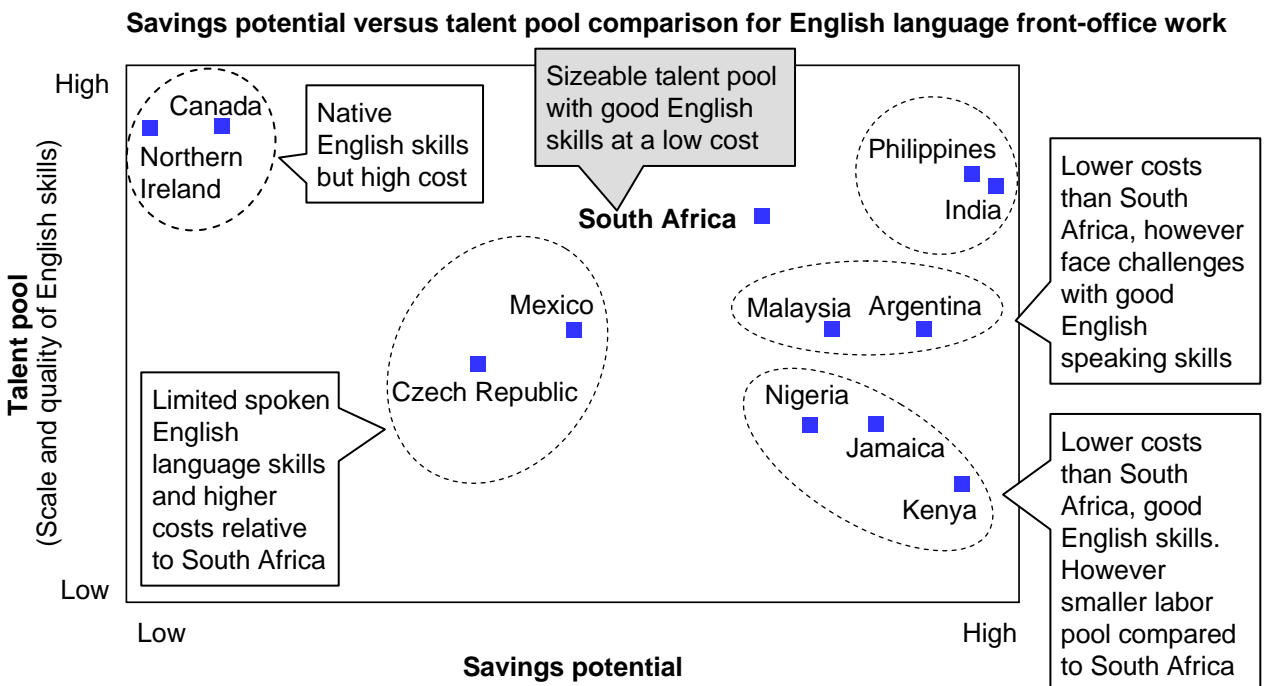
F3. Near-shore scalable destination for sub-Saharan Africa

South African Financial Services majors are expanding operations rapidly into sub-Saharan Africa. This presents opportunities for service providers to use South Africa as a base to serve the sub-Saharan Africa operations of domestic majors. Although costs in South Africa are higher relative to other locations in the region (e.g. Kenya, Nigeria), South Africa is well positioned to serve as a near-shore scalable destination given its larger talent pool, more evolved BPO industry and better quality infrastructure.

F4. Risk-diversification option for India and Philippines

As the chart below (**Chart 5**) indicates, South Africa is one of the few alternative locations to India and Philippines that can provide sizeable, good quality English skills at a low cost. South Africa is therefore an attractive location option for investors looking to diversify beyond India and Philippines

Chart 5: Savings potential versus talent pool comparison across offshore destinations for English language work



The Full Report

The detailed report is available free of charge on The Business Trust’s website (www.btrust.org.za). In addition to the report, an investor-focused’ “tool”, namely an ROI Model is also available on the website. This model helps international investors gauge savings potential from South Africa, given certain parameters such as scale of BPO work. A limited number of printed Executive Summaries with a CD are also available from The Business Trust.



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