Experts

by H.Karthik and Nikhil Rajpal, Everest Group

Africa: The emerging frontier for services offshoring

Africa's growth in offshoring has been primarily driven by its low-cost proposition and talent availability in meaningful scale. However, Africa is often perceived as 'high-risk' by foreign investors.Here, the continent is analysed across key decision drivers in location selection.

The offshoring of global services is an established phenomenon. In 2009, over $90B of services were sourced across BPO and IT through ~4 M people from offshore locations.

As demand grows, the offshore location landscape is evolving rapidly, with over 150 cities that are potential location options for companies. Africa is a relatively recent entrant to this list of potential destinations. The region has witnessed significant uptick in offshoring activity in the past 24-36 months. Recent investments by leading global companies (e.g., Amazon in South Africa) are likely to favorably influence interest in the region as a global sourcing destination.

Among the African destinations, Egypt, Morocco, South Africa, and Mauritius are the leading countries in terms of scale of direct employment in the offshore services sector. Each of these countries has more than 10,000 offshore jobs in this sector and host delivery centers for a number of leading global suppliers and captives.

Africa's growth in offshoring has been primarily driven by its low-cost proposition and talent availability in meaningful scale. However, Africa is often perceived as 'high-risk' by foreign investors. In this article, we explore key African countries across three key decision drivers in location selection, namely talent availability, costs and operating risks.

Meaningful scale of talent available in many countries

Everest analysis suggests that at least four countries in Africa provide talent in meaningful scale to support large operations (in excess of 1,000 FTEs). Egypt, South Africa, Morocco and Tunisia each produce more than 50,000 graduates annually. South Africa, for example, produces 350,000 graduates annually and is among the Top 3 global locations that can provide English language skills at scale. While the size of talent pool in these countries is smaller than the established offshore locations (India, Philippines), it is comparable to that of emerging offshore locations in Central and Eastern Europe, Latin America. Other African countries such as Kenya, Ghana and Mauritius can support moderate-scale centers.

Historical influences from the colonial era have provided these countries with a pool of language skills that are a key driver towards growth in offshoring. Given the diverse language skills in the region, we see three "belts" emerging:

- ***Francophone belt in North-Africa and Mauritius***: Primarily comprising Morocco, Tunisia and Mauritius, these countries constitute the majority of the Francophone offshoring market. Most offshore operations in these countries support clients and customers in France and pan-European multinationals having significant French-language needs. For example, Capgemini has a ~1,500 FTE strong operation in Morocco providing French-centric IT application development, transactional BPO and contact center services to its customers.
- ***English language belt in sub-Saharan Africa***: Primarily comprising South Africa with Kenya also starting to gain traction, these countries primarily deliver English language BPO services. South Africa is one of the leading destinations to serve the UK market, given its preferred accent and cultural affinity with the UK. Five of the top 10 global contact center players are already leveraging South Africa to deliver voice work for the UK market.
- ***Multi-lingual destinations for Europe:*** Some countries in Africa can support service delivery across multiple languages. Mauritius offers an attractive bilingual proposition for French and English work. Egypt is well positioned to support multiple European languages at moderate

scale and has witnessed credible success to the effect.

Costs significantly lower than source markets; however, costs vary across locations

Locations in Africa offer significant arbitrage potential from source markets. For example, costs in South Africa are 50-60 percent lower than the UK. Also, most locations in Africa offer lower costs than the Central and Eastern European region.

However, costs vary significantly across locations. Whilst Kenya, Mauritius and Egypt are among the lowest cost destinations in the region, Tunisia and Morocco are among the more expensive ones. Some countries offer attractive incentives that make a significant difference to the cost of operations. For example, the recently announced (Nov 2010) incentives in South Africa help reduce costs by 20percent.

Whilst payroll and facility costs in African countries are in general competitive to India and Philippines, telecommunication costs are higher. This is largely driven by historical telecom bandwidth constraints. On an average, the cost of telecommunications in African countries is 5-7 times higher than that in India and Philippines. However, telecoms costs have reduced considerably over the past 3-4 years. Going forward, the advent of new cables (e.g., SEACOM) is expected to further reduce telecom costs and strengthen cost competitiveness of several countries in the region.

Concerns on risks are a blend of real issues and perceptions; risks can be managed

Investors are often concerned with risks in Africa (e.g., stability, security, infrastructure). Whilst perceptions of risks in some areas are exaggerated, there are some challenges that investors need to consider and manage effectively. Also, these risks vary across countries and investors need to make conscious risk-reward tradeoffs in making location choices in the region.

While the size of talent pool in these countries is smaller than the established offshore locations (India, Philippines), it is comparable to that of emerging offshore locations in Central and Eastern Europe, Latin America

From a relative risk standpoint, the region can be segmented into three groups

- Egypt, Morocco, Tunisia and Mauritius are stable locations on account of a favorable geopolitical climate, socio-economic regime and investor-friendly business environment
- South Africa offers a "First-World" environment in terms of its infrastructure and quality of life. Investor confidence in South Africa has grown in recent years and the success of the FIFA 2010 World Cup has further strengthened the country's reputation. However, there are some concerns on security that can be managed with appropriate investments
- Instability of the political and macro-economic environment is a concern in some countries such as Kenya, Nigeria and Ghana (e.g., unstable coalition and burgeoning economic debt in Kenya). In addition, there are concerns with violence and unrest in Nigeria and Senegal.

Governments are making concerted efforts and strong commitments to improve the attractiveness of the operating environment. Initiatives include skill development (e.g., ITIDA-led programmes in Egypt, Monyetla programme in South Africa) and accelerating infrastructure development through technology parks (e.g., Casanearshore parks in Morocco, Ebene Cybercity in Mauritius). Most countries offer incentives for the offshoring sector; however, the nature of these incentives and their financial impact varies across countries.

On the whole, the outlook on the offshoring opportunity for Africa is positive. We expect that growth will continue to accelerate as both suppliers and buyers build global delivery networks and diversify into newer locations. In addition to growth from international markets (e.g., UK), locations in Africa are also likely to witness growth from regional shared services operations (i.e., leading companies consolidating their back-office operations for the African region). Furthermore, the expected improvements in infrastructure augur well for the future of this region.

Most of the work delivered from African markets is currently transactional in nature. While this is expected to continue, some countries offer opportunities to deliver complex work in certain areas (e.g., South Africa for complex BPO in financial services, Morocco in applications outsourcing). The political and security environment may continue to remain a concern in few countries but investors are finding ways to manage risks as they enter these markets. GS

H.Karthik is Vice President, Global Sourcing, Everest Group. Nikhil Rajpal is Partner, Everest Group