

Implementation Evaluation of the  
Business Process Services Incentive  
Scheme Programme

Final report

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## **Contact Information**

### **Genesis Analytics (Pty) Ltd**

Office 3, 50 Sixth Road  
Hyde Park, 2196, Johannesburg  
South Africa

Post to: PO Box 413431, Craighall, 2024  
Johannesburg, South Africa

Tel: +2711 994 7000  
Fax: +2711 994 7099

[www.genesis-analytics.com](http://www.genesis-analytics.com)

## **Authors**

Genesis Analytics

## **Contact person**

Alyna Wyatt

(+27) 11 994 7000

[alynaw@genesis-analytics.com](mailto:alynaw@genesis-analytics.com)

# 1. SUMMARY FINDINGS & RECOMMENDATIONS

The Department of Performance Monitoring and Evaluation (DPME), under the National Evaluation Plan Framework (NEPF), commissioned Genesis Analytics to undertake the evaluation of the Business Process Services (BPS) incentive scheme. The purpose of the evaluation was to determine the extent to which the incentive scheme's objectives - namely attracting foreign investment and creating employment - are being met. These findings would be used to inform improvements to the scheme so as to enhance the efficiency, up-take and impact of the scheme going forward.

The key findings and recommendations arising from the evaluation are summarised as follows:

- The cost of operations is a key investment consideration for investors in the Business Process Outsourcing (BPO) industry. Although the incentive scheme does not completely bridge the cost gap between South Africa and its main competitors, it does make South Africa more competitive and acts as an important signalling mechanism to potential investors concerning South Africa's commitment to the BPS industry. Given the relative immaturity of the South African BPS industry in the international market, this foothold is crucial to enable the country to compete and to secure international contracts. However, over the long term, whilst it assists in developing both the reputation and maturity of the South African BPS industry, the incentive scheme on its own does not constitute a sustainable mechanism for maintaining our competitiveness, enhancing our value proposition and growing the industry.
- The design of the incentive scheme should be reviewed and a graded scheme implemented. This should be graded by service type, such that higher value 'back office' operations receive a higher incentive value compared with lower value 'front office' operations. This will more accurately reflect their different unit costs of operation and smaller size (which inhibits access to the existing scheme). The incentive scheme currently does not directly promote training nor the skill development of agents. The additional option of providing a graded incentive scheme by job level and/or an additional incentive for training should be considered.
- The duration of the incentive scheme, at three years, is shorter than most other countries' schemes (typically at five years), thus making long term cost projections unfavourable for investors when considering South Africa as a BPO location. In order to maintain the competitiveness of South Africa as a BPO destination, the period of the incentive scheme should be extended, potentially to a five year period. The need to make a decision on the future of the scheme and to communicate this widely to the industry should be a key priority so as to reduce the uncertainty that characterises the scheme currently.
- Although international investors are aware of South Africa as a BPO location, there is a low level of awareness of the incentive scheme itself. This is because the current BPS promotion strategy includes the incentive scheme only as a component of the entire value proposition. The take-up of the incentive scheme and therefore the rate of job creation can be increased with a more targeted, coordinated approach to promoting the incentive scheme itself.
- A key constraint to the growth and sustainability of the South African BPS industry is the current skills shortage, which is set to worsen as the industry grows. Whilst the incentive scheme is not intended to address this, it is essential that this shortage be addressed.

## 2. EXECUTIVE SUMMARY

### 2.1. INTRODUCTION

The DPME, as part of its mandate under the NEPF, and in partnership with **the dti**, issued a TOR in August 2012 to undertake an implementation evaluation of the BPS incentive scheme (launched in 2011). The purpose of the evaluation was to investigate the extent to which the BPS incentive scheme is achieving its main objectives of job creation and attracting foreign direct investment (FDI). The evaluation covers the period from the inception of the incentive scheme in January 2011 through to December 2012

The evaluation assessed the efficiency, effectiveness, impact and sustainability of the design and implementation of the BPS incentive scheme. The information gathered enabled the formulation of recommendations for improvement, the feasibility of which will be assessed by **the dti**.

### 2.2. METHODOLOGY

A multi-method approach was undertaken to collect data for each of the indicators. This involved document review, data analysis, stakeholder interviews, and a cost-competitiveness analysis. Data collection involved a desktop review of the available project documentation, collection of data on projected and actual jobs created and projected FDI; an analysis of the cost-competitiveness of South Africa's BPS incentive scheme compared with key competitors; and 34 stakeholder interviews were conducted which included service providers and investors active in the industry, relevant government department personnel, and industry body representatives.

### 2.3. FINDINGS

The findings of the qualitative and quantitative research processes are presented under the five evaluation criteria, and may be summarised as follows:

Evaluation criterion	Key findings
<b>Efficiency</b>	<ul style="list-style-type: none"><li>• In general, the administration of the incentive scheme was assessed as being efficient.</li><li>• It was noted that the paper-based application and claim process can be improved, and that in some instances the administrative team is not equipped to respond to strategic queries.</li><li>• Almost two-thirds (60%) of respondents stated that the scheme was not marketed in tandem with the promotion of the industry, or that they were unsure of whether any specific promotion of the scheme took place.</li></ul>
<b>Relevance</b>	<ul style="list-style-type: none"><li>• Just over half of respondents were of the opinion that the incentive scheme should be designed in such a way that the amount of incentive received is graded by the type of service provided or agent skill level, while the same proportion of respondents noted that the BPS incentive does positively influence their investment decisions.</li></ul>
<b>Achievement</b>	<ul style="list-style-type: none"><li>• Since the start of the incentive scheme, 3,807 jobs have been created</li><li>• Audited actual FDI is not captured or measured by the BPS incentive scheme administration. Instead, estimated total investment is provided by firms as part of their claim documentation. Estimated actual investment to date is approximately R2.7 billion, which refers primarily to operational expenditure.</li></ul>
<b>Sustainability</b>	<ul style="list-style-type: none"><li>• There is significant market uncertainty around the future of the incentive scheme.</li><li>• 100% of respondents noted that there has been no communication from the government regarding the future of the scheme, resulting in increasing uncertainty among operators.</li><li>• The majority of responses noted that as the industry grows, unless the level of skills increases</li></ul>

	commensurately, the skills pool will not be sufficient to meet the industry's demands and to enable sustained sector investment and growth
<b>Additionality</b>	<ul style="list-style-type: none"> <li>The fact that about 50% of firms stated that their investment in the industry was strongly influenced by the presence of incentives implies that the incentive scheme has catalysed significant additional activity and investment and has resulted in job creation and investment that would not have occurred otherwise.</li> </ul>

## 2.4. ANALYSIS AND RECOMMENDATIONS

In addition to an assessment of the five standard evaluation criteria discussed above, the analysis and recommendations respond to the seven specific evaluation questions highlighted in the TOR. These are split between those which are specific to the incentive scheme, and those which are of broader relevance to the BPS industry as a whole.

### Incentive scheme specific analysis and recommendations:

Question	Key findings	Recommendations
<b>Are the objectives of the programme being achieved?</b>	<ul style="list-style-type: none"> <li>There is no forward-looking targets set for job creation or FDI</li> <li>The maximum number of jobs to be supported per year is determined by the budget allocated for the scheme in alignment with the MTEF.</li> <li>After two years the BPS incentive scheme has created/supported 3,807 jobs and has paid out 83% of the potential maximum allocation.</li> <li>An estimated R2.8 billion of investment has been made by companies on the scheme</li> </ul>	<ul style="list-style-type: none"> <li>Firms must be encouraged to more accurately project how many jobs they expect to create</li> <li>A target for FDI and job creation must be provided</li> <li>The nature of what is meant by FDI should be clearly defined. Clarity in the reporting of investment must be obtained.</li> <li>The monitoring system and process applied by the projects on the scheme need to be improved to better collect data on actual FDI and jobs created.</li> <li>Promotion of the scheme itself needs to be improved.</li> </ul>
<b>Is the design of the incentive programme supporting the achievement of programme objectives?</b>	<ul style="list-style-type: none"> <li>The incentive scheme is straightforward to understand and operate.</li> <li>Participants felt that the scheme should have been applied over a period of five (rather than three) years, which is more comparable with incentive schemes in other countries.</li> <li>Back office operations, which require high skilled employees, and in most cases are smaller operations, struggle to meet the minimum requirement for 50 employees and benefit proportionately less from the incentive scheme than is the case for front office operations.</li> <li>The administration of the scheme is perceived to be efficient but could nonetheless be improved by addressing two main areas: the time-consuming, labour-intensive nature of the paper-based application and claims processes; and administrators' inability to respond to technical queries relating to these processes and criteria in certain instances.</li> </ul>	<ul style="list-style-type: none"> <li>A graded scheme by type of service should be introduced to provide higher incentives for firms offering a higher value niche service offering, particularly the back office firms.</li> <li>The requirements for back office operators should also reflect their smaller size, and the minimum requirement should be reduced to 20 jobs for such firms.</li> <li>The application and claims processes should be moved to an electronic, web-based platform from the current paper based system, which will increase the efficiency of the process.</li> <li>Communication specific to the policy guidelines and strategic issues relating to the incentive scheme needs to be allocated to a specific point of contact, which is well informed and equipped to respond to such queries.</li> </ul>

Question	Key findings	Recommendations
<b>What is the current rate of job creation through the BPS incentive scheme?</b>	<ul style="list-style-type: none"> <li>Given that there is no job target set, it is difficult to assess a rate of job creation as there is no benchmark that the incentive is aiming to reach</li> <li>The budget allocation has never been fully utilised, which indicates that there is scope for an increase in the rate of job creation</li> </ul>	<ul style="list-style-type: none"> <li>The number of companies participating in the scheme must be increased in order to increase job creation, linking to improving the promotion strategy of the incentive scheme to attract more investors, as well as a need for the introduction of graded incentives to capture more of the entire BPS value chain.</li> <li>Companies should be encouraged to make more realistic projections</li> </ul>
<b>How competitive and cost-effective is South Africa's BPS incentive programme?</b>	<ul style="list-style-type: none"> <li>The incentive scheme has contributed to making South Africa more competitive than it was in 2010.</li> <li>However, when a full assessment is made over the life of the scheme and compared with other countries, South Africa's cost disadvantage is set to increase rather than decrease. This is primarily due to two factors: the reducing nature of the incentive scheme; and the three year duration of the scheme as compared to other schemes that typically run for five years in competitor countries.</li> <li>There is uncertainty around the future of the incentive scheme. This was noted by every participant as being a major current source of concern. This uncertainty is beginning to adversely affect South Africa's competitiveness as an investment destination.</li> <li>There is no specific strategy to promote the incentive scheme. The marketing of the scheme occurs within the broader marketing of South Africa's BPS industry.</li> </ul>	<ul style="list-style-type: none"> <li>The incentive scheme is playing a role in reducing the cost gap between South Africa and its competitors.</li> <li>There needs to be communication from the government on the possible future of the scheme.</li> <li>There needs to be a more concerted effort to promote the incentive scheme prominently within South Africa's value proposition. A promotional strategy for the incentive scheme must be communicated to all industry participants to ensure consistency in the message that is given to potential investors.</li> <li>Better coordination is needed between the government body responsible for the promotion of the incentive scheme and industry bodies and companies, to develop a coherent strategy for communicating and promoting the incentive scheme to investors.</li> </ul>

### **BPS industry analysis and recommendations:**

The questions of key factors affecting the success of the BPS sector, the up-scaling of the programme, the barriers to sector growth, and the sustainability of the sector relate to the BPS industry as a whole. The recommendations stemming from analysis of the information around these specific questions are inter-related and as such are dealt with as a collective.

Key findings	Recommendations
<ul style="list-style-type: none"> <li>There are two primary factors that will determine South Africa's BPS industry success: the cost of operating, and the quality of service provided.</li> <li>There is an insufficient skills pool to meet the current and future demands of the BPS industry in South Africa. This is a threat to the competitiveness and sustainability of the industry.</li> </ul>	<ul style="list-style-type: none"> <li>The incentive scheme must be continued beyond its current three year duration to keep South Africa cost-competitive.</li> <li>Broader than the incentive scheme, the BPS industry should align employee training to better meet the demands of the industry.</li> </ul>

## 3. SUMMARY REPORT

### 3.1. INTRODUCTION

One of the first evaluations to be undertaken as part of the National Evaluation Policy Framework (NEPF) was an implementation evaluation of the Business Process Services (BPS) Programme, paying particular attention to the incentive scheme portion of the programme. The BPS incentive scheme is administered by the Department of Trade and Industry (**the dti**) through Incentive Development Administration Division (IDAD)

The Department of Performance Management and Evaluation (DPME), in partnership with IDAD, issued a Terms of Reference (TOR) in August 2012 for an implementation evaluation of the BPS incentive scheme. The purpose of the evaluation is to investigate whether the BPS incentive scheme is achieving its main objectives, namely those of job creation and attracting foreign direct investment (FDI). The evaluation covers the period from the inception of the incentive scheme in January 2011 through to July 2012. The evaluation covers Gauteng, Western Cape and KwaZulu-Natal; where BPS companies operate.<sup>1</sup>

The DPME contracted Genesis Analytics (Genesis) to conduct the implementation evaluation of the BPS incentive scheme. An inception report was submitted and approved in October 2012, and a field report was submitted in early February 2013.

#### 3.1.1. OBJECTIVES OF THE IMPLEMENTATION EVALUATION

The evaluation assessed the efficiency, effectiveness, impact and sustainability of the design and implementation of the BPS incentive scheme. It was through this process that key barriers to the achievement of these targets were revealed. The information gathered highlighted the strengths of the BPS incentive scheme and has enabled the formulation of recommendations for improvement where possible.

There are a number of key questions that guided the evaluation:

- Are the objectives of the BPS incentive programme being achieved?
- What are the key factors influencing the success of the BPS sector in South Africa?
- Is the design of the incentive programme supporting the achievement of programme objectives?
- What is the current rate of job creation through the BPS incentive scheme?
- How cost-effective and competitive is South Africa's BPS incentive programme relative to those of competing countries?
- How can the programme be up-scaled for greater impact and what are the barriers to growing the BPS sector in South Africa?
- How can the BPS sector be sustained post-incentive period.

A number of the evaluation questions relate specifically to an assessment of the BPS incentive scheme, whilst others have a broader scope assessing the overall industry.

The evaluation included the collection and analysis of primary and secondary research information on the BPS incentive scheme since its introduction in 2011.

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<sup>1</sup> Although the BPS incentive scheme is a national programme, investors have not yet set up substantial investment in any of the other six provinces.

## 3.2. OVERVIEW OF THE OUTSOURCING AND OFFSHORING INDUSTRY

### 3.2.1. GLOBAL OVERVIEW

The global offshoring and outsourcing market has evolved significantly since its initial phase of expansion between 1995 and 2000.<sup>2</sup> Recently released figures **estimated global BPO revenues for 2012 to be US\$175 billion with annual growth rates of 8-12% forecast for the period 2012 to 2016.**<sup>3</sup> This growth is on top of an already significant industry growth rate where, for the period of 2006 to 2010, the industry was estimated to be growing at an average rate of approximately 6%.<sup>4</sup>

Primarily, it is the developed markets<sup>5</sup> that outsource BPO activities to developing markets. These service markets are broken down into tier I and tier II markets, where tier I refers to mature BPO locations and tier II refers to emerging BPO locations. India and the Philippines are generally considered to be tier I locations, whereas countries such as Egypt, Poland, South Africa and Kenya are considered as tier II locations. South Africa's main competitors are fellow tier II destinations.

### 3.2.2. SOUTH AFRICA'S OUTSOURCING INDUSTRY

In September 2005 the South African government identified the BPO sector as a priority sector for job creation and attracting foreign direct investment. In order to encourage investment and to position South Africa as a preferred location for outsourced business processes, a decision was made to work towards better collaboration between the public and private sectors to make the industry competitive internationally. To enable this collaboration, the BPO Sector Support Programme was established; which aimed to position South Africa as a tier II player in the international market for BPO locations, and setting a target of the creation of 25,000 direct jobs and 75,000 indirect jobs.

In February 2006, the Accelerated Shared Growth Initiative (ASGI-SA) was formally launched, and identified the Business Process Outsourcing and Off-Shoring (BPO&O) sector as one of the country's top three priority sectors to stimulate growth. Following from this, Cabinet Memorandum no. 41 of 2006 outlined the key constraints to attracting investment in the South African BPO sector. As a means of overcoming these constraints, Cabinet approved a substantial Government Assistance and Support (GAS) programme, aimed at improving marketing, increasing ease of entry into the South African BPO&O market, improving processes for expanding existing BPO&O operations, deepening the skills pool, improving administrative processes and introducing investment incentives. This strategy was subsequently evaluated and revised, resulting in the BPS Incentive Scheme of 2011.

### 3.2.3. THE BPS INCENTIVE SCHEME

The BPS<sup>6</sup> incentive scheme came into effect in January 2011. The objective of the BPS incentive scheme is to create jobs and attract foreign investment. The BPS incentive is comprised of two components, namely a base incentive, and a graduated bonus incentive (Figure 1). The Base Incentive comprises a three year opex grant which tapers down in line with narrowing the cost gap between South Africa and other destinations; while the bonus Incentive is offered for greater job creation, if the applicant exceeds annual offshore job creation targets. This is paid once in the year that the bonus level is first achieved

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<sup>2</sup> Accenture, *Achieving High Performance in BPO* (2012)

<sup>3</sup> The Outsourcing Unit, Department of Management, London School of Economics and Political Science, *Becoming Strategic-South Africa's BPO Service Advantage*, (November 2012)

<sup>4</sup> Nassom and Everest Global Inc, *India BPO Study: Roadmap 2012-Capitalizing on the expanding BPO landscape* (2012)

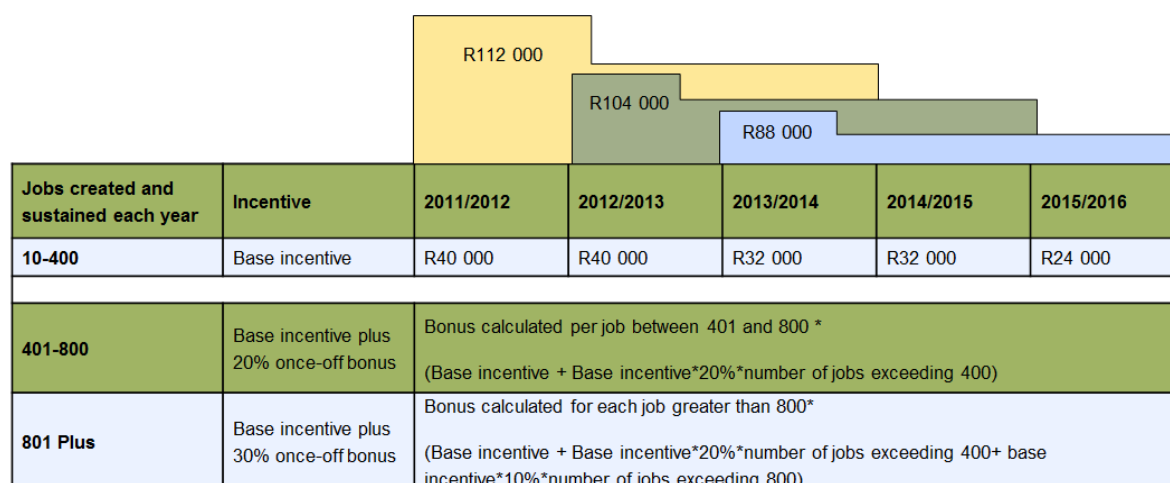
<sup>5</sup> Such as the United Kingdom (UK), the United States of America (USA) and Australia

<sup>6</sup> The name of the scheme was changed from BPO&O to Business Process Services (BPS) with the launch of the revised scheme in 2011



The base incentive is disbursed quarterly, over a period of three years. This is disbursed on the basis of actual jobs created and sustained. The incentive is only available to applicants who are servicing the offshore market with those operations servicing the domestic market ineligible for the incentive. For a project to be eligible for the scheme, it must create at least 50 new offshore jobs by the end of the three years, and to qualify for the first disbursement a project must have employed a minimum of ten offshore jobs. Furthermore, a project cannot displace existing jobs in South Africa and projects may not be receiving concurrent incentives under the BPO&O incentive scheme.

**Figure 1: BPS Incentive payment design**



Source: Adapted from BPeSA, *the dti* and the Business Trust's *Our Incentives: Making a Difference*

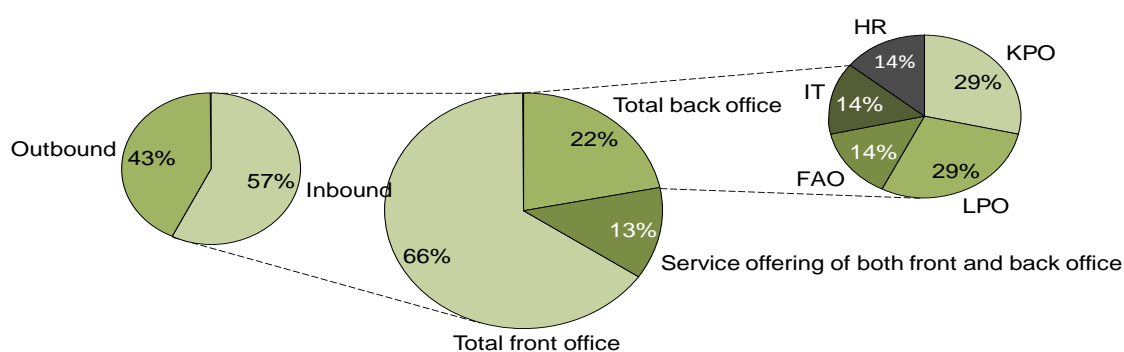
### 3.2.4. OVERVIEW OF BPS INCENTIVE SCHEME PARTICIPANTS

Data made available by **the dti** identifies 32 projects participating in the BPS incentive scheme as of March 2013. The 32 projects are run by 31 companies<sup>7</sup> comprising a combination of service providers and captive operators. For the service providers, an approved project may involve services to more than one client but grouped as one project for the purposes of the incentive application. Of the service providers, 45% are international companies (mainly from the UK) who have set up operations in South Africa to offer outsourcing services to other international companies. This reflects the increasing attractiveness of South Africa as an outsourcing destination.

The projects under the incentive scheme are distributed across service types and geographical locations. The company's service type has been roughly categorised as the function which is its predominant activity (for example, where a company is primarily a contact centre with a few seats as back office operations, it is categorised as a front office operation). Where companies do not have a clear split between front and back office operations, these are categorised as servicing both front and back office; these were all found to be captive operators who are in the shared services operations. As shown in Figure 2, the majority (66%) of the projects are in front office operations, and within this, there is an almost even split between inbound (57%) and outbound operations (43%). Back office services account for 22% of the total operations; and of these there is an almost even split between operations that focus on HR and pay roll, information technology (IT), KPO, LPO and FAO; with a slightly larger proportion of operations being KPO and LPO services. 13% of projects are shared services operations, which are primarily a combination of HR, FAO and customer query services for the captive operation.

<sup>7</sup> Merchants SA (Pty) Ltd have two projects on the incentive scheme

**Figure 2: Split of projects by service type**



Source: Genesis Analytics, 2013, adapted from dti data

The 32 projects are distributed across KwaZulu-Natal, Gauteng and the Western Cape. This split is shown in Table 1 below. The projects in KwaZulu-Natal are mostly outbound contact centres; and those projects in the Western Cape are mainly inbound contact centres, with a significant number of back office operations. There are four shared services operations taking part in the incentive scheme; three of these are in Gauteng, and one is located in the Western Cape.

**Table 1: Distribution of projects by province and service type**

KwaZulu-Natal	n=11	Western Cape	n=15	Gauteng	n=6
<b>Front office</b>	<b>9</b>	<b>Front office</b>	<b>9</b>	<b>Front office</b>	<b>3</b>
Inbound	1	Inbound	9	Inbound	2
Outbound	8	Outbound	0	Outbound	1
<b>Back Office</b>	<b>2</b>	<b>Back Office</b>	<b>5</b>	<b>Back Office</b>	<b>0</b>
KPO	1	KPO	1	KPO	0
LPO	0	LPO	2	LPO	0
IT	0	IT	1	IT	0
FAO	0	FAO	1	FAO	0
HR	1	HR	0	HR	0
<b>Combination of front and back office</b>	<b>0</b>	<b>Combination of front and back office</b>	<b>1</b>	<b>Combination of front and back office</b>	<b>3</b>

Source: Adapted from dti data, 2013

## 3.3. METHODOLOGY

### 3.3.1. ANALYTICAL FRAMEWORK

The analytical framework was developed by identifying 26 indicators across the four evaluation criteria described above. The indicators comprise a combination of quantitative and qualitative questions.<sup>8</sup> In order to maintain an objective and standardised approach to assessing the indicators, qualitative responses were coded into a quantitative scale wherever possible to ensure that the indicators could be aggregated in order to provide comparable findings. A multi-method approach was undertaken to collect data for each of the indicators. This involved document reviews; data analysis; interviews; and cost-competitiveness analysis. The methodology and analysis framework were approved by the Steering Committee through the Inception Report (October 2012) and the Analysis Framework (January 2013).

<sup>8</sup> The analytical framework and indicators were presented to the Project Steering Committee and were approved prior to finalisation and implementation.

### 3.3.2. DATA ANALYSIS

Quantitative data was collected through the data from the companies' application approval reports and the BPS company data provided by **the dti**. The data analysis included all 32 projects which were on the incentive scheme at the time of the evaluation.

- The quantitative analysis focused on the following elements:
- The achievement of each project's job creation against its targets;
- The total number of jobs created;
- The projected investment to be generated from the incentive scheme;
- The distribution of the projects by province and service type; and
- The type, size and ownership of companies on the incentive scheme.

This analysis was crucial to accurately map the range of BPS incentive scheme participants. The analysis enhanced the team's understanding of the type of companies participating in the incentive scheme and the programme's achievement of its objectives. It was also important in identifying the position of these firms in the industry (for example, in terms of growth stage), how long they have participated in the incentive scheme, and the type of service provided by these firms. This quantitative review further uncovered gaps and additional pertinent questions to be included in the interview process.

### 3.3.3. INTERVIEW PROCESS

Interviews were conducted in Johannesburg, KwaZulu-Natal and Cape Town with representatives from participating companies, rejected or cancelled applicants, BPS industry bodies/representatives and key government officials involved in the BPS incentive scheme and the BPS industry as a whole.

The interviews were conducted with 24 of the 28 companies participating in the scheme at the time of the evaluation (see section 3.3.5)<sup>9</sup>, nine government officials and one industry body. In a number of instances, more than one interview was held for a company where there was more than one relevant person to speak to and the interviews could not be held at the same time.

### 3.3.4. COST-COMPETITIVENESS ANALYSIS

A core component of the evaluation of the BPS incentive scheme involved an assessment of the cost-effectiveness and competitiveness of South Africa's BPS incentive programme compared with competing countries.<sup>10</sup> The work focused on two main areas:

1. ***A historical (2010) and current benchmarking view of SA BPS cost-competitiveness, focussing on:***
  - Contact centre services: benchmarking South Africa's fully loaded cost per FTE for contact centre services, considering the impact of incentives. The countries included in this comparison were Egypt, Kenya, Poland, Philippines, and India.
  - Financial services: benchmarking South Africa's fully loaded cost per FTE for financial services back-office, considering the impact of incentives. The countries included in this comparison were India and Poland.

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<sup>9</sup> Due to it being financial year end at the time interviews were scheduled, two participants could not schedule interview time with us. Two participants were travelling for the duration of the interview process; despite attempts to schedule telecons with these companies, this could not be scheduled. CCMG was contacted but informed the researchers that they had nothing to do with the BPS incentive scheme and indicated that there was no point in interviewing them.

<sup>10</sup> Genesis outsourced the cost-competitiveness analysis to the Everest Group, a leading global services advisory firm, with extensive experience of Business Process Services, particularly in South Africa.

2. *An updated, forward looking view (i.e., next 3-5 years) on the projected cost gap between South Africa and other offshore locations. The countries included in this comparison were India and Poland.*

The methodology for this portion of the study included market intelligence and secondary research, proprietary tools, databases and experiences, and selective primary interactions with market participants.<sup>11</sup>

### 3.3.5. LIMITATIONS OF METHODOLOGY AND SCOPE OF RESEARCH

As with any research, this research relied on a number of critical assumptions and was subject to inherent constraints, including:

- At the time that our fieldwork began, there were 28 companies taking part in the incentive scheme. We aimed to engage each participant in the scheme; however, four were unable to participate in the research within the necessary timeframe.
- At the end of January 2013, three additional companies were approved for the incentive scheme. These companies could not be included in the qualitative analysis owing to the timeline of the evaluation. However, they were included in the quantitative analysis.
- Ideally we would have interviewed each provincial industry body as well as the national body. However BPeSA National's CEO had resigned, and thus BPeSA National and BPeSA Western Cape were represented in the same interview by Gareth Pritchard in his capacity as CEO of both BPeSA Western Cape and BPeSA National. There was no representation from industry bodies from Gauteng or KZN. Despite attempts to interview stakeholders who had been part of the incentive scheme and had had their applications rejected or cancelled, only one such interview was completed (given the reluctance of others to participate). Thus the sample has a bias towards participating companies. This point has been noted in analysis of qualitative findings.
- There were a few inconsistencies in the data relating to job projections and actual jobs created<sup>12</sup>. As the average number of jobs created is calculated by an electronic calculator developed by an external firm, inconsistencies with the data and the underlying calculations were difficult to clarify with **the dti**.
- The investment values used in this report are based on reported investment according to submitted claim sheets. The investment figures are not audited and are therefore reported as estimates. These values include operational expenditure, which in the majority of cases includes salaries. Since no set template was provided in terms of the form in which these figures are reported, these figures were taken as additional in some cases, and cumulative in others, as recommended by **the dti**.

Given the number of interviews successfully conducted and the amount of information yielded, it is highly unlikely that the limitations identified above have significantly affected the analysis.

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<sup>11</sup> Egypt: Information Technology Industry Development Agency; India: National Association of Software and Services Companies (NASSCOM); Kenya: Kenya BPO and Contact Centre Society; Philippines: Business Processing Association of the Philippines; Poland: Polish Information and Foreign Investment Agency

<sup>12</sup> In some cases, minor differences existed relating to projected and claimed-for job numbers between various data sources.

3.3.5.1. Scope of the research

The scope of this evaluation includes elements that cover certain issues relevant to the broader industry. The seven evaluation questions can be split into those specific to the incentive scheme (Questions 1, 3, 4, 5), and those relevant to the broader BPS industry (Questions 2, 6, 7).

The components of the evaluation that did not form part of the evaluation included:

- Monyetla Work Readiness Programme™
  - Marketing
  - Industry Mobilisation
  - Standards
- Talent development initiative
  - Quality of sector operators
  - Industry organisation

However, in the research process, it was impossible to totally exclude certain aspects of these themes especially where there were links to elements of the evaluation of the BPS incentive scheme specifically. In particular, this concerns issues relating to the Monyetla Work Readiness Programme™, marketing and the skills of industry employees.

3.4. FINDINGS

3.4.1. EFFICIENCY

3.4.1.1. Administration of the incentive scheme

In general, the incentive scheme was perceived to be efficient. Both the application and claims processes are generally perceived to be efficient with a high percentage of companies responding positively to questions on this theme.

Table 2: The perceptions of administration efficiency of the application and claims processes

Administration indicator	Yes	No	Don't know	N/A
Applications				
Is the process of applying for the incentive programme efficiently administered?	60%	36%	4%	
Were there any delays in processing your application?	32%	64%	4%	
Were queries relating to the application process efficiently resolved?	88%	12%		
Claims				
Is the claims process efficiently administered?	64%	16%		20%
Is a quarterly claim cycle appropriate	56%	20%		24%
Is the claims verification process effective	72%	4%		16%
Were queries relating to the claims process efficiently resolved?	76%	12%		12%
Is sufficient preparation time given for site visits	76%	8%		16%

Source: Genesis Analytics, 2013

An overwhelming majority (88%) of respondents described the communication and explanation of the details of the scheme during the application process as sufficient and efficient in promoting timely and informed decision-making. In some cases respondents reported that the communication from the dti representatives during this phase had been invaluable and had played an important role in initiating instrumental relationships between industry and government. Similarly, more than three-quarters of participants described communication during the claims process as effective and efficient. Of the remaining 24%, half had not experienced the claims process, and half had reported less positive

interactions in this regard. In the case of the latter, a main area of concern was that of the accessibility of relevant **dti** representatives and the efficiency of communication in terms of response time.

Despite the generally efficient responses, certain areas for improvement were noted for the applications and claims processes:

- In certain instances the administration officials were happy to help but were not able to respond to certain technical issues/queries relating to the incentives
- The process can be quite a tedious one, although this has recently been reduced
- In certain cases insufficient notice for site visits was given

#### 3.4.1.2. Promotion of South Africa's BPS incentive scheme

**There is room for improvement in the promotion of the scheme.** Only a quarter of participants reported that they had been exposed to, or were aware of, any promotion of the BPS incentive scheme itself. These findings reiterate those of the London School of Economics (LSE) where South Africa's BPO industry was found to be is "under-marketed" and needing increased marketing through a single source.<sup>13</sup>

**The collective response of industry bodies and government officials to this question contradicts that of the companies,** with more than half (55%) of industry body and government department representatives interviewed stating that the BPS incentive scheme was indeed well-marketed alongside the South African BPS industry as a whole, and in fact that this marketing was a foremost consideration in their respective entity's BPS industry development strategy and budget.

#### 3.4.2. RELEVANCE

The relevance of the scheme assesses the extent to which the scheme is meeting the needs of beneficiaries, as well as national and local priorities.

##### 3.4.2.1. Design of the incentive

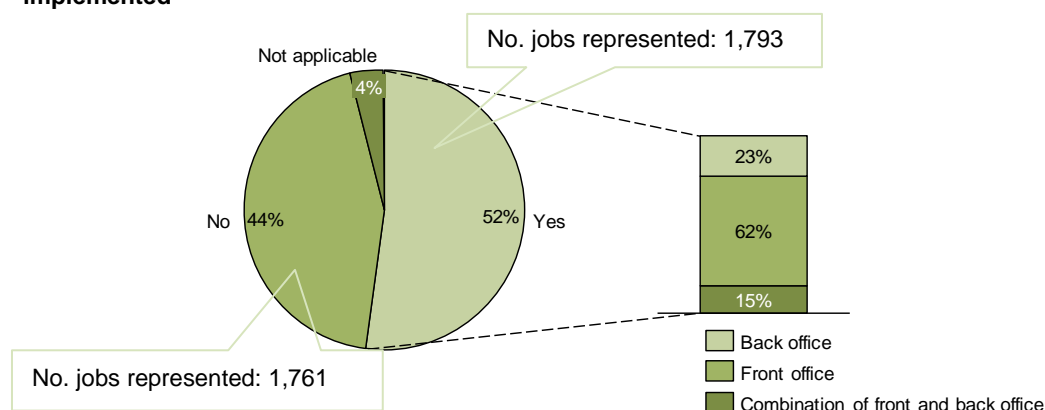
**Just over half of respondents were of the opinion that the incentive scheme should be designed in such a way that the amount of incentive received should differ by the agent skill level or level of work.** The request for grading is generally on two fronts, firstly different service types require different levels of experience, for example, call centre services versus financial service outsourcing; and secondly within each outsourcing industry there are different levels of employees – agents, team leaders, quality assurance officers – and there is a perception within the industry that incentives should be graded for these different levels. It was argued by a number of respondents that there is a lack of quality skilled employees, particularly at the team leader and quality assurance levels. A higher incentive for these job levels will encourage firms to invest more resources in acquiring, training and retaining such employees.

On the other hand, a number of respondents argued that whilst it would be a good extra offering, grading the incentives would overcomplicate the scheme and decrease the efficiency of its administration.

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<sup>13</sup> The Outsourcing Unit, Department of Management, London School of Economics and Political Science, *Becoming Strategic-South Africa's BPO Service Advantage*, (November 2012), page 28

**Figure 3: Interviewee responses when asked whether a graded or tiered incentive scheme should be implemented**



Source: Genesis Analytics, 2013

One important aspect of South Africa's incentive scheme is the duration of the incentive (three years as compared to longer ones in other countries). Interestingly, 56% of companies interviewed stated that the duration of the incentive scheme had no real impact on their investment plans. A majority of these (64%) were service providers who had set up offices in South Africa for the long term. What they did mention was that while they (service provider) have set up for the long term, the duration of the incentive scheme definitely influences the decision-making of the investors that they aim to attract to South Africa. The remaining 36% of the companies who responded that the duration did not influence their investment decision were the larger captive operators who had stated that their decision to enter the outsourcing industry was primarily driven by an internal business strategy decision, and as such the incentive was a positive extra.

Discussions with government officials and industry bodies indicated **that the BPS incentive scheme as it is currently designed is not adequately flexible to account for the high degree of differentiation across segments and growth stage within the BPS industry**, and that improving this particular aspect of the scheme's design is an issue that has been noted for further investigation.

### 3.4.2.2. Investment decisions

**Just more than half of respondents noted that the BPS incentive does influence their investment decisions and growth strategies.** This primarily relates to the amount of the incentive received as well as the duration of the incentive, currently a 3 year tapering incentive scheme.

**Table 3: Indicators for impact of incentives on investment decisions**

Investment decision indicator	Yes	No	Not applicable
Does the BPS incentive as it is currently designed strongly influence your company's growth strategies and investment decisions?	52%	48%	
Was the design of the BPS incentive scheme a major driver in your initial investment decision in South Africa?	44%	36%	20%

Source: Genesis Analytics, 2013

Of the 48% who stated that the incentive design does not substantially influence their growth and investment decisions, this was due to a number of factors:

- The larger firms stated that outsourcing is part of their business strategy and they make their decisions taking into account a broad range of factors

- A number of service providers stated that the impact of the incentive scheme was relevant to them only to the extent that it factored into the considerations of their clients (due to the effect on price)

It is important to note here that the impact of the incentive scheme on investment decisions and growth strategies is highly dependent on the nature of service provision. This is illustrated by the fact that 71% of front office operations stated that the incentive scheme strongly influenced their investment decisions, whereas over 80% of back office operations stated that it did not feature as a major component of company's growth strategy and investment decisions.

**44% of respondents stated that the BPS incentive scheme was a major driver in their *initial investment decision in South Africa*.** Although a significant proportion of the respondents stated that it was not a major driver of initial investment (36%), these companies accounted for only 22% of total employment created by the incentive scheme. **This indicates that the incentive scheme, although not being an initial investment driver to all companies, is an important factor for those companies generating sizeable employment numbers.**

More interesting are the range of factors that influence the decision of where to locate the outsourcing service. **Of the criteria that respondents mentioned, costs were mentioned most frequently, featuring in 43% of the responses.** This finding highlights the importance of the incentive scheme's effect on reducing costs on job creation in the BPS industry. Interrogating this further showed that the vast majority (60%) of respondents who stated that cost was the primary investment criteria were contact centre operations. This reflects the fact that the contact centre industry is more cost sensitive than back office operations, and as such costs are a bigger factor to operational successes. Agent skills play a more central role in the investment decisions of back office operations than in contact centre operations given the niche offerings in the back office operations. Accent and the quality of service also featured often.

**80% of the contact centre operations stated that if the incentive scheme were to end, it would have a significant impact on their operations and their decision to continue operating in South Africa.** This accounted for 86% of the jobs which have been created by the incentive scheme. This is again indicative of the competitiveness and cost-driven nature of contact centre operations as discussed above.

### **3.4.2.3. Cost-competitiveness**

**Cost is one of the most important factors in the investment decisions of investors when selecting a country to set up an outsourced part of their business. South Africa's incentive scheme helps to increase its cost competitiveness, but does not adequately reduce the cost gap between South Africa and its main tier II competitors.**

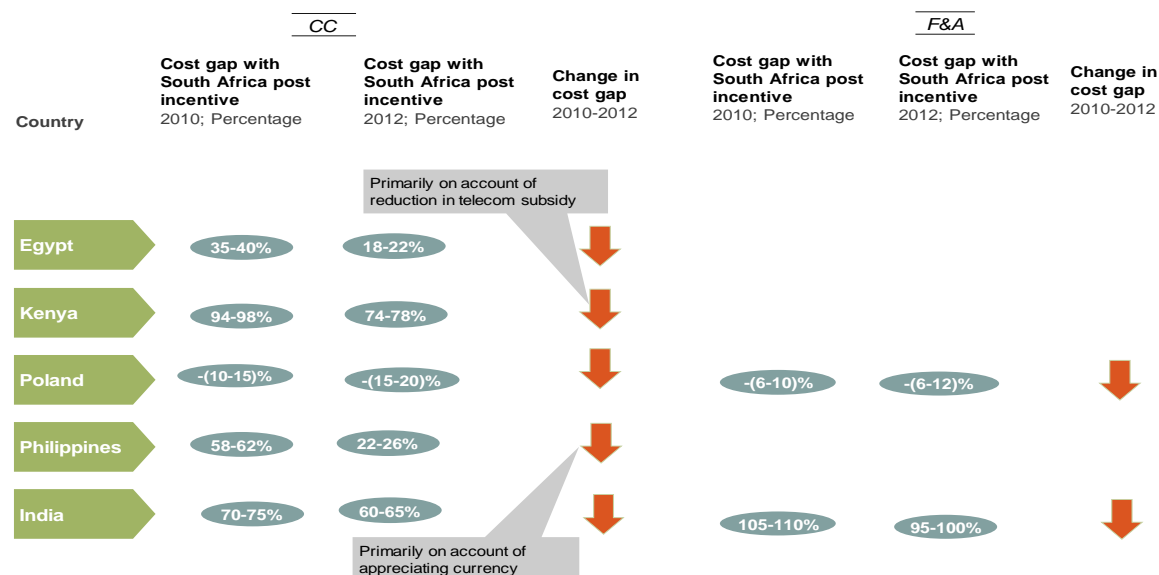
In terms of competitiveness, South Africa's incentive is at par or higher than India, Philippines and Poland, which are the established outsourcing destinations. However the incentive offered in South Africa is lower than that in the emerging locations of Egypt and Kenya.

Despite the fact that the incentives are at par with most countries, they have not contributed to reducing the initial cost gap that existed between South Africa and its main competitors. On the contrary, the cost-gap has increased post incentives in most cases. It is only the cost gap with Philippines for contact centre services and with Poland for financial services that remains the same post-incentive. This is mainly due to the yearly reducing nature of the incentives and the fact that South Africa has a three year timeframe for its incentives, and a 'sunset' for incentives in FY2015-16 resulting in incentives being applicable only for the next three years whereas they are available for five years in most of the competing countries.



What is important to note is that while the incentives have not reduced the cost gap between South Africa and its closest competitors, it has helped to alleviate a more unfavourable position that we were in in 2010 were our costs were even higher. The Everest report found that for all countries, our cost gap has reduced since 2010 (Figure 4).

Figure 4: Reduction in cost gap from 2010 - 2012



Source: Everest Group, 2013

Only 50% of respondents feel that the BPS incentive scheme sufficiently bridges the cost gap of operations enough to make operations competitive. This contradicts the general view of government officials, the majority of whom are under the impression that the incentive scheme is a major contributor to reducing the cost of operations for all firms in the BPS industry.

#### 3.4.2.4. Links to national developmental objectives

Given the profile of unemployed individuals who are likely to take up jobs in this sector, there is a natural absorption of historically disadvantaged South Africans (HDSAs) into employment in the firms taking part in the scheme, and as such the **incentive scheme is contributing to the national development goal.**

### 3.4.3. ACHIEVEMENT

#### 3.4.3.1. Job creation and FDI

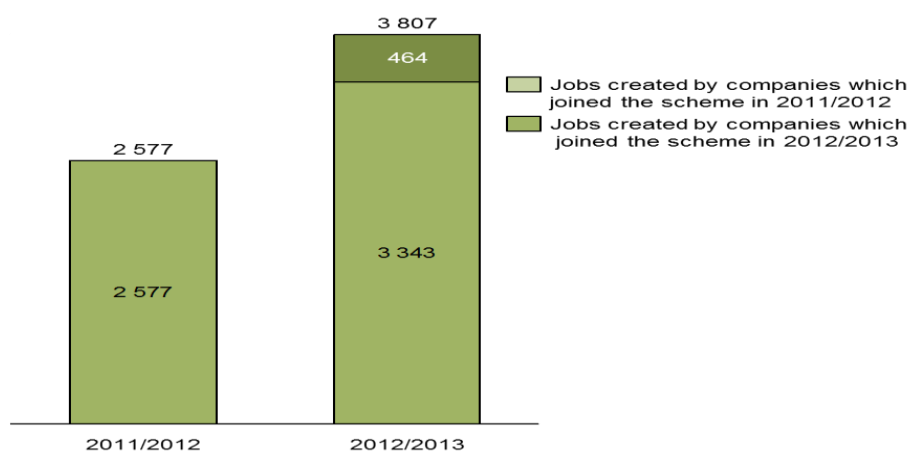
Our analysis of jobs created and FDI generated is for the period of January 2011 to December 2012.<sup>14</sup> This relates to the full period of year 1 of the incentive scheme, and the first 9 months of year 2. Figure 5 below shows the breakdown of jobs created, in the 2011/2012 year, **20 projects were approved on the scheme, creating/supporting<sup>15</sup> 2,557 jobs.** In the 2012/2013 year, the number of projects on the scheme grew by 60% to 32. The number of jobs created/supported however only grew by 48% to 3,807. Of the 1,230 new jobs claimed for on the scheme in 2012/2013, 464

<sup>14</sup> Although the incentive scheme officially began in April 2011, firms could claim for jobs created between January – April 2011.

<sup>15</sup> The term 'supported' is included because a number of firms, particularly captive operators who are in the industry purely for the business rationale, would have created these jobs anyway, however the incentive scheme does support the existence of these jobs

(38%) of these were created by the 12 new projects on the scheme. The remainder of new jobs were from firms already on the scheme who expanded their operations

**Figure 5: Jobs created per financial year**



Source: Genesis Analytics, 2013 adapted from dti data

**Attaining a consistent definition amongst stakeholders of what a job actually is remains a challenge** not only in the BPS industry, but across the South African economy as a whole. The Full Time Equivalent (FTE) definition is applied by only 36% of respondents, while the remaining 64% are unsure of any clear definition. Whilst only 36% of respondents actively use the FTE definition – a 40 hour week where lunch breaks are excluded from the payroll – the majority of respondents agree with this definition and indirectly use it so as to maintain consistency with **the dti**. Consequently, in this industry, the FTE definition is an appropriate definition for a job, however, it must be noted that **an FTE job created does not necessarily correspond to an additional person in the workplace**.

Although the core objective of the incentive scheme is to contribute to job creation, **there is no defined target for the number of jobs that the incentive scheme is expected to create/support**. The scheme's administration team receives a yearly budget aligned to **the dti's** Medium Term Expenditure Framework (MTEF) approved by the National Treasury. This budget is then used to determine what can be termed the 'maximum allocation' of jobs that can be supported annually. This then serves as the informal benchmark or 'target' for the number of jobs to be created by the scheme in that particular year. The 'maximum allocation' of jobs contained implicitly within the set MTEF budget was 3,557 jobs for the 2011/2012 period and 5,225 jobs for the 2012/2013 period.

The incentive scheme paid out **72% of the potential allocation budget in 2011/2012, covering 2,577 jobs**.<sup>16</sup> Given that the data on actual jobs is only available up to December 2012, the figure above compares this figure with the corresponding pro-rated maximum MTEF allocation as at December 2012 (4,563).<sup>17</sup> **As at December 2012, the incentive scheme has supported 3,807 jobs (cumulatively), this translates into expenditure of 83% of its potential maximum job-allocation for that period.**

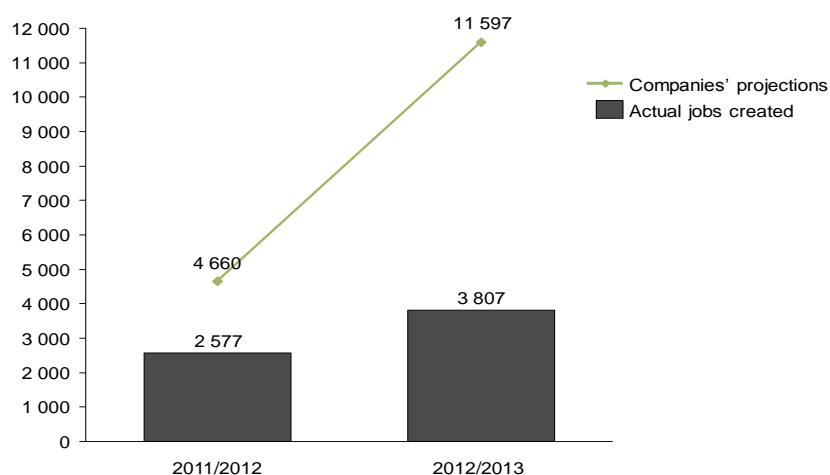
In both years, the **actual number of jobs was substantially less than that which was projected by companies on the scheme** in their applications, as is shown in Figure 6 . The number of actual

<sup>16</sup> There were a further 692 jobs paid for under the incentive scheme budget for this period, but these jobs were created by firms on the previous BPO&O scheme, and so have not been included here.

<sup>17</sup> This figure was arrived at by multiplying 5225 by 0.75 to account for the 9 months of this period.

jobs created/sustained is 33% of the total projected jobs up to March 2013. Job creation projections exceed the number of actual jobs created by over 300%.

**Figure 6: Companies' job projections and actual job creation**



Source: Genesis Analytics, 2013 adapted from dti data

The disparity between numbers of actual and projected jobs created has been attributed to a number of factors. Firstly, it is possible that many companies have been optimistic in their growth projections and have underestimated the difficulties in setting up in the BPS industry. Secondly, it is possible that companies have over projected to ensure that they are approved for a greater incentive amount which would compensate for unexpected additional job creation. Discussion with **the dti** indicates that allowances do exist for those instances in which firms create more jobs than projected, which implies a miscommunication between **the dti** and companies regarding the protocol for these instances.

There is also **no target set for the amount of FDI to be generated by the scheme**. This makes it impossible to analyse whether the FDI that has been attracted is more or less than what was expected at the onset of the scheme. The reported investment figures are not audited and as such are taken as estimates for the purposes of this report. The projected investment value for 2011/2012 was approximately R998 million for the first year and approximately an additional R1.8 billion in the second year. This investment is primarily composed of operational expenditure (accounting for over 85% of total expenditure for both years), which mainly consists of rent expenditure, salary bill and telecoms costs. The high proportion of operations expenditure validates the decision to shift from the previous BPO&O capex-based incentive to the current BPS opex incentive, but suggests that it is inappropriate to describe this figure as FDI in its strict form.<sup>18</sup> A number of service providers and South African captives also serve the domestic market. It is likely that in these cases, domestic costs are included in the reporting of expenses to **the dti** despite their encouraging companies to “ring-fence” expenditure that relates to offshore business. It cannot, in the absence of any form of auditing, be confirmed whether this occurs in practice.

In general there is a **close alignment between projected and reported investment figures**. For the 2011/2012 year, reported investment was 78% of the projected amount, while in the 2012/2013 period reported investment exceeded projections by 12.4%.

<sup>18</sup> Foreign direct investments are the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital.

#### 3.4.3.2. Perceptions of the incentive scheme

Over 64% of respondents stated that **the strength of the incentive scheme was its impact on reducing the cost of operations**. This is in line with the core objective of the incentive scheme, and there were very few other positive influences of the incentive scheme on business operations cited by companies.

In terms of weaknesses of the scheme, **36% of respondents noted that the incentive scheme does not adequately deal with the issue around a lack of skills**. The scheme incentivises firms to employ agents but not to train them and increase their skill levels. 12% of respondents noted that the scheme does not adequately reduce their cost of operations. About 44% of the responses related to other areas of concern such as a lack of flexibility around the incentive scheme, the duration of the scheme and uncertainty around the future of the scheme.

#### 3.4.3.3. Perceptions of the BPS industry

**General business environment conditions within the industry have largely been described as positive**, with 64% of respondents claiming that it had met their pre-investment expectations, while 4% reported that theirs had been exceeded. In the remaining cases, 8% had been disappointed and 24% had entered into the industry without expectations, or had already been operating in the country and as such had no point of comparison.

**The issue of “skills” has two interpretations in this industry**. In some cases people categorised skills as a positive attribute in terms of the supply of labour available, and in other cases responses noted that the supply was ample, however the quality of these skills was described as insufficient, especially for experienced contact centre agents and middle-management employees.

#### 3.4.3.4. Incentive take-up

As reported by dti officials, **job creation as attributed to the scheme has not been as rapid as initially expected**. The pay-out of incentives for jobs created has therefore not reached the maximum budget allocation in each year. Based on the data from **the dti**, R70,306,600 was paid out in 2011/2012 and R149,372,134 was paid out in 2012/2013.<sup>19</sup> The second period of the incentive scheme reflects a larger component of the allocated budget being disbursed; this disbursement will increase as there are still outstanding payments for 2012/2013.<sup>20</sup>

The lower disbursement of funds in relation to the budgeted amount does not reflect a lack of inefficiency on the incentive scheme's administration team. Almost all of the complete applications that **the dti** receive are processed and approved onto the scheme. Suitable companies that apply that are not approved on to the scheme, are as a result of incomplete applications and missing documentation.

### 3.4.4. SUSTAINABILITY

#### 3.4.4.1. The skills pool

**A central issue facing the longer term viability of the outsourcing industry in South Africa is the diminishing pool of skills**. 36% of companies felt that the current **skills pool is insufficient to**

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<sup>19</sup> Three of the companies who have had claims paid out were not included in this data.

<sup>20</sup> Although the original budget request for the programme was approximately R750 million, annual budget provisions as per the MTEF have resulted in a different total budget for the scheme.

**sustain the industry currently and for future growth.** Another 36% felt that the skills pool was average. The majority of responses who considered the skills pool sustainability to be average were assessing the current level of skills in relation to the current demand for agents, and noted that as the industry grows, should the skilled labour not increase rapidly, the level of skills will be unsustainable to meet the industry's demands. **The main category of concern is with skilled team leaders and quality assessors.** 24% of respondents felt that the current skills pool is sustainable; 67% of these are from higher skilled functions such as KPO and LPO operations. This reiterates the skills concerns mentioned above and indicates that although skills in the niche segments may be sustainable, there is a general concern about the availability and sustainability of the skills pool for experienced employees for front office operations.

**A number of government officials and industry bodies highlighted the need for improved skills in order to maintain a sustainable industry.** This was mentioned in relation to the need for skilled team leaders and quality assessors and that if this is not addressed, the poaching and churn in the industry will continue. Some officials stated that the industry is sustainable on the condition that the skills shortages are addressed.

#### **3.4.4.2. The future of the incentive scheme**

**100% of respondents noted that there has been no communication from the government regarding the future of the incentive scheme.** This has led to increasing uncertainty around the future of the incentive scheme. This could have severe adverse effects on the industry as there is the risk of investors moving their business away from South Africa to other destinations where they would be offered incentives.

#### **3.4.4.3. BPS industry sustainability**

The **vast majority (84%) of respondents stated that they believed the advantages of the South African BPS industry to be sustainable.** Areas of concern were noted relating to the sustainability of the skills pool in the absence of some form of effective skills development initiative; the purpose of which would be to increase the size of the labour pool in terms of suitability to the BPS industry so as to reduce churn and drive down labour costs in the industry. Trepidation around the sustainability of transport infrastructure in light of the limitations current systems place on operational expansion and the cost implications thereof was also noted.

**Cost was considered to be a key driver of investment,** as such the narrowing cost gap of the South African BPS industry in comparison to that of India (when taking incentives, operating costs, and exchange rates into account), indicates that if the above constraints to the industry's sustainability can be overcome, then the industry may be sustainable.

#### **3.4.5. ADDITIONALITY**

##### **3.4.5.1. Sustainable employment**

Sustainable employment assesses the extent to which the jobs created are not short term employment but rather that the projects on the scheme are for the longer-term and thus create sustainable jobs. **The majority (76%) of the projects on the scheme are based on contracts which exceed 12 months in duration.** This is good for employees as they can be guaranteed jobs for at least a year. The longer term contracts also increase the probability for upward mobility of employees since agents who are familiar with a particular client service and excel in their performance to the client can be promoted to team leader and quality assessor roles on those projects.

**Less than one-fifth (16%) of companies stated that they did not intend to continue operations of their incentivised project(s) beyond the approved incentive period.** 90% of the all the jobs created by the incentive scheme are represented by employers who would continue their operations post the incentive scheme period, indicating that the scheme is contributing to sustainable employment. Many of these companies, however, stated that although they would continue with their operations, these may have to be downsized.

## 3.5. ANALYSIS AND RECOMMENDATIONS

A number of central themes emerged through our engagement with stakeholders. These themes are analysed with reference to the core evaluation questions posed in the TOR. As indicated, a number of the questions deal specifically with the BPS incentive scheme whilst three questions have a broader scope in relation to the BPS industry as a whole. The analysis first looks at the BPS incentive scheme, before addressing the broader industry questions. For the incentive scheme specific analysis, the four related questions are answered individually, whilst the three questions relating to the broader incentive scheme are assessed together. In each instance recommendations are provided on how the emerging analysis can be used to improve the performance and impact of the incentive scheme and the industry.

### 3.5.1. BPS INCENTIVE SCHEME ANALYSIS

#### 3.5.1.1. Are the objectives of the programme being achieved?

***The incentive scheme does not have a job creation target per se. Instead, maximum number of jobs to be supported per year is determined by the budget allocated for the scheme in the MTEF.*** Assessing the performance of the BPS incentive scheme is limited to a comparison of jobs created in relation to the maximum allocation from the MTEF budget. Given that the scheme has never fully utilised its budget allocations, an increasingly restrictive budget is provided to the scheme annually. A tangible job creation target rather than annual MTEF budget allocations is essential to the development of a clear understanding of the success of the scheme. This would also allow for better strategic planning, budgeting and improved operational and promotional processes.

Assessed in relation to the scheme's budget-based planning methodology, **the dti** has to date performed reasonably well in its job creation figures. As at December 2012, the incentive has paid-out 83% of the potential maximum allocation. However, this figure may be well short of what might have been possible if the scheme's managers had been driven by a target. However, this cannot be accurately ascertained based on the results of this study.

***Companies' job creation projections are significantly higher than actual jobs created.*** After two years, the BPS incentive scheme has created/supported an average of 3,807 jobs. This represents 33% of companies' job projections. Of the 20 projects on the scheme in the 2011/2012 period, only three met or exceeded their projections. 11 of the projects (55%) failed to create even half of the jobs they had projected. It should be noted that **the dti** team administering the scheme has little influence on the companies' ability to meet their targets. This team should however avoid using the projections as an indication of the scheme's likely performance as the projections are so much higher than actual jobs created.

***No specific target has been set for FDI.*** A core objective of the scheme is to attract FDI, and since the introduction of the incentive scheme, an estimated R2.8 billion of investment has been made by companies on the scheme. Whilst this is a notable amount of investment, it is difficult to assess whether it is line with the expectations of government as it has not stipulated how much FDI the scheme is expected to attract. No assessment can be made therefore as to whether the amount of

FDI coming into South Africa through firms on the incentive scheme is meeting the expectations at the onset of the incentive scheme.

***The incentive scheme is not adequately measuring the achievement of its targets.*** The current system by which the job creation and FDI targets are measured needs to be improved. Interactions with firms indicated that whilst in most cases firms did not dispute the incentive amount paid, many firms did not have a good grasp of how their payment was calculated.

Importantly, the job creation data collected does not stipulate the skill level of the jobs that are projected or created. There is thus no means of assessing the different skill level of jobs created. This is a limitation which undermines the relevance and ability of the scheme to deepen the skill base of South Africa's BPS sector, and needs to be addressed.

The investment numbers can only be taken as indicative since they have not been audited. Also, investment numbers provided include operational expenditure such as salaries and wages, telecoms costs, electricity costs and other running costs. Moreover, the investment figures assembled are inconsistently recorded: they are recorded by some companies cumulatively since the start of the incentive period, whilst other firms record their actual investment for each claim period. These inconsistencies in the recording standards make it difficult to get an accurate estimate of the amount of FDI that is associated with the scheme.

#### **Recommendations:**

- A more rigorous target needs to be set for jobs to be created and FDI attracted by the scheme. This will assist **the dti** team in managing the incentive scheme more proactively and in more accurately assessing its impact. Although the incentive scheme is already mid-stream in its term, it will be useful to set targets for the rest of the incentive scheme's duration.
- In the current context of no policy target, **the dti** should aim to achieve a higher jobs created/sustained figure than stipulated by the MTEF budget. Opportunity exists for this initiative to be supported by access to extra funds, and successful attempts will encourage a higher budget provision for future years of the scheme.
- Firms must be encouraged to more accurately project how many jobs they expect to create. One way to incentivise more accurate projections would be to offer a financial reward to firms that create 90% or more of the jobs that they have projected to create. This financial reward should be calculated as a percentage of a firm's projected job numbers, as opposed to being based on by how much they exceed their target, so as to prevent firms from under-projecting on purpose in order to receive this 'bonus'. At the very least, firms should be required to provide an explanation for notable variances between their projected and actual jobs.
- The method of calculating average jobs created/sustained by a company on which the incentive amount is paid out should be made more transparent. **The dti's** calculation model is not fully understood by many of the scheme participants and thus should be shared with and clearly explained to firms. An embedded spread sheet for example, would allow companies to enter their job figures for a claim period, and arrive at their incentive payment amount. This will increase understanding of the calculation process, go some way to managing firms' expectations, and will encourage a more transparent and predictable process of calculating the incentive pay-out.
- The measurement of investment must be better defined in terms of what is included/excluded from the investment figures provided. The reporting of investment by firms must be standardised with clear instructions provided on how the recording should be done – either cumulatively or additionally.

### 3.5.1.2. Is the design of the incentive programme supporting the achievement of programme objectives?

#### Design of the incentive scheme

***A positive aspect of the incentive scheme is that it is straightforward to understand.*** Most companies have a good understanding of how the scheme works. Once the scheme was explained to them, it was quite straightforward and the design and conditions associated with the scheme are easy to understand and apply.

***The main concern expressed around the design of the scheme relates to its duration.*** Most participants felt that the scheme should have been for five years, which is more comparable with incentive schemes in other countries, and that if the three year period was chosen at the initial design of the BPS incentive programme, the incentive scheme should have been extended by now. The duration of the incentive scheme has also had implications for analysing South Africa's cost competitiveness as potential investors compare South Africa's incentive scheme against other countries with schemes that have a longer duration. The extent to which the duration of our incentive scheme has discouraged investment in South Africa to date is not clear.

***The incentive scheme should be graded by different service types.*** The BPS industry is split into two broad categories of front-office and back-office operators, which differ not only in their service offerings, but in their employment requirements, average size, and cost of operations. The back office operations (LPO and KPO services) require high skilled employees, and in most cases are smaller operations. This has implications in relation to the incentive scheme on two fronts. Firstly, a number of the back office operations are unable to take advantage of the scheme because they do not meet the minimum requirement for 50 employees. Secondly, given their smaller size, higher unit costs, and higher labour cost, the incentive amount contributes less to reducing their cost of operations than for front-office operations. The incentive scheme does not take into account these differences in service types, thus prejudicing the back office operators.

***The scheme indirectly promotes employment of historically disadvantaged South Africans.*** The design of the scheme positions it well to meet national targets of employment creation for historically disadvantaged South Africans (HDSAs). Although not explicitly stated as an objective, the nature of the BPS industry in South Africa, and specifically its relatively low entry-level skill requirements, implies that the incentive scheme will directly contribute to the employment of HDSAs. There is therefore no need for any further measures which target HDSAs.

#### BPS incentive scheme theory of change

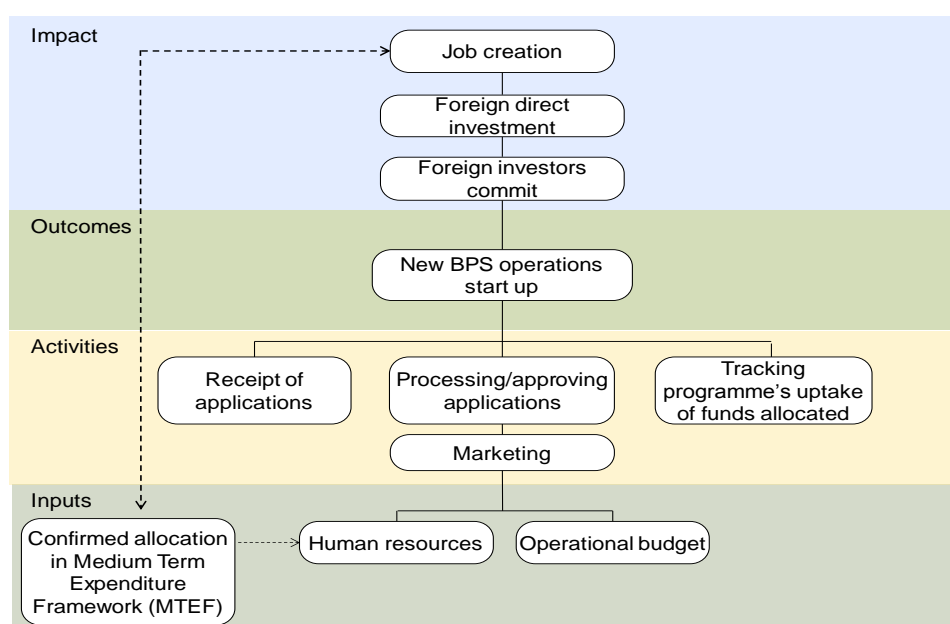
A review of the theory of change of the BPS incentive scheme was included in this implementation evaluation. What was received by **the dti** is a Performance Monitoring Plan (PMP)<sup>21</sup>, and not a full theory of change or results chain. Thus the evaluation team undertook the development of a notional results change. Figure 7 is a representation, based on our analysis, of a notional results chain for the BPS incentive scheme, described in detail below.

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<sup>21</sup> Document reference: BPS PMP 15 October 2012



**Figure 7: Proposed Results chain**



Source: Genesis Analytics, 2013

**Table 4: Description of the proposed results chain**

Category	Description
<b>Inputs</b>	The initial catalyst for the incentive scheme was the confirmation of the allocation of funding from the MTEF. This catalysed the deployment of a team from <b>the dti</b> and an operational budget for the implementation and running of the scheme.
<b>Activities</b>	Once companies have heard of the scheme (ideally through marketing), they compile applications and submit to <b>the dti</b> . Officials process the applications and where applicable approve them for the incentive scheme. Once companies are approved on the scheme, <b>the dti</b> tracks the disbursement of their MTEF allocation based on the number of jobs created (a key component of this activity is the validation of the claims process to ascertain the number of jobs created).
<b>Outcomes</b>	Once approved onto the scheme, the company begins operations on the new, incentivised project. For captive operations this model has a simple logical transition: once a project is approved, it begins operations on this project. However, for service providers the logical progression is not as simple: service providers need to attract investors through a lower pricing model, thus when they market to their investors, they discount the cost of their operations as if they have already been approved onto the incentive scheme; however in order to qualify for the scheme, the project needs to have a signed investor. Thus there is a “chicken and egg” scenario, where the service provider needs use the incentive scheme as a means to attract investors, however, they will only be approved for the scheme if they have a signed investor. Despite the discrepancy in logical progression for service providers and captive operations, the result of being approved on the scheme is that operations on a new project begin.
<b>Impact</b>	In the case of service providers, the start of the new project will be dependent on a contract being signed with a foreign investor, the investor will thus be committed to South Africa for the duration of the contact. In the case captive operations, the investor will have signed a lease/property agreement, signifying a commitment to investing in South Africa for a significant period. Once these investors have made this commitment to South Africa, they begin to buy/rent telephones, rental space and so on which is the inflow of FDI to South Africa. Along with this FDI is the employment of individuals to staff the operation. Thus jobs are created at each new project, resulting in increased job creation at the national level. The dotted line back to the MTEF signifies that the incentive money is only disbursed once the jobs are actually created.

As there have been no formal discussions with **the dti** around the results chain or theory of change, the results chain presented here is conceptual, and provides the basis for the development of a more detailed model.

## **Institutional structure**

***The administration of the scheme is perceived to be efficient with no major issues with the application and claims processes.*** One of the main positive highlights of the evaluation was the generally positive impression of the administration and communication from the administrative team at **the dti**. Stakeholders are impressed with this aspect of the scheme and this is an area of demonstrated proficiency.

The administration of the incentive scheme can be improved further by addressing two main areas: the time-consuming, labour-intensive nature of the application and claims processes; and administrators' inability to respond to technical queries related to these processes in certain instances. In terms of the former, there is demand from the industry to transition towards an electronic system (preferably in the form of an online platform) for the application and claims processes. Regarding the second issue, and notwithstanding the generally good communication from **the dti** team, in certain cases the team is unable to provide guidance on policy and strategic queries regarding the scheme. It is appropriate to publicise a single point of contact, including a website to be contacted for all policy/strategic issues relating to the incentive scheme (e.g. regarding the duration and grading of the system).

### **Recommendations:**

- A graded scheme by type of service should be introduced to provide higher incentives for firms a niche service offering, particularly the back office firms. The requirements for back office operators should also reflect their typical size, the minimum requirement should be reduced to 20 jobs for such firms.
- Any adjustments to the design of the scheme must not complicate the associated administrative processes. One of the positive elements highlighted in the qualitative research is that the incentive scheme is quite straightforward and simple to understand, and whilst improvements are necessary, they must not occur at the expense of complicating the design and operating processes involved.
- The proposed theory of change should be considered, and appropriate and measurable indicators should be finalised to assist in the monitoring of progress.
- The application and claims processes can be moved to an electronic platform, this will increase the efficiency of the process.
- Communication specific to the policy guidelines and strategic issues relating to the incentive scheme needs to be allocated to a specific point of contact, well informed and equipped to respond to such queries.
- The monitoring process of the projects on the scheme need to be improved to better collect data on actual FDI and jobs created. This is an essential part of ensuring that the stated objectives of the incentive scheme are being monitored and measured. This can be incorporated into the above recommended electronic platform.

### **3.5.1.3. What is the current rate of job creation through the BPS incentive scheme?**

***There is scope for an increase in the rate of job creation.*** This assessment is closely linked to how the scheme is meeting its targets. Firstly, given that there is no job target set, it is difficult to assess a rate of job creation as there is no benchmark that the incentive is aiming to reach. In the 2012/2013 year, the number of projects on the scheme grew by 60% to 32. The number of jobs created/supported grew by 48% to 3,807. While this is a significant increase over the two years, the

fact that the budget allocation has never been fully utilised indicates that there is scope for an increase in the rate of job creation.

**Recommendations:**

- There needs to be a bigger drive to get more companies onto the scheme to increase the rate of jobs created. It is understandable that **the dti** is limited in its ability to influence how many job projections are translated into actual jobs, however should more projects be included in the scheme, this will increase the overall number of actual jobs.
- This is linked to improving the promotion strategy of the incentive scheme to attract more investors, as well as a need for the introduction of graded incentives to capture more of the entire BPS value chain.
- Companies should be encouraged to make more realistic projections. This might be achieved through the application of a bonus incentive designed to reward accurate forecasting and the fulfilment of projections.

#### **3.5.1.4. How competitive and cost-effective is South Africa's BPS incentive programme?**

##### **Cost competitiveness and cost-effectiveness**

The rationale for the BPS incentive scheme is to address the unfavourable cost differential between South Africa and its major competitors. It was not anticipated that the incentive would totally remove this cost differential but rather contribute significantly to reducing the cost gap. What is important to note is that the incentive scheme is designed to serve as a "ticket to the game", to enable South Africa to compete with other Tier II competitors, and not to totally cover all costs of operating in South Africa. South Africa's value proposition shows that its BPS offering goes beyond cost to include other advantages such as the quality of service provided, our accent and affinity to the UK market.

That said, it is still relevant to analyse the extent to which South Africa's competitiveness has been improved through the incentive scheme. The incentive scheme has contributed to making South Africa more competitive than it was in 2010. The cost gap has reduced when compared with the situation prior to the start of the BPS incentive scheme with each of the five countries compared, and for both contact centre services and financial services. However when a full assessment is made over the life of the scheme and compared with other countries, South Africa's cost gap is increasing rather than decreasing. This is primarily due to two factors – the reducing nature of the incentive scheme, and the three year duration of the scheme as against schemes that run for usually five years in other countries.

An important part of the analysis of the cost-competitiveness is related to the duration of the scheme. Our projections indicate that the narrowing of the cost gap is likely to continue if the incentive scheme is extended beyond its current three year duration. This relates directly to the next analysis below on the future of the incentive scheme.

In terms of cost-effectiveness, the incentive scheme is providing a positive return on the investment made by the government. A very simplistic assessment shows that the estimated actual investment made by companies on the scheme exceeds the budget allocated per year to the incentive scheme. The positive ROI remains with the inclusion of the operational cost of running the programme.<sup>22</sup>

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<sup>22</sup> It must be noted that a comprehensive assessment of the return on investment of this scheme was not conducted

## **The future of the incentive scheme**

***Uncertainty around the future of the incentive scheme was noted by every participant as being a major current source of concern.*** None of the companies interviewed were aware of the future duration of the incentive scheme. As such, companies are unable to base their strategic decisions on the scheme. While some of the larger companies in the industry have been able to adjust their business plans for the next few years to account for the possibility of an end to the incentive scheme, many other firms, particularly at the growth stage or those more reliant on the incentives to help cover their operational costs, are very concerned about the ambiguity around the future of the scheme.

The uncertainty about the future of the scheme is also starting to have an adverse impact on the BPS industry's attractiveness and future competitiveness. When investors weigh up the costs of setting up in a country, the incentives offered are a central part of the comparison between countries. Service providers interviewed noted that South Africa's value proposition as an outsourcing destination is currently being limited by the lack of clarity on the future of the incentive scheme.

## **Promotion of the incentive scheme**

***The promotion of the BPS incentive scheme within South Africa needs improvement.*** While there is generally knowledge in the global BPO industry about South Africa as a BPO location, there is a lower level of awareness of the scheme by firms in South Africa prior to entering the industry. The incentive scheme has been marketed as part of the broader value proposition of South Africa's BPS industry, with seemingly more focus on marketing to international investors than to firms in South Africa. There needs to be improved promotion and communication about the scheme to South African service providers who provide the service to the international investors and those South African shared services operations that service their African operations..

A number of companies were actually already operating in the industry servicing international clients before they heard about the scheme. Many of the larger service providers who frequently travel to liaise with potential investors stated that they often promoted the scheme as part of their overall cost breakdown. The existence of multiple channels of promotion increases the risk of a disjointed, incoherent marketing effort in which insufficient, out-dated or inaccurate information may be provided to potential investors.

## **Recommendations:**

- The incentive scheme is playing a role in reducing the cost gap between South Africa and its competitors, and should be extended in duration to fully derive this benefit. It is important, however, that this simple cost-based subsidy is enhanced by measures to deepen the skills base of the industry – an essential pre-requisite for South Africa to realise and sustain its competitive advantage in the global BPS market.
- There needs to be communication from the government on the possible future of the scheme. Even though a final decision may not be made immediately about the extension of the scheme, communication which indicates that the issue is currently being explored, and if possible, suggests a date by when decided decision will be made, will alleviate the current anxiety.
- There needs to be a more concerted effort to promote the incentive scheme to domestic service providers and captives. A promotional strategy for the incentive scheme must be communicated to all industry participants in South Africa to ensure consistency in the message that is given to potential investors.
- Better coordination is needed between the government body responsible for the promotion of the incentive scheme, industry bodies and companies to develop a shared and coherent

strategy for communicating and promoting the incentive scheme to investors, specifically to domestic service providers with the potential to attract offshore work.

### 3.5.2. BROADER INDUSTRY ANALYSIS

The three themes included in the TOR that relate to the broader BPS sector are factors influencing the success of the industry, barriers to growing the BPS sector, and how the sector can be sustained and up-scaled for greater impact. These are briefly discussed below, with recommendations provided at the end.

#### Factors influencing the success of the BPS sector

There are two primary factors that will determine South Africa's BPS industry success – the cost of operating and the quality of service provided.

- **Cost of operating.** As expected, a key success factor for every BPO location relates to the cost of setting up and operating. While this is primarily an assessment of the financial cost, other business costs such as the ease with which a company receives a license to operate; legislative requirements, such as work permits, are also relevant. South Africa's success as a BPO destination will always be linked to its cost-competitiveness in relation to other BPO locations. Although we are not aiming to become the lowest cost operator, the incentive scheme was introduced to lower the higher cost of operating in South Africa. This was the justification for the provision of the BPS incentive, and is still a relevant factor today.
- **The quality of service is a key factor influencing South Africa's success.** Many respondents indicated that South Africa is chosen because of its higher quality of service compared with other destinations. This is a broad theme that relates to the affinity of the South African accent for the UK market, and the culture and work-ethic of the South African labour pool. This is one of the main reasons why South Africa is chosen over other destinations. Should the high standard of service drop, this will have adverse consequences for the success of South Africa's BPS sector.

#### Barriers to growing the BPS sector

***The findings strongly indicate that there is an insufficient skills pool to meet the current and future demands of the BPS industry in South Africa.*** This appears to be the main barrier to increasing the scale and deepening the value base of the BPS sector. The skills shortage concern was highlighted by many respondents as one of their major areas of constraint when setting up and/or expanding their operations. It is important to note that the issue is not one of a lack of supply of labour, but rather of labour with the required skills for servicing the international outsourcing market. Currently, this shortage of skills is most felt in the team leader and quality assessor roles.

At the agent level, the skills pool currently appears to be adequate and as such companies have few difficulties with filling these positions. However, many companies noted that should the rapid growth of the industry over the last few years continue, the current skills pool will not be able to keep pace with the future demand for all levels of employees, and this could limit the growth of the industry.

This evaluation purposively did not investigate the Monyetla Work Readiness Programme™. However, the indication is that a more targeted approach must be taken to supply the industry with skilled labour suitable for servicing the international market. The Monyetla Work Readiness Programme™ is considered by respondents to be insufficient in terms of supplying the quality and

quantity of employees, especially at the team leader and quality assessor roles. As such, a number of firms, mostly the larger service providers, use internal training programmes for their employees<sup>23</sup>.

### **Sustaining and up-scaling the BPS sector post the incentive period**

In essence the sustainability of the BPS sector is dependent on a number of factors highlighted above. Whilst South Africa is not positioned to compete directly with countries such as India on cost grounds, our unique offering (affinity to the UK market, quality of service provided etc.) may position us adequately to compete with these countries on the grounds of quality. Most of the companies interviewed indicated that the strengths of the BPS industry can be sustained, should the main areas of concern relating to the skills pool and the uncertainty around the future of the incentive scheme be addressed. The recommendations below speak to the key conditions for and barriers to expansion of the industry.

#### ***Recommendations for the BPS industry:***

- The incentive scheme must be continued to keep South Africa cost-competitive.
- The key barrier to growth of the industry is the skills challenge. The skills shortage has a broader implication for South Africa's current and future value proposition and needs to be addressed with urgency by the government, in partnership with industry. Broader than the incentive scheme, the BPS industry should align employee training to better meet the demands of the industry.
- While it is noted that the incentive is a fungible tool that firms can use to address a variety of input costs, training has not been and is not likely to be one of these costs that firms are directing the incentive towards. The incentive is used primarily to reduce their overall cost gap with competitor countries, which are driven by operational expenditure items. An additional and distinct support mechanism for training should be considered given the critical role played by the skills pool in the sustainability of the industry.

## **3.6. PRIORITY CONSIDERATIONS**

The evaluation report has highlighted the main positive attributes of the BPS incentive scheme, as well as the areas requiring attention to improve the scheme going forward. To conclude this report, we highlight some priority considerations that need to be addressed and that, in our view, will have a notable effect on improving the impact of the scheme at meeting its objectives. The improvements suggested here are readily achievable and could be expected to yield results in a relatively short time.

***Develop a clear target for job creation and FDI, and implement adequate measures to achieve, measure and review these targets.*** The BPS incentive scheme has a clearly defined objective to attract FDI and create jobs. To adequately assess whether the scheme is achieving these objectives, it is crucial to set clear targets for both job creation and FDI. These targets must be clearly communicated to prospective and participating firms. For example, in the case of FDI, the types of investment that are included in this component of the incentive scheme must be defined for all companies. It is then vital to develop accurate and consistent records of the actual FDI that has been generated and of the number of jobs created. The administrative team should have a dedicated and consistent means of monitoring the achievement of these targets, making use of the online platform

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<sup>23</sup> The Monyetla Level 4 Programme, which is due to be implemented shortly, aims to support skills development at a higher level of work for agents, and also for team leaders and quality assessors. **The dti** designed the programme for this purpose, although there have been delays in starting the programme. However it is uncertain whether this programme will meet the needs of the industry participants

for capturing, calculating and reporting this information. The number of jobs supported by the scheme must be recorded consistently to ensure a continuous up to date view on the performance of the incentive scheme.

**Review the design of the scheme.** Given that the current time frame of the scheme is three years, and this is set to be completed soon, it is an appropriate time to review the design of the scheme to identify how the scheme can be refined to better meet its objectives and attract more FDI and create sustainable jobs. The review of the design should explore the possibility of providing a slightly different incentive amount and requirement for front-office and back-office operators. Important also is the need to encourage as a separate measure or component the training and development of agents to reach specific levels of skill required for international services. The management of the scheme should consider the option of providing a graded incentive by job level and/or an additional incentive for training. This will require more detailed financial modelling for each industry segment and each respective value.

**Improve communication on the future of the scheme.** Possibly the most immediate priority is to begin a process of communication with the industry participants regarding the future of the incentive scheme. Whilst it may not be possible to provide a definite directive on the future of the scheme, improved communication indicating that **the dti** is in the process of reviewing the scheme's current format. A timeframe within which a directive will be released should be communicated to the industry participants. **The dti** needs to make a decision fairly soon as to whether the scheme will be extended beyond the current timeframe, and if so, if any changes are to be made to its design.

**Develop a specific promotions strategy for the BPS incentive scheme.** The promotion of the BPS incentive scheme is currently conducted as part of the broader marketing of South Africa's BPS industry value proposition. While this is appropriate, it should be in addition to a targeted approach for promoting the incentive scheme to South African service providers - since domestic firms are crucial to the success of the scheme, and can be encouraged to broaden their offer to overseas investors. There should be measures to improve collaboration between **the dti** marketing department, the administration officials of the scheme, and the industry bodies to develop a coherent strategy that more effectively promotes the scheme and also that equips service providers to attract investors to South Africa.

**Move key administration process to an online platform.** Transferring the current application, claims and progress reporting process to an online platform will immediately improve the administrative efficiency of the scheme. The platform should also provide the opportunity for participants to email queries they have on the administration process. This will help streamline the queries process and help the administration team keep track of the common queries they receive. This is a process that has begun but needs to be prioritised and implemented as a matter of urgency.

**Address the skills pool in South African BPS industry.** While this was explicitly excluded from the evaluation scope of work, the skills pool is the key driver in ensuring the sustainability of the industry beyond the incentive period and in developing and sustaining South Africa's competitive advantage. The development of a strategy and related measures to address this goal should be adopted as a priority.