# 10 Changing geographies of service delivery in South Africa

## Towards regional value chains?

*Charlotte Keijser*

### Introduction

Global value chains (GVCs) are a defining feature of the current wave of globalisation and a reflection of the increasing interconnectedness of economies (OECD, 2015). Many firms, predominantly from more advanced economies, seek efficiency gains and cost savings by delegating their non-core activities to external firms in the country (that is outsourcing) or to firms abroad, mostly in developing countries (offshore outsourcing or offshoring) (Gereffi and Fernandez-Stark, 2010). This has given rise to value chains of services, typically referring to business processes or functions with usage of information technology (IT) in the delivery process, which is also known as the IT-enabled services (ITES) industry. These value chains of IT-enabled services include a broad spectrum of services, ranging from customer services and data processing to higher value-added work, such as software development, risk management, and research and design (Dossani and Kenney, 2007; Palugod and Palugod, 2011).

The ITES industry has opened up opportunities for developing countries to participate in GVCs of services without having to develop a full range of functional capabilities. Participation in GVCs of services is argued to be vital for their economic development in terms of diversification and sophistication of exports, access to markets, and considered an opportunity to add value to their local industries (Gereffi *et al.*, 2010; OECD, 2015). Understanding how developing countries can successfully integrate into GVCs of services has thus become an important subject for development practitioners.

South Africa is an interesting case, as the country only in recent years made name for itself as a provider of IT-enabled services like customer relations, data management and legal services. Furthermore, the case of South Africa shows that it does not solely engage in GVCs through acting as a delivery platform for services from overseas, but also as an end market for IT-enabled services, and as a gateway to the rest of Africa. This has attracted foreign service providers to South Africa seeking ITES contracts in the domestic and sub-Saharan Africa (SSA) market, giving rise to local value chains (LVCs) and regional value chains (RVCs) of services. The resulting heterogeneity of value chains is partly driven by firms' strategies to create a global delivery model, which refers to having a global network of service delivery centres (Gereffi *et al*., 2010; Sako, 2009). In addition, this study reveals that some South African owned service providers struggle to compete on the global market and have instead turned to the domestic and regional ITES market. This is also evident in African agriculture where policy measures have already been directed at developing and promoting RVCs through harmonising national policies, laws and regulation, and standards across regional economic communities in SSA (Ramdoo, 2014). The key argument is that RVCs have the potential of expanding market opportunities, especially for African countries with small populations and fragmented national markets. National and regional markets in developing countries offer an alternative to the global market that is characterized by strong competition, high-quality standards and that favours large-scale producers (ERA, 2009).

The South African ITES industry fits well into recent academic debates on the need to look at the potential of RVCs of services, defined as chains of activities where the final product (here a service) is provided from a country within the region (here the SSA market). This subject is especially important, as entering GVCs of services is vital for economic development, yet often challenging for firms in developing countries. Scholars argue that RVCs offer them more opportunities to participate, gain experience and build capabilities needed to compete globally, and thus serve as a stepping stone into GVCs (see Bamber *et al*., 2013).

While RVCs have captured increasing interest by researchers and policymakers, empirical evidence mainly remains limited to manufacturing sectors. Drawing on primary and secondary data collected in South Africa this chapter analyses heterogeneous value chains of IT-enabled services. It particularly sheds light on what RVCs of services look like, in terms of how services are organized in the regional market through different sourcing modes. In doing so, this chapter will provide a conceptual background (section 2), methodology (section 3), followed by an overview of South Africa's ITES industry (section 4), and examples of RVCs leading to an extension of modes of outsourcing/offshoring as currently reflected in the literature (section 5 and 6).

## Theoretical overview

### *Outsourcing and offshoring*

The globalisation of production and trade are important features of the contemporary economy (Gereffi *et al*., 2001). World markets are rapidly integrating while at the same time production is becoming more fragmented through lower transportation costs and technological advances. The term outsourcing is used to refer to a firm's decision to not undertake all of its business functions internally, but to outsource to an external firm. Offshoring involves a transfer of business activities that had been previously performed in the home country to another country; independent of whether simultaneous outsourcing (transfer of ownership of the activity) is occurring. In doing so, business functions can be performed offshore within the same firm (captive or subsidiary offshoring) or by an independent service provider (offshore outsourcing) (see Table 10.1) (Massini and Miozzo, 2012). The contracting of services to a firm in a nearby country is referred to as nearshoring.

According to Massini and Miozzo (2012), the current wave of outsourcing and offshoring concerns the relocation of service activities from large global operators and less internationalised companies from developed to less developed countries (see also Gereffi, 2005; Gereffi *et al*., 2010; Oshri *et al*., 2015). Firms set up captive units offshore in lower cost countries to provide services for the parent country (offshoring) or outsource it to an external service provider offshore (offshore outsourcing). As such, a range of activities that were once considered strictly the domain of the industrialised world are now also performed in developing countries (Gereffi *et al*., 2011). Furthermore, it has opened up opportunities for developing countries to engage in international trade of services without having to develop the full range of capabilities, but only to specialise in specific stages of the chain. According to Sturgeon and Memedovic (2010) through participating in GVCs of services, developing countries can leap-frog development and make non-linear catch up possible.

### *Global and regional value chains*

Global value chain scholars have devoted several studies to the act of outsourcing and offshoring, particularly how developing countries can insert themselves successfully into value chains of services (see Bamber *et al.*, 2013; Gereffi, 2005; Gereffi *et al.*, 2010). Although the value chain from production to consumption of services is commonly short, the GVC approach has proven useful to understand shifting patterns of global production, capabilities key for competitiveness, and the role played by different actors in developed and less developed countries (Gereffi *et al.*, 2010).

*Table 10.1* Sourcing modes of services by client firms

| | | *Location of client* | |
|---|---|---|---|
| | | *Home country (Domestic market)* | *Overseas (Global market)* |
| *Type of provider* | External (independent service provider) | *Domestic outsourcing* Outsourcing of services to an independent provider in the firm's home country | *Offshore outsourcing* Outsourcing of services to an independent provider abroad |
| | Internal (captive unit) | *Domestic captive* Service delivery is performed at home by the firm itself | *Offshore captive* Firm sets up affiliate abroad to provide in-house services |

Source: Adapted from Massini and Miozzo, 2012.

For the purpose of this study, the terminology of Bamber *et al.*, (2013) is used to refer to RVCs as chains of activities at the regional market level and GVCs encompassing chains at the global market level, that is, across two or more continents. RVCs differ from GVCs in that the end product (here a service) of a RVC is provided by a country within the region, often within trading blocs; rather than across continents. However, questions remain concerning the definition of these so-called RVCs and how they differ from GVCs, for instance in terms of key drivers and (lead) actors. Furthermore, limited empirical evidence is available on what these regional chains look like in the context of services.

### *The case of sub-Saharan Africa*

For many sub-Saharan African countries competing in the global market is a struggle, and their participation in GVCs is hampered by structural factors (OECD, 2015). It is argued that firms in these countries could gain experience and build the capabilities needed to compete globally by first reaping the benefits of intra-regional trade. The African regional market would function as a playing field where firms could 'learn by doing' and develop the capabilities and gain the experience needed to compete in global markets (OECD, 2015). Kaplinsky and Farooki (2010) argue that understanding consumer preferences in less advanced markets may be easier for firms from these markets or region, due to cultural, geographic and regulatory proximity. In addition, they claim that these markets often have less demanding standards compared to markets in advanced countries with respect to quality and product sophistication and often place more emphasis on price competitiveness.

In the context of outsourcing and offshoring of services, empirical literature on the opportunities of the regional market remains scant, especially with regard to studies on SSA. Only in recent years studies have been conducted on sub-Saharan African countries as new players in the IT-enabled services landscape, particularly on hub destinations Ghana, Kenya and South Africa (see Adelakun and Iyamu, 2013; Beerepoot and Keijser, 2015; Dihel, 2011; Mann and Graham, 2016; Wausi *et al*., 2013). There is much common ground in these studies, as they all predominantly use a GVC perspective for analysing the 'offshore readiness' of these countries with regard to obtaining services contracts overseas, leaving little focus on the opportunities of the local or regional market.

## Methodology

The aim of this chapter is to provide an overview of South Africa's ITES industry, explore different value chains of IT-enabled services, and to understand what sourcing modes give rise to RVCs of services. In doing so, this study draws upon academic papers, company data, industry reports, and other secondary sources. In addition, qualitative field research for this study was carried out in Cape Town from January until March 2015. Semi-structured interviews were conducted with CEOs and managerial staff of eight service providers based in Cape Town, of which the majority has multiple offices across South Africa. These companies were purposively selected to ensure that a comparison could be made between firms servicing the South African, regional and global market as well as a distinction between South African versus foreign owned companies. Short semi-structured interviews and panel discussions during the Business Processing enabling South Africa (BPeSA) Offshoring Summit (March 4–6, 2015), which brought together stakeholders, service operators and academia, led to information from six more firms.

On the institutional side, nine semi-structured interviews were conducted with representatives from government agencies, business associations and international organisations. These interviews aimed at understanding the ITES industry in terms of expectations, challenges and perceptions towards the opportunities on the local, regional and global market. The qualitative data gathered through semi-structured interviews and from policy reports and secondary data, were analysed using software programme Nvivo.

## Analysis of South Africa's ITES industry

### *Industry overview*

The beginning of South Africa's presence in the offshore market dates back to 1998 when Lufthansa was the first global company to choose Cape Town as a base for the delivery of its services. However, it was not until the year 2012 that South Africa experienced strong demand for ITES service delivery, especially in the offshore market reaching growth rates above 12 per cent per annum (Willcocks *et al.*, 2015). Despite recent growth, the ITES industry in South Africa is relatively small with around 200,000 jobs created, compared to approximately a million people working in the outsourcing/offshoring industry in the Philippines (BPAP, 2015) and approximately 3.5 million in India (NASSCOM, 2015). Domestic demand for captive and outsourcing operations accounts for the largest number of employees (see Table 10.2).[1] The domestic market is serviced both by local owned firms as well as foreign service providers mainly based in Johannesburg.

The offshore market is small, but has shown significant growth in recent years expanding from approximately 10,000 jobs in 2012 to over 25,000 jobs in 2015 (BPeSA, 2015). It concerns mainly firms from the United Kingdom that have offshored services to South Africa, due to historical links, family ties, and similarities in business environment, laws and regulations. The offshore market is serviced by captive units of parent firms or by independent (foreign) service providers (BPeSA, 2015).

International companies currently offshoring to South Africa include Amazon, American Airlines, British Gas, IBM, Lufthansa, Shell, Shop Direct and TalkTalk (BPeSA, 2015). The arrival of captive units of these international firms and expansion of existing operations of foreign service providers (e.g. Accenture, IBM and Infosys) have put the country on the map as player in the global ITES industry.

*Table 10.2* Number of jobs created in the South African IT-enabled services industry by January 2015

| *Market* | *Captive* | *Type of investment* *Outsource* | *Total* |
|---|---|---|---|
| Domestic | 64,056 | 124,344 | 188,400 |
| Offshore | 7,156 | 18,578 | 25,734 |
| Total | 71,212 | 142,922 | 214,134 |

Note: Domestic captives refer to 100 per cent subsidiaries of firms in South Africa, which provide services exclusively to the parent company. Offshore captives refer to 100 per cent subsidiaries of companies based outside South Africa, which provide services exclusively to the parent company outside South Africa.

Source: BPeSA, 2015.

Services are performed mainly in three cities, Johannesburg and the Gauteng region, Durban and the KwaZulu Natal (KZN) region, and Cape Town and the Western Cape region. These three main areas comprise what Willcocks *et al*., (2015) refer to as the 'service triad'. Cape Town counts the largest number of customer related jobs coming from the offshore market, mainly due to the quality of its infrastructure and attractive expat lifestyle (Willcocks *et al*., 2015). Service providers in Johannesburg and the wider Gauteng region predominantly focus on customer relations, IT and financial services in the domestic ITES market. This is because the region is home to most of the headquarters of multinational companies (MNCs) operating in Southern and Eastern Africa, and the centre of South Africa's main industries and financial centres. In the last decade firms in Durban and the wider KZN region have started to provide sales-related services to client firms in both the domestic and offshore market. The overall cost of doing business in KZN is lower than in the Gauteng and Western Cape region, and is generally home to providers opening up a second office in South Africa (Willcocks *et al*., 2015).

### *Breakdown of ITES value chains*

Service providers in South Africa deliver non-primary business process outsourcing (BPO) services as well as higher value-added services in the segments of Information Technology Outsourcing (ITO) and Knowledge Process Outsourcing (KPO) (see Table 10.3). The BPO segment includes low value-added services that do not require specialised skills and have minimum training requirements and qualifications compared to ITO and KPO activities (Gereffi *et al.*, 2010). The BPO segment is by far the largest segment, which consists for 70 per cent of front office services (for example customer relations such as call centre services), and the remaining of back-office services (like data processing). The ITO segment constitutes activities, such as coding, testing and maintenance of software and higher value-added services including software development and system integration. No accurate numbers are available, but it is argued that the ITO market is

*Table 10.3* Different segments within value chains of IT-enabled services in South Africa

| *Information technology outsourcing (ITO)* | *Knowledge process outsourcing (KPO)* | |
|---|---|---|
| IT consulting | Business consulting and research | Legal services/LPO |
| | Actuarial servicing/ Risk management | Legal research |
| | Accountancy | Compliance |
| Software | | Contract management |
| Software development | | Mergers, acquisitions and due diligence review |
| System integration | | Document and Contract review |
| Desktop management | | Document drafting |
| Infrastructure | *Business process outsourcing (BPO)* | |
| IT management | Front office/contact centres | Back office/data processing |
| IT infrastructure solutions | Marketing and Sales | HR/Payroll management |
| | Credit collection | Transaction processing |
| IT support | Customer services | Asset management |
| | | Administration |

Source: different secondary sources.

significantly smaller than the BPO market, due to fewer IT skills available (BPeSA, 2015). KPO entails high-end knowledge work, such as consulting practices and marketing research, and makes up the high-end of the value chain. Particularly, Legal Process Outsourcing (LPO) has been identified as a niche where South Africa can compete globally (Willcocks *et al.*, 2015). The LPO sector in South Africa is fairly new, but is fast growing and employs approximately 1,350 employees (Zille, 2015). South Africa has a large group of law graduates that have not made it to practice yet, while possessing the appropriate skills for LPO (for example paralegal skills). The LPO market in South Africa consists of standardised jobs such as document review and higher value-added services such as legal research.

Table 10.3 gives an overview of the different segments in the ITES sector, the financial industry is responsible for the highest demand for services, coming mainly from the domestic market, whereas the demand for services from offshore markets is mainly driven by the telecommunication industry (BPeSA, 2015). Capabilities are particularly built in both front and back-office services across several sub-verticals, such as insurance, banking, and asset management (Everest Group and Letsema Consulting, 2008).

Interviews reveal that upgrading along the value chain from BPO activities to higher value-added activities is considered crucial for the development of the industry, especially since its domestic BPO market is argued to be maturing. Furthermore, firms want more complex jobs for their employees to promote an attractive career path. Even though BPO remains the backbone of South Africa's ITES industry, upgrading is occurring with for instance, firms delivering legal services. There is overall consensus among the respondents that there is also a need to move into more complex services within different segments of services.

In fact, upgrading within the field of BPO has already taken place, especially since transactional services are now mostly automated. For instance, providers in customer services have started to engage in more complex and non-scripted activities, allowing for more judgement and adopting more complex technologies, such as smartphone application development and deployment (BPeSA, 2015; Everest Group and Letsema Consulting, 2008).

### *South Africa's value proposition*

South Africa has been selected by client firms, predominantly from Europe and Australia, as an alternative destination for their activities. While not having the scale of India and the Philippines in terms of firms' size, South Africa is one of the few destinations offering English speaking skills at relatively low cost, and having close cultural affinity to Western markets. Furthermore, the education system as well as products and regulation in South Africa's domestic services sector are very much in line with those of its client markets, particularly the UK (Everest Group and Letsema Consulting, 2008). For instance, legal services are provided from South Africa, as the country is argued to be strong in auditing and reporting standards, and has data protection laws and certifications, similar to the UK (Willcocks *et al*., 2015).

The cost of doing business in South Africa has dropped significantly in recent years to approximately 54 per cent cost savings for firms in the UK and Western Europe, mainly due to the incentive scheme provided by the Department of Trade and Investments (Willcocks *et al.*, 2015). However, South Africa is not trying to compete as a low cost location for large volume contracts. South Africa is aiming for a position as a destination for 'high-quality, medium-cost contact centres and back-office services' (Willcocks *et al.*, 2015). The respondents confirmed that global investors turn to South Africa for the quality of customer services, which is argued to anchor in high quality of English language skills, neutral accent and cultural affinity to suppliers' markets. As one respondent from a UK based supplier of legal services explained:

> We have work delivered by Indian agents and South Africans. Some of the bulk goes to India, but when it comes to customer interaction we like to have South African agents doing the work. […] We offshore large volume back-office work to India, but for the customer experience we choose South Africa.
> (interview with a UK based supplier of legal services)

In addition, foreign firms opt for South Africans to deliver their complex services involving judgement calls, because of their ability to undertake non-scripted work. The CEO of a customer solutions company argues that this distinguishes South Africa from more traditional offshore destinations such as India.

> We service our company out of India. When the tasks are well scripted and frameworks are in place then India is a good option, but if it deviates Indian

> employees are off. We have experience in both countries, but for our company we see more value in South Africa, because the employees are more capable to work off the script.
>
> (interview with a foreign supplier of customer solution services)

In addition, foreign service providers also chose South Africa as a delivery base. For instance, Indian service providers have opened offices in South Africa, because it offers a pool of multi-lingual skills at close proximity to the Middle East and European market (KPMG, 2011). Also, its domain skills in service delivery in financial services, particularly in actuarial science (risk management) act as a pull factor. For instance, South Africa's number of qualified actuaries is argued to be three times higher than India and the Philippines combined (BPeSA, 2015). In addition to the skills base, the growing demand for ITES in the South African and regional market itself also acts as a pull factor for foreign service providers, which will be further discussed in the next section.

Despite South Africa's capabilities in the ITES industry, particularly in customer services, some challenges need to be addressed in order to sustain the recent growth rates of the industry. Although there is a massive labour pool with generic skills, there is a shortage of experienced and adequate team leaders and senior managers. Initiatives to address this include training programmes, and individual firm strategies, such as having overseas managers on the job. In addition, firms encounter problems when it comes to retaining staff as the growing demand for employees enables them to easily switch between employers. Another severe constraint to growth of the industry is the lack of coordination and alignment across industries, which also evidences in scattered initiatives related to workforce development. For instance, respondents stress the need for cooperation between universities and the private sector, to cater to the needs of the services industry by increasing the employability of people and hence increasing the scalability of projects.

## The emergence of regional value chains of services and the strategic position of South Africa

### *Foreign investments in the South African and SSA market*

South Africa serves not only as a platform for service delivery to firms overseas but foreign service providers have also opened up offices in South Africa to access the untapped market potential in the country and the SSA region. This market potential is reflected in increasing foreign direct investments (FDI) into Africa, with services outperforming manufacturing and primary extractive industries. For instance, in 2012, services accounted for 48 per cent of the total FDI stock in the African continent, more than twice the share of manufacturing (21 per cent), mostly flowing to South Africa and Nigeria (UNCTAD, 2015). Future potential for investments has been identified in consumer services such as: technology, media, telecommunications, financial services, consumer products and retail (EY, 2015). Respondents claim that foreign interest from both service providers and client firms in the South African and regional market for services is a result of saturated markets in Western countries and a rising middle class and growing consumerism in African markets.

> First a cost saving option, but now BPO is also the result of market seeking behaviour. In Europe, there is no potential market. South Africa is an easy entry and safe option into Africa.
>
> (interview with a representative of an organization targeting skills development in the South African BPO sector)

For example, Indian service providers have explored new emerging markets in the Middle East and Africa to reduce their overreliance on customers in the United States. Consequently, Indian service providers have established a presence in the South African market to service the domestic market for outsourcing (KPMG, 2011; The Economic Times, 2010).

Foreign service providers have also expressed their interest in the South African market through acquisitions of South African firms. An example of the latter includes the UK firm Quindell, which acquired South African-based telecom outsourcing service provider Quintica (in 2012). Indian outsourcing group WNS announced in 2012 that it had acquired South African BPO provider Fusion Outsourcing Services, supporting clients both domestically and offshore (Southafrica.info, 2012b). These examples of foreign investments in the domestic market for IT-enabled services are an illustration of the significance of local value chains.

### *Nearshoring in SSA*

Foreign acquisitions of South African firms are also driven by the interest in the SSA region. For instance, UK outsourcing service provider Capita expressed its desire to enter the SSA market starting with the acquisition of the South African firm Full Circle. In a press release the CEO of Capita explained that:

> The acquisition of Full Circle, a leading contact centre solutions business in South Africa, will enable us to provide a full range of offshored services in the region to our clients.
>
> (Southafrica.info, 2012a)

Furthermore, a study by Everest Group and Letsema Consulting (2008) claims that businesses providing outsourcing solutions in the financial services sector in South Africa have expanded their operations more rapidly into SSA, servicing firms in the neighbouring countries. This is also notable in the IT industry, where South Africa has for a long time been the major supplier of IT products and services to neighbouring countries. As such, market seeking behaviour of firms is not restricted to South Africa as a potential market, but extends to other African countries. This has often taken the form of nearshoring in SSA, referring to the outsourcing of services from firms in the region to service providers in South Africa, which give rise to RVCs. Even though the cases appear to be incidental and not well documented, respondents highlight that a lot of potential for nearshoring is present. A respondent from a South African owned IT firm in South Africa explains:

> It wasn't intentional. Our client in South Africa expanded its business to neighbouring countries, and because of that we are now also servicing our client and new clients in the African region. […] BPO rides on the back of it.
> (interview with a South African owned ITO firm)

There are also cases where service providers in South Africa service clients in the SSA market through joint ventures with local partners in the region. For instance, Direct Channel Holdings (DCH), one of South Africa's largest privately owned BPO service providers partnered with service provider Simba Technology Ltd to deliver services in Kenya, Tanzania and Uganda. DCH's operations (call and contact centre outsourcing solutions to banking, insurance, telecoms and retail customers) are currently also provided in Nigeria through a joint venture with Nigeria's local service provider XL Management Services Group (ITnewsAfrica, 2010).

The market seeking behaviour of international service providers on the African market is not restricted to the case of South Africa, but also applies to the case of Ghana. A number of overseas foreign service providers have started operations in Ghana to service the local or regional market rather than the offshore market (for example TechMahindra, TeleTech). The foreign firms perceive the growing demand for services in Ghana and the African market, especially in financial services and the telecommunications industry, as an opportunity to increase their client base (Beerepoot and Keijser, 2015).

### *Shared services centres in South Africa*

In addition to nearshoring in SSA, RVCs of services also consist of large companies in SSA having multiple offices across the region, which choose not to deliver their services in a dispersed matter, but bundle and perform these out of South Africa. This type of service delivery, referred to as shared services, is a form of outsourcing whereby various business functions and processes (for example in Finance and Accounting, IT, and Human Resources) from several departments, often across countries, are grouped together and provided from one location. This is generally done to achieve cost savings and business efficiencies (BPeSA, 2015). There are approximately 40 shared services centres operating in South Africa, of which 87.5 per cent are run as captive operations, and the rest are run by third-party providers (Zille, 2015). An example includes the launch of Barclays shared services centre in Pretoria, which provides operation support and services to its offices across SSA. The centre has created 4,000 jobs in voice and back-office services. Opportunities and trends have also been signalled for shared services in the field of LPO.

> Law firms have global relations, and with South Africa as a gateway to Africa the stage is set to utilize those relations.
>
> (interview with a South African legal services consultant)

> It's a matter of time before law firms move into Africa and execute their 'African strategies'.
>
> (interview with a South African owned LPO firm)

Shared services is different from nearshoring in that a centre could also perform bundled services from within a country, and that services are generally not outsourced to a third-party provider. Nevertheless, the market for shared services in South Africa is gaining momentum and appraised for demonstrating similar opportunities and capabilities as the outsourcing/offshoring industry. In some cases, a third-party provider first runs the operation before it is turned into a shared services centre. Furthermore, the networks between different branches and actors across the continent that underpin these centres are emphasised by respondents as increasing the likelihood of knowledge sharing, learning and hence capacity building in South Africa. As such, shared services are seen as integral and essential to the ITES industry.

The examples on nearshoring and shared services include both foreign firms and local owned firms in South Africa providing services in the SSA market to foreign and African client firms (often MNCs). Although limited data is available, there appears to be no clear pattern of RVCs being restricted to (African) trade blocs such as the Southern African Development Community (SADC).

### *RVCs and their potential as stepping stones to GVCs*

The growing services industry and trade in the African region is expected to open up more opportunities for the South African ITES industry. Particularly more potential is identified in the ITO segment, as industries such as banking and telecoms need more advanced IT infrastructure management. The growing services industry in the region is also coupled with increased demand for customer relationship management and back-office services (Everest Group and Letsema Consulting, 2008). Within the African continent South Africa has the competitive edge, as it is has the largest BPO sector on the continent, the most reliable infrastructure, largest talent pool, and a more stable political and financial climate compared to other African nations (Everest Group and Letsema Consulting, 2008). Additionally, the respondents claim that South Africa, especially Cape Town, offers a 'first world experience' to its investors. Direct flights from Europe to Cape Town, luxurious expat amenities, and high-quality infrastructure set the city apart from many other African cities.

Most respondents confirm South Africa's strategic position and emphasise the pressing need to look into the African market more carefully to diversify risks, reduce overreliance on the overseas market, and secure future growth.

> The African market could be the new offshore market, which we need because globally there is a lot of competition, prices are going up in South Africa […] and it is a way to expand our talent pool.
>
> (interview with a representative of an organization targeting skills development in the South African BPO sector)

The regional market, and especially the domestic market are argued to be important for South African owned firms, particularly small to medium sized firms (SMEs). There are successful South African owned firms, but they are mostly restricted in firm size and service only the domestic market. The main explanation given by respondents is the lack of resources and experience and inability to compete with large (foreign) MNCs. Furthermore, offshore deals often involve large-scale contracts whereas firms having no prior experience with large-scale (international) business processes experience difficulties in securing funds from banks.

> There are few success stories, but the African success stories on the offshore market often have a larger firm behind them to back them up in terms of resources.
>
> (interview with a representative of an industry body)

Even though the regional market appears to be not fully explored yet, the regional and especially the domestic market have already served as an entry into the global offshore industry for some local owned firms. For instance, the CEO of a South African owned firm, which employs approximately 20 people delivering IT outsourcing solutions, explained that the local and regional industry provided its management team the toolset needed to enter the global market. The provider also faced fewer difficulties obtaining a contract in the regional market compared to the global market, because its contract with the client firm in the region was the result of prior established relationships in the domestic market.

Respondents from UK owned service providers located in South Africa argued that for them the African market is not used as a stepping stone into the global market. They perceive the regional market more as risk diversification and an opportunity to expand their global services delivery capacity. In fact, some highlighted the need for local expertise to expand in Africa. A respondent from a foreign firm in South Africa, servicing the offshore and local market, explained how they were looking to expand operations into the rest of Africa servicing neighbouring countries, but needed resources and local expertise to do so.

> Knowledge is needed, in particular local expertise to roll out to the rest of Africa. [...] Partnership is important, learning from other operations, what they know.
>
> (interview with a contact centre subsidiary of a UK firm)

Several foreign service providers in South Africa have been cooperating closely with South African firms to share best practices, marketing leads and business developments to expand the local and regional industry (BPeSA, 2012). Furthermore, foreign investors setting up a captive unit have often done this with the help of local third-party providers, showing that South African firms may indeed have a better understanding of the domestic and regional market.

## Discussion: implications for outsourcing and offshoring

The case of South Africa shows that firms have offshored their services operations to South Africa either through a captive unit or through an external service provider. In addition, foreign service providers from advanced and emerging economies increasingly use South Africa as a base not only to service the overseas market, but also the South African market, giving rise to local value chains of IT-enabled services. These LVCs, in turn, have demonstrated the potential to be extended to RVCs as service providers seek to expand their delivery capacity further into the African region. This occurs particularly through nearshoring and through shared services centres.

The case of South Africa further shows that it is not solely large MNCs in advanced markets offshoring to developing countries to achieve business efficiencies. Rather, the case demonstrates the importance of the South African and SSA market for IT-enabled services as well. There is thus a need for a more elaborate overview of outsourcing/offshoring modes in which different markets (domestic, regional and global) come to the fore and in some cases overlap. Table 10.4 provides an overview of different sourcing modes when taking into account the heterogeneity of value chains. In each mode, the type of provider, viewed from the perspective of South African based service providers, could be an independent provider or a captive unit. The location of the client depicts the end market of the service, hence, giving rise to different value chains (local, regional and global value chains).

Although South Africa's share in the global offshore market has grown in recent years, its engagement in LVCs of IT-enabled services is currently more significant than its engagement in GVCs. Furthermore, RVCs for IT-enabled services are emerging and gaining attention, illustrating that South Africa does not solely act as an export platform for services to advanced nations. This shows the growing importance of developing and emerging country markets in the outsourcing/offshoring industry, arguing that this change in geographies of services is not well reflected in the literature.

## Conclusion

The case of South Africa is breaking with the mainstream understanding of the current wave of outsourcing/offshoring focusing mainly on GVCs of services (see Massini and Miozzo, 2012; Gereffi *et al*., 2010; Oshri *et al*., 2015; Lambregts *et al*., 2015), which involve the relocation of services from firms in advanced countries to less developed countries. Instead, local and regional value chains of

*Table 10.4* Service providers in South Africa: heterogeneous value chains

| | | *Location of client* | | |
|---|---|---|---|---|
| | | *Domestic market* | *Regional African market* | *Global market* |
| *Type of provider* | Local or foreign independent (third-party) provider | *Onshore outsourcing services* South African-based firm provides services to client firm in South Africa | *Regional outsourcing services (nearshoring)* South African-based firm provides services to client firm located in SSA, shared services for multiple units of the client firm | *Global outsourcing services* South African-based firm provides services to overseas client firm (outside of SSA) |
| | Captive unit of a local or foreign firm | *Onshore captive services* Captive unit in South Africa provides services to the parent company in South Africa including onshore shared services centres | *Regional shared services* Captive unit of a firm in South Africa provides bundled services to other affiliates of the firm across SSA countries | *Offshore captive services* Captive unit of a foreign client firm provides services to the parent firm overseas |

IT-enabled services are equally important for firms based in less developed countries. The domestic and regional ITES market allow some firms to build capacity and gain experience to compete in the global market place. This finding is line with advocates of RVCs who argue that RVCs serve as a stepping stone into GVCs (see Bamber *et al*., 2013; Cattaneo *et al*., 2010; ERA, 2009; Kaplinsky and Farooki, 2010). However, the examples documented in this research show that client firms in the regional market are both African firms as well as foreign firms, predominantly large MNCs. This raises questions as to how different RVCs are from GVCs in terms of governance structures (such as the power relations between client firm and provider). Additional and more detailed research is needed that includes a large number of cases to explore how RVCs look like in terms of types of service providers and client firms and the required skills and experience, and compare these to the characteristics of the global offshore market (GVCs). In other words, to what extent RVCs are different from GVCs of services and whether they indeed offer more opportunity for African operations to compete in the outsourcing and offshoring industry. Questions also arise concerning the sources of knowledge and innovation underpinning firm competitiveness. For instance, what role these different value chains play and the different learning opportunities resulting from these different networks between provider and client firm. This subject is still understudied while it is crucial for understanding firm competitiveness in the current economic landscape where learning and innovation are key (see Ernst, 2002; Morrison *et al*., 2008; Pietrobelli and Rabelloti, 2011).

The ITES services industry in South Africa is relatively small, but has expanded rapidly in recent years. South Africa has the potential to attract more (international) investments in the IT-enabled services industry provided that it can successfully position itself to deliver higher value services. Yet, integral to this and to upgrading trajectories is human capital development. Challenges related to workforce development (for example management training and skills development) need to be tackled, as well as the lack of coordination and alignment between stakeholders across industries. Furthermore, the South African ITES industry needs to be better marketed not just in terms of South Africa's capabilities in the field of service delivery, particularly in customer services and its domain skills in the financial industry, but also in the SSA market for nearshoring and shared services. South Africa acting as a gateway to the African market could allow firms to pursue their 'Africa strategies'. The latter has the potential of becoming the country's major strengths and unique value, within the changing global sourcing landscape where MNCs seek to expand their global delivery capacity (see Gereffi *et al*., 2010; Sako, 2009).

## Note

1 Domestic captives refer to 100 per cent subsidiaries of firms in South Africa, which provide services exclusively to the parent company. Offshore captives refer to 100 per cent subsidiaries of companies based outside South Africa, which provide services exclusively to the parent company outside South Africa.

## References


Adelakun, O. and Iyamu, T. (2013). Offshore IT Outsourcing to South Africa Analysis of Readiness and Attractiveness, International Conference on ICT for Africa, Harare, Zimbabwe.

Africa report (2012). Outsourcing: the Indian connection and Africa. Retrieved from www.theafricareport.com/North-Africa/outsourcing-the-indian-connection-and-africa.html [accessed 21 October 2015].

Bamber, P., Fernandez-Stark, K., Gereffi, G. and Guinn, A. (2013). Connecting Local Producers in Developing Countries to Regional and Global Value Chains: Update, *OECD Trade Policy Papers, No. 160,* OECD Publishing.

Beerepoot, N. and Keijser, C. (2015). The service outsourcing sector as driver of development: The expectations of Ghana's ICT for accelerated development programme. *Tijdschrift voor economische en sociale geografie,* 106(5), pp. 556–569.

BPAP (2015). IT-BPO Road Map 2011–2016. Retrieved from www.ibpap.org/about-us/it-bpo-road-map-2011–2016 [accessed 20 October 2015].

BPeSA (2012). BPO giant Aegis takes Cape Town SMME under its wing. Retrieved from www.bpesa.org.za/2012/07/13/bpo-giant-aegis-takes-cape-town-smme-under-its-wing [accessed 20 October 2015].

BPeSA (2015). Key indicator report 2014/2015. BPeSA, South Africa.

Cattaneo, O., Gereffi, G., and Staritz, C. (2010). *Global Value Chains in a Postcrisis World: A Development Perspective*, Washington, DC: World Bank.

Dihel, N. (2011). Can Kenya become a global exporter of business services? International Centre for Trade and Sustainable Development, 10(9), pp. 19–21.

Dossani, R. and Kenney, M. (2007). The Next Wave of Globalization: Relocating service provision to India. *World Development,* 35(5), pp. 772–91.

ERA (2009). Developing African Agriculture Through Regional Value Chains, United Nations Economic Commission for Africa Addis Ababa, Ethiopia.

Ernst, D. (2002). Global production networks and the changing geography of innovation systems. Implications for developing countries, *Economics of Innovation and New Technology*, 11(6), pp. 497–523.

Everest Group and Letsema Consulting (2008). South Africa's BPO proposition: discussion document. London: Everest Group.

EY (2015). EY's attractiveness survey Africa 2015 making choices, Ernst and Young Global Limited.

Fernandez-Stark, K., Bamber, P. and Gereffi, G. (2011). The Offshore Services Value Chain: Upgrading Trajectories in Developing Countries. *International Journal of Technological Learning, Innovation and Development*, 4(1-2-3), pp. 206–34.

Gereffi, G. (2005). *The New Offshoring of Jobs and Global Development*. Geneva: International Labor Office.

Gereffi, G. and Fernandez-Stark, K. (2010). *The Offshore Services Global Value Chain,* Center on Globalization, Governance and Competitiveness, Duke University.

Gereffi, G., Fernandez-Stark, K. and Psilos, P. (2011). *Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries*, Center on Globalization, Governance and Competitiveness, Duke University.

Gereffi, J., Humphrey, J., Kaplinsky, R. and Sturgeon, T. (2001). Introduction: Globalisation, Value Chains and Development, *IDS Bulletin,* 32(3)*,* pp. 1–9.

ITnewsAfrica (2010). SA IT company invests in Nigeria. Retrieved from: www.itnewsafrica.com/2010/05/sa-technology-company-invests-in-nigeria [accessed 21 October 2015].

Harji, K., Best, H. and Jackson, E-T. (2013). *Digital Jobs*, The Rockefeller Foundation.

Humprey, J. and Schmitz, H. (2002). How does the insertion in global value chains affect upgrading in industrial clusters? *Regional Studies*, 36(9), pp. 1017–27.

Kaplinsky, R. and Farooki, M. (2010). Global Value Chains, the Crisis and the Shift of Markets from North to South. In: Cattaneo, O., Gereffi, G., and Staritz, C. (2010), *Global Value Chains in a Postcrisis World: A Development Perspective* (pp. 125–154). Washington, DC: World Bank.

KPMG (2011). India-South Africa Corridor Newsletter, Building Relations, KPMG International Cooperative.

Labour Research Service (2011). South African MNCs in Africa – Trends in 2010 / 2011: A report covering MNCs submitted by Global Unions. Cape Town: Labour Research Service.

Lambregts, B., Beerepoot, N. and Kloosterman, R.C. (eds) (2015). *The Local Impact of Globalization in South and Southeast Asia: Offshore Business Processes in Services Industries*. London and New York: Routledge.

Mann, L. and Graham, M. (2016). The Domestic Turn: Business Processing Outsourcing and the Growing Automation of Kenyan Organisations. *Journal of Development Studies*, 52(4), pp. 530–48.

Massini, S. and Miozzo, M. (2012). Outsourcing and Offshoring of Business Services: Challenges to Theory, Management and Geography of Innovation, *Regional Studies*, 46(9), pp. 1219–42.

Morrison, A, Pietrobelli, C. and Rabellotti, R. (2008). Global Value Chains and Technological Capabilities: A Framework to Study Learning and Innovation in Developing Countries, *Oxford Development Studies*, 36(1), pp. 39–58.

NASSCOM (2015). India IT-BPM Overview. Retrieved from www.nasscom.in/indian-itbpo-industry [accessed 20 October 2015].

OECD (2015). The Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade Policy, Paris: Organisation of Economic Cooperation and Development.

Oshri, I., Kotlarsky, J., and Willcocks, L.P. (2015). *The Handbook of Global Outsourcing and Offshoring*, 3rd Edition, Palgrave Macmillan.

Palugod, N. and Palugod, P. (2011). Global trends in Offshoring and Outsourcing, *International Journal of Business and Social Sciences*, 2(16), pp. 13–19.

Pietrobelli, C. and Rabelloti, R. (2011). Global Value Chains Meet Innovation Systems: Are There Learning Opporunities for Developing Countries? *World Development,* 39(7), pp. 1261–69.

Ramdoo, I. (2014). Developing value chains: What role for regional integration? *GREAT Insights*, 3(7).

Sako, M. (2009). Global Strategies in the Legal Services Marketplace: Institutional Impacts on Value Chain Dynamics, Paper presented at the SASE Conference. Paris, France. 16–18 July.

Southafrica.info (2012a). UK outsourcing giant buys into SA. Retrieved from www.southafrica.info/business/investing/capita-250712.htm#.Veax8nhUPNo#ixzz3kZGHyWSm [accessed 19 October 2015].

Southafrica.info (2012b). SA's outsourcing reputation grows. Retrieved from www.southafrica.info/business/investing/opportunities/outsourcing-260912.htm#.VebCgnhUPNo [accessed 19 October 2015].

Sturgeon, T. and Memedovic, O. (2010). Measuring global value chains: intermediate goods trade, structural change and compressed development. Vienna: UNIDO working paper.

The Economic Times (2010). Indian IT companies like TCS, Infosys and Wipro tap Africa's new-fangled fad for technology, Retrieved from http://articles.economictimes.indiatimes.com/2014-05-10/news/49757824_1_hcl-technologies-south-africa-finacle.

UNCTAD (2015). World Investment Report 2015: Reforming International Investment Governance, United Nations Conference on Trade and Development, Geneva.

Wausi, A., Mgendi, R. and Ngwenyi, R. (2013). The labour market and digital jobs in Africa: Kenya's workforce potential in Impact Sourcing, *Research Brief June,* No.3.

Willcocks, L., Lacity, M. and Craig, A. (2015). *South Africa's BPO Service Advantage,* Palgrave London.

Zille, P. (2015). Analysis of the Business Process Services Sector, *Genesis Analytics,* Johannesburg.