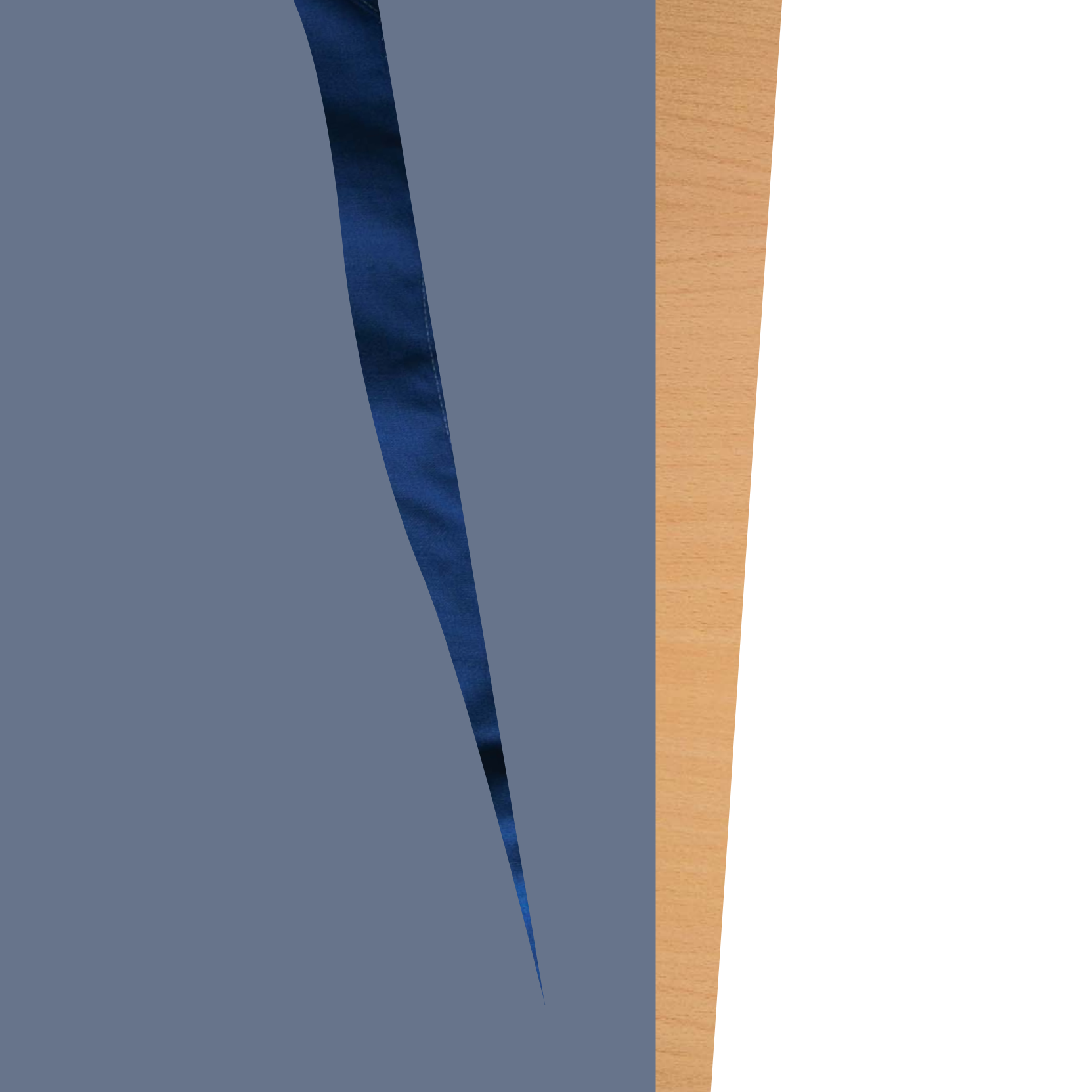


Ready to COMPETE

SOUTH AFRICA'S BUSINESS PROCESS
OUTSOURCING CAPABILITIES
IN THE FINANCIAL SERVICES SECTOR

Executive Summary





Foreword

The Financial Services sector constitutes the largest segment (about 45%) of the global sourcing industry. South Africa's standing in this sector is world class. It is backed by a sound regulatory and legal framework, and has a large number of domestic and foreign institutions providing a full range of services: commercial, retail and merchant banking, mortgage lending, insurance and investment.

The sector presents a significant opportunity for firms building offshore global delivery networks. It offers a 50-60% cost advantage over international destinations and a quality and sophistication that compare with the major source markets in this sector.

This report was commissioned to provide potential investors with fine-grained information to support the business case for investing in Business Process Outsourcing (BPO) Financial Services in South Africa. It was produced by The Everest Group and Letsema Consulting under the guidance of a Leadership Group drawn from industry leaders in South Africa and supported by the Department of Trade and Industry (the dti) and the BPO industry association (BPeSA). The full report is presented in a compact disc that can be found at the back of this document and summarised in the following pages.

Honourable Minister Mandisi Mphahlela

Department of Trade and Industry
South Africa

Brian Whittaker

Chief Executive: Business Trust

The BPO Partnership



The Department of Trade and Industry (the dti) represents the government in the partnership. It participates in the Business Process Outsourcing (BPO) Sector Support Programme through its Strategic Competitiveness Unit, situated in the Enterprise and Industry Development Division (EIDD). www.thedti.gov.za



The Business Trust combines the resources of business and government to accelerate the achievement of nation objectives. The Business Process Outsourcing Support Programme was established to enable actors in the public and private sectors to work together to establish South Africa as a preferred location for Business Process Outsourcing. www.btrust.org.za



Business Process enabling South Africa (BPeSA) is the national co-ordinating body representing the interests of the Business Process Outsourcing & Off-shoring sector in South Africa. The organisation represents the industry, and has four regional arms in Gauteng, the Western Cape, KwaZulu-Natal and the Eastern Cape. www.bpesa.org.za



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Introduction and context

South Africa is emerging as an important destination for Business Process Outsourcing (BPO). Some 86 000 people are employed in business process outsourcing for the financial services sector which is the subject of this report. 75 000 of those people are employed by South African Financial Service companies for meeting their own needs in so called “captive centres” and 11 000 in the provision of services to third parties and by global firms for their own organisations in other parts of the world (in “off-shore captives¹”). The industry has been growing at a rate of 33% per year.

South Africa aims to create an additional 100 000 jobs by 2010 by expanding the BPO sector. Significant success has been achieved to date, and several public and private sector initiatives are in place to attract more offshore BPO business to South Africa.

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

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

¹ “Domestic captives” refers to 100% subsidiaries of companies in South Africa, which provide services exclusively to the parent company. Off-shore captives refers to 100% subsidiaries of companies based outside South Africa which provide services exclusively to the parent company outside South Africa.

GLOBAL OPPORTUNITY *in* **offshore Financial Services** *Business Process Outsourcing*

The Financial Services sector continues to be the largest adopter of the off-shoring model, accounting for some 45% of the global off-shoring industry. The estimated current market size for offshore Financial Services BPO is around US\$10 billion. Most leading global Financial Services firms have placed significant amounts of their business processing offshore.

However, there is still significant growth potential for offshore Financial Services BPO. The estimated addressable opportunity is around US\$250 billion, which is around 25 times the current market size. Growth opportunities exist across many areas, including front-office (customer-service) and back-office work (non-customer-facing functions).

The financial crisis triggered in 2008 could have a short-term negative impact on Financial Services companies' off-shoring plans. However, the medium-to-long-term growth outlook for offshore Financial Services BPO is robust, with companies expected to move their business offshore to reduce costs.

Financial Services firms wanting to grow their offshore footprint are looking beyond the leading offshore destinations such as India and the Philippines. This presents opportunities for South Africa to gain an increasing share of the global offshore Financial Services BPO market. South Africa has established a good starting point in Financial Services BPO, as described in the following section.

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CURRENT SERVICE PROVIDER LANDSCAPE for **Financial Services BPO**

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

Scale of operations

Service providers (suppliers and offshore captives) in South Africa have established credible scale in Financial Services BPO, employing some 11 000 people. While this scale is smaller than that of traditional offshore destinations for example India and the Philippines, it is comparable to emerging offshore destinations such as Romania, Malaysia and the Czech Republic. In addition to service providers, there are many large-scale domestic Financial Services firms who provide business process services for their own clients (through so called domestic captives) in South Africa. These domestic Financial Services captives employ between 65 000 and 75 000 people.

Delivery maturity in Financial Services (FS) BPO

The following factors demonstrate that service providers have credible delivery maturity in Financial Services BPO:

Significant client experience: Service providers serve some 240 Financial Services clients across retail banking, insurance, and asset management.

Breadth of process capabilities: While front-office capability is a key strength (with some 6 000 employees across inbound and outbound functions), significant back-office work also exists (for around 5 000 employees) as indicated in **Chart 1**.

Chart 1

Financial Services BPO employee split across types of BPO functions

Number of employees
100% = 11,000

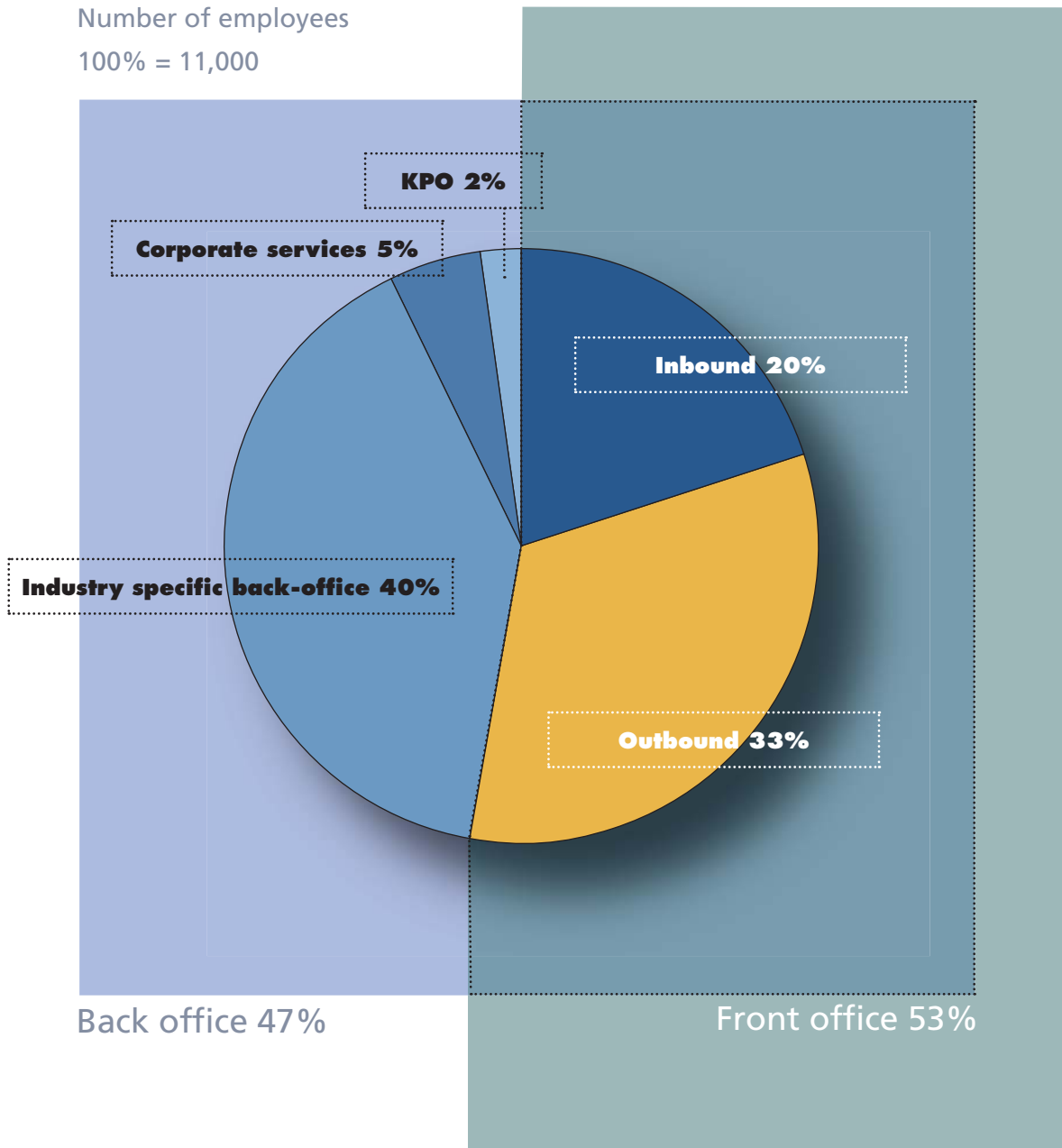


Chart 2 Insurance-specific back-office processes supported by service providers in South Africa

Processes	Key success areas				
	Product development	Business origination	Policy servicing and reporting	Claims processing	Health Insurance specific processes
Sub-processes	Actuarial data processing	Proposals, illustrations	Policy servicing – financial	Claims requirement gathering and data capture	Plan design
	Actuarial analysis and review	Agent and broker management	Policy records management	Claims management	Eligibility services
		Regulatory and compliance management	Eligibility enquiry and verification	Claims review and investigation (adjudication)	Revenue cycle management
		Initial policy creation		Claims Adjustment and disbursements	Denial management
		Underwriting		Fraud detection and management	Healthcare collections
		Premium collection and accounting		Claims litigation, recovery/subrogation	Medical records management
		Policy issuance			
		Member enrolment and management			

Service providers support most outsourceable front-office processes (including inbound customer service, outbound sales and collections processes). They also support around 75% of outsourceable Financial Services back-office processes. Specifically, insurance back-office processes are a key strength, with service providers supporting nearly all (95%) outsourceable processes. Chart 2 indicates the breadth of activity covered by insurance back-office services.

Value delivered beyond labour arbitrage:

The service provider industry continues to deliver robust cost benefits and meet clients' quality and service-level expectations. The industry is evolving to deliver business benefits beyond cost reduction in a number of ways, including:

- Leveraging technology to drive process transformation;
- Delivering a higher quality of service compared with the baseline (e.g. improved first call resolution, improved customer satisfaction, reduced turnaround time); and
- Using strong domain skills to support sophisticated financial products and complex processes.

Client geography focus

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



POTENTIAL FOR GROWTH *in* **Financial Services BPO**

Although current offshore activity is modest (around 2 900 jobs), there is significant potential for growth.

Four key drivers are:

- A large, experienced talent pool with service-delivery and domain skills in the domestic Financial Services industry;
- A sizeable talent pool with specialised skills (e.g. actuaries);
- The narrowing of operating cost differences between South Africa and other low-cost offshore locations; and
- Availability of scalable, affordable, high quality English skills.

Service delivery and domain skills in the domestic Financial Services industry

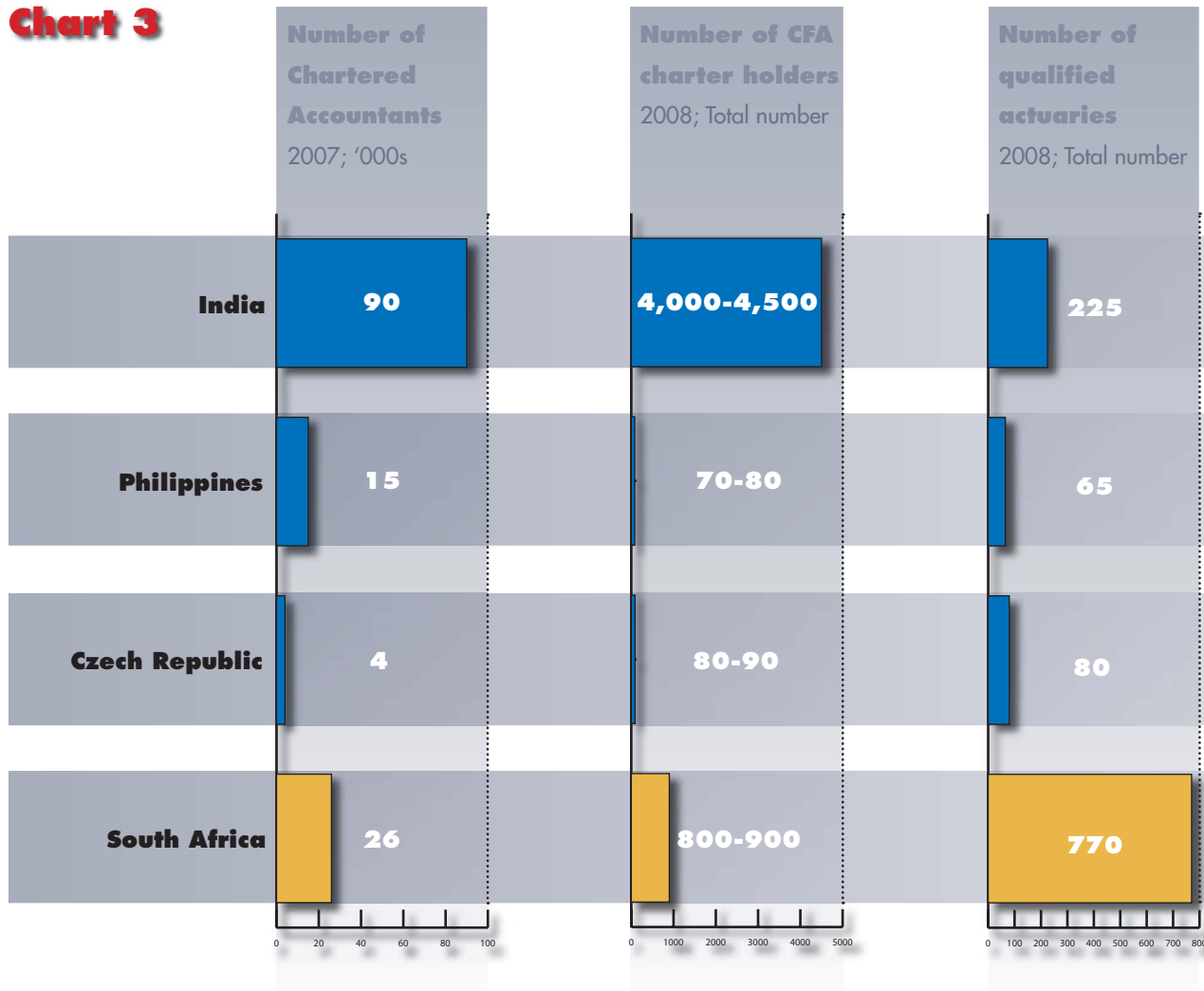
Service delivery skills: Domestic Financial Services captives have built significant scale, with many of these firms employing over 4 000 people. The domestic captive industry employs 65 000 to 75 000 people overall. Although captive entities, they are managed similarly to outsourced operations (for instance through defined service-level agreements with the parent companies). In addition, these captives have demonstrated distinctive capabilities, especially in the areas of process improvement, efficiency and quality assurance.

Domain skills: Products and regulations in South Africa's domestic Financial Services sector are similar to those in developed markets (for example the UK) and more advanced than most other offshore destinations. The strength of the talent pool in South Africa's domestic Financial Services lies in its knowledge and experience of working with advanced products and regulations. The sector also has significant technology experience and a strong orientation towards adopting new technologies, for instance cell phone banking.

Specialised skills in the market

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

Chart 3



Comparison of scale of niche skills relative to other offshore destinations



**Narrowing
operating cost
differences
between South
Africa and
other offshore
destinations**

Current cost saving potential from South Africa relative to western markets such as United States of America is in the order of 50-60% on an operating cost basis. While South Africa is not the lowest cost destination, the savings gap with other low-cost destinations is narrowing. Two factors drive the narrowing savings gap. While most currencies appreciated over the past three years (2005-2008), the South African currency depreciated. Secondly, inflation levels in South Africa are lower than in other low-cost destinations. **Chart 4** indicates the extent to which the savings gap is narrowing for the front-office (customer-service) function.

Given underlying drivers of this cost gap it is likely that this difference could reduce further. At current cost levels, however, the savings gap is even smaller when considering the impact of lower attrition in South Africa.

Chart 4 Savings gap between South Africa and India relative to U.S. (Tier 2 locations)



Availability
of scalable,
high quality
English skills

While South Africa has a lower number of university graduates than more populous countries, high-school graduates in South Africa have shown to be highly suitable for the BPO labour pool. The estimated total entry-level talent for BPO in South Africa (including high-school graduates) is estimated to be 470 000 annually. In addition to scale, the talent pool in South Africa has strong English-language proficiency and cultural affinity with Western geographies, particularly the United Kingdom.



KEY RISKS *and* **structural** **factors**

While South Africa has clear advantages in terms of its robust physical infrastructure and expatriate quality of life, there are some challenges around telecommunications, crime and the prevalence of HIV/AIDS.

Steps are being taken to improve telecommunications infrastructure and reduce service costs, with tariffs having dropped by some 47% year on year over the past four years (2004-2008). Proposals are under discussion to enhance bandwidth and further reduce tariffs.

Most companies find that the risks related to crime and HIV/AIDS can be effectively managed. Examples include implementing security solutions to prevent and deter external crime, supporting structured initiatives such as Business Against Crime, and investing in HIV/AIDS awareness and treatment programmes.



ROLES *that* SOUTH AFRICA *can play* **for** **investors**

The global-sourcing location landscape is evolving and investors have over 150 global city options. As investors expand their offshore-location footprint, they are increasingly considering the supply chain and the role of each location in the broader global delivery network.

South Africa provides the investor with a number of opportunities in the Financial Services BPO.

An offshore destination for high-quality English language front-office functions

A large talent pool with good-quality English skills, neutral accents and cultural affinity with countries like United States of America and United Kingdom position South Africa well for this role. South Africa also offers significant savings potential. On an operating cost basis, South Africa is 50-60% cheaper than leading international destinations. The savings gap between South Africa and other low-cost destinations, such as India is narrowing and is likely to reduce even further.

An offshore destination for complex back-office work

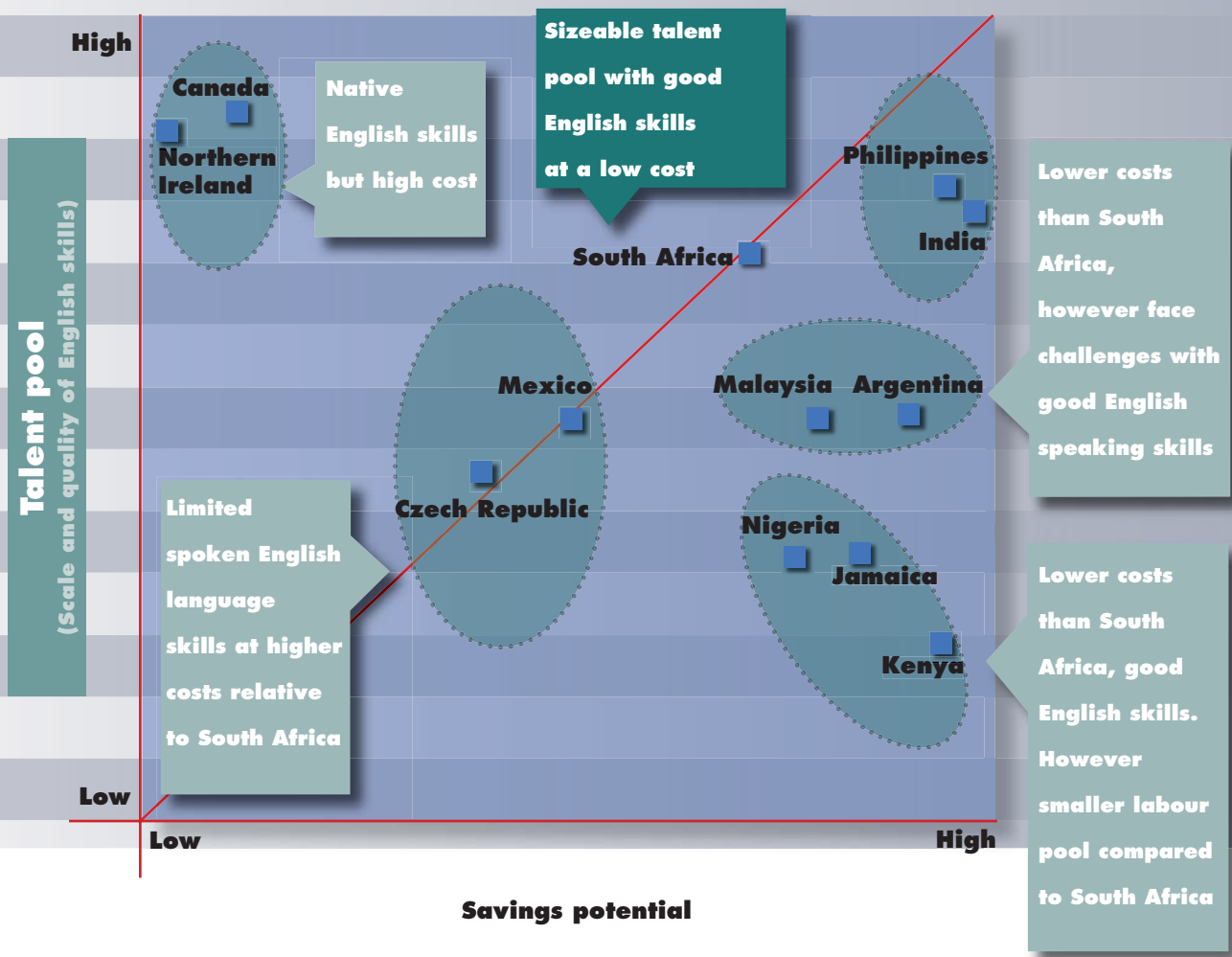
South Africa has key strengths in terms of its large, experienced talent pool with relevant service delivery and domain skills in the domestic Financial Services sector. It has clear advantages in certain niches such as actuarial skills. Savings potential from South Africa for complex Financial Services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

A near-shore scalable destination for sub-Saharan Africa

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

Chart 5

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



Risk-diversification option for India and Philippines

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

The authors

Everest Group is a global consulting firm with offices in leading business centres such as Dallas, New York, Toronto, London, Amsterdam, New Delhi, Melbourne and Sydney. Everest Group helps clients to achieve maximum value from their operations, including sourcing strategy and implementation. Everest provides information; insight and advisory services to help leading companies, suppliers and service enablers capture value from strategic sourcing services. Everest Group established its research arm, **Everest Research Institute**, as a commitment to provide thought leadership and fact-based insights about the outsourcing and offshoring marketplace. Everest Group has extensive experience working with country associations and investment agencies. It partnered with Nasscom to develop the roadmap for the Indian BPO industry and has been engaged with the South African BPO programme since 2007. www.everestgrp.com

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Letsema Consulting and Advisory has been engaged in the national BPO Programme since its inception in 2005, initially running the Quality Assurance work-stream that resulted in the BPO Standards SANS 990 (1-3). Letsema thereafter supported the programme in the launch of the BPO Incentives, various Trade Missions abroad and in implementing the 2007 Marketing Plan. Finally, the company facilitated a national review of the BPO Marketing Strategy, resulting in a major revision in 2008.

Letsema was founded in 1996 and is based in Johannesburg. The company serves clients across the public and private sector, and advises companies on strategy, transformation, operational improvement and Enterprise Architecture.

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Ready to COMPETE

The full report and executive summary can be found on the accompanying CD. These can also be downloaded from the Business Trust website at www.btrust.org.za.

An investor-focused return-on-investment tool (**ROI tool**) is also on the CD. This Excel tool is designed to help investors assess the potential savings generated from locating their offshore processes in South Africa. It was created using the underlying cost information from the research that forms the basis of this summary, and incorporates the dti's BPO investment incentives (Capex grant and training grant) to demonstrate how investors can offset their costs through these incentives.



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