Developing an African Offshoring Industry—The Case of Nigeria

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Introduction

Nigeria’s economic potential is vast. The country’s considerable resource endowment, strategic coastal location and large internal market should allow it to become an economic powerhouse for Africa. Yet Nigeria has not yet realized this potential. Like most African countries, in order to begin on a path of rapid and sustainable development, Nigeria will have to support private sector growth and look for opportunities to diversify the economy away from the oil sector. One attractive way to do this could be to develop the nascent offshoring information communications technology (ICT) sector. Countries around the world that are investing in high value added sectors such as ICT, in particular countries such as India, South Korea, and the Philippines, are reaping the benefits of adapting their economies to be more competitive in global services trade.

This note aims to raise awareness for Nigeria’s potential as an offshoring hub in Africa, and is aimed primarily towards policy makers and potential private sector investors. It addresses the questions of what Nigeria can do to take advantage of the benefits of global trade in services, how the country can brand itself as an offshoring destination for international investors, and what government policies are required to ensure that Nigeria play a role in the growing ICT offshoring sector. This note will also provide policy prescriptions and practical advice for policy makers, enterprises, and other stakeholders for developing a successful offshoring sector in Nigeria. In addition, this policy note should be of interest to policy makers and stakeholders throughout the region, as many challenges and policy prescriptions examined here are relevant to countries throughout Africa.

What is Offshoring?

Outsourcing occurs when one company delegates responsibility for performing a function or series of tasks to another company. When the second company is based in another country, outsourcing becomes offshoring. Recent improvements in information technology and lower costs of data transmission have extended the concept of offshoring to tradable services. Services offshoring has become a popular strategy for firms looking to streamline costs, improve customer service, and enhance their core competencies. Services offshoring encompasses a wide variety of export-oriented services that span the

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entire value chain. In 2010, the global offshoring market was estimated to be around $90 billion, and is likely to grow rapidly as technology and countries’ capabilities improve.

How Can Services Offshoring Reduce Poverty?

Services trade can be an engine for growth and can catalyze poverty reduction. In countries that have grown quickly and that have been able to sustain high growth over long periods, the service sectors have been responsible for much of that growth, generally growing much faster than other sectors of the economy, as can be seen in Figure 1. Indeed, engaging in services trade enables countries potentially to bypass the industrial development stage and engage directly in high value added sectors. An example of this is found in Nigeria where mobile phone subscribers greatly outnumber those with landlines and the mobile phone has made investing in costly fixed line infrastructure unnecessary.

In addition to the economic logic behind developing an offshoring sector, the wider context of global demand for services also shows the benefits of engaging in services trade. The global market for offshoring has been growing at 30 percent annually between 2003 and 2010, far outpacing the growth rate of goods trade and even other services trade. Similarly, the percentage of the total workforce engaged in services is expanding at a rapid pace, which demonstrates the job-creating nature of services sectors. Furthermore, since many service sector jobs are relatively well paid, it is estimated by UNCTAD that each new position generates a further three jobs in the rest of the economy.

Beyond job creation, offshoring creates positive spillover effects that can further benefit the economy as a whole. Among these benefits are:

- **Incentives are created for education.** While manufacturing outsourcing relies on a cheap, low-skilled workforce, services outsourcing relies on a well-educated and skilled workforce. The employment of a relatively skilled labor force in services trade increases the returns to education, and in this way creates incentives to acquire skills that are marketable in the global economy.
- **Technology and knowledge are transferred.** Repeated and frequent interactions with foreign firms increase knowledge transfers. This is not limited just to technical knowledge, but also includes the business standards and managerial know-how that feature prominently in the long-run growth trend for any developing country.
- **Human capital is improved.** Export-oriented zones have been shown to improve the quality of human capital and the productivity of the local workforce in domestic economies as long as foreign investors help to train the local workforce and encourage further learning. This can take place at all levels, from entry-level workers to the managerial level. In this way, developing countries can acquire experience and put in place the conditions necessary to foster local entrepreneurship.

Developed countries provide the majority of demand for offshore business services. The McKinsey Global Institute estimates that approximately 225,000 jobs—or 1-2% of total jobs created in the United States—will be offshored on average per year and that in total up to 11% of worldwide service employment could be performed remotely, suggesting that up to 18 million jobs are likely to go offshore.
On the supply side, India has emerged as the leader in the international offshoring space, with as much as 65 percent of the market. However, as a larger number of firms look to diversify their service sources to prevent dependence on a single provider, more countries are competing to gain a share of the expanding market. It was estimated by the consulting firm A.T. Kearney in its *Making Offshore Decisions* report in 2004 that more than 4,000 companies in 150 countries were then competing to offer offshored services to a handful of wealthy nations, and that number has likely increased since the report’s publication. A 2009 report from A.T. Kearney argued that Africa has the potential to “redraw” the global offshoring map by attracting relatively more foreign firms than other regions.8

**Nigeria and the Drivers for Services Offshoring Growth**

Companies engage in offshoring activities for a variety of reasons, the most important of which is that offshoring can often reduce labor costs. Since salaries comprise a significant portion of variable costs, offshoring business processes can provide sizeable savings to firms in developed countries. In addition to cutting costs, firms can use offshoring to increase their productivity and competitiveness. Offshoring generic business processes allows firms to focus on their core competencies and increase innovation initiatives, which often enables firms to expand their operations and broaden their customer base. In addition, in some instances offshoring can present an opportunity for better risk management and diversification, which can reduce a firm’s liabilities and direct responsibilities. By offshoring certain business services, therefore, multinational and foreign companies can accelerate the delivery of work products, improve customer satisfaction, and reduce costs.

There are several key factors that determine whether a particular region would be an attractive offshoring operation. The Offshore Location Attractiveness Index, presented below, can be used to evaluate different locations around the world in terms of their attractiveness for offshoring activities. The index consists of three major categories including financial structure, people skills and availability, and business environment (see Table 1 for details of the key elements). Financial structure is given 40% of the total weight, since cost advantage was determined to be the primary driver of offshoring activities, while people skills and business environment each accounts for 30% of the remaining weight.

**Table 1: Offshoring Attractiveness Index**

<table>
<thead>
<tr>
<th>Category</th>
<th>Sub-Category</th>
<th>Key Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Structure (40%)</strong></td>
<td>Compensation Costs</td>
<td>Average wages and median compensation costs for relevant positions</td>
</tr>
<tr>
<td></td>
<td>Infrastructure Costs</td>
<td>Electricity and telecommunications costs</td>
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<td></td>
<td>Real Estate Costs</td>
<td>Office rents per square meter</td>
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<td></td>
<td>Regulatory Costs</td>
<td>Corporate tax rate and quantification of other regulatory costs</td>
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<tr>
<td><strong>People Skills and Availability (30%)</strong></td>
<td>Workforce availability</td>
<td>Population and total workforce</td>
</tr>
<tr>
<td></td>
<td>Labor Force Quality</td>
<td>Literacy rates and English-speaking ability</td>
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<td></td>
<td></td>
<td>Proportion of population pursuing tertiary education</td>
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<tr>
<td></td>
<td></td>
<td>Education expenditure as a % of GDP</td>
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<tr>
<td></td>
<td>Reputation</td>
<td>Existing IT and BPO market size</td>
</tr>
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<td>Quality rankings</td>
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Nigeria is typical of Africa as a possible destination for foreign firms in that it has a mix of strengths and weaknesses for these indicators. This framework could be useful for other African countries that are interested in attracting foreign firms. The results are summarized in Table 2 below, and the remainder of this section examines in more detail how Nigeria scores in each of these key categories.

### Table 2: How Attractive is Nigeria as an Offshoring Destination?

<table>
<thead>
<tr>
<th>Financial Structure</th>
<th>People Skills/Availability</th>
<th>Business Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation Costs</td>
<td>Labor Availability</td>
<td>Infrastructure</td>
</tr>
<tr>
<td>Infrastructure Costs</td>
<td>Labor Quality</td>
<td>Regulatory Policies</td>
</tr>
<tr>
<td>Real Estate Costs</td>
<td>Reputation</td>
<td>Stability</td>
</tr>
<tr>
<td>Regulator Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Factor Rating (1-4)</strong></td>
<td>3.5</td>
<td><strong>Factor Rating (1-3)</strong></td>
</tr>
</tbody>
</table>

Source: Authors’ estimates

**Financial Structure**

Financial structure is a key determinant of an offshoring location’s attractiveness. Countries that can offer reliable services at a low cost will be more competitive than those countries with higher costs or less reliable services.

- **Labor Costs:** Labor costs in Nigeria are relatively low, making Nigeria attractive in terms of average monthly and annual labor costs.
- **Infrastructure:** Infrastructure in Nigeria is relatively poor, making Nigeria unattractive in terms of possessing cheap and reliable infrastructure.
- **Telecommunications and Internet:** Nigeria is relatively unattractive in comparison to its competitors in terms of telephony costs (which are high), and access to reliable Internet and broadband services (which are low).
- **Electricity:** Developing a reliable source of energy for Nigeria is a key challenge. The high cost and low reliability of electricity often deters international investors from relocating to Nigeria.
- **Transportation:** The Nigerian transportation system will remain an area of weakness in the country’s business environment unless resources are devoted towards improving the road network, especially in the major urban areas.
**Labor Quality and Availability**

Beyond cost, the quality and availability of labor is an important factor in determining the attractiveness of a country for offshoring activities.

- **Population size:** Nigeria has the population size to compete successfully in global markets.
- **Literacy:** English is widely spoken in Nigeria, and this can provide the country with a competitive edge. In terms of adult literacy, Nigeria ranks ahead of many countries competing for a share of the offshore services market, with male literacy at 75 percent and female literacy at 60 percent.
- **Education quality:** On the other hand, Nigeria needs to expand its tertiary education and offer more technical and scientific subjects. Nigeria lags other offshoring destinations in tertiary education enrollment, a trend that could hamper Nigeria’s ability to grow its offshoring sector.
- **Education investment:** The government continues to under-invest in the education system compared to South Africa, India, and China. In the medium term, Nigeria will have to pay closer attention to educational outcomes to become truly competitive in the global economy.
- **Technical training:** The quality and availability of technical and vocational training, particularly in information technology, must be improved. Nigeria has very few specialized technology, IT, and management colleges, and the effectiveness of existing schools is typically hampered by financing and human capacity constraints.

**Business Environment**

When selecting potential investment locations, international firms generally look for a stable political, legal, and macroeconomic environment. Providing such an environment has been a challenge for Nigeria, but there have been some positive developments.

- **Contracts:** Contract enforcement is an area where Nigeria has become stronger, yet further progress can be made. A contract still takes more than a year to be enforced and costs 27 percent of the claim in Nigeria, but this is considerably faster and less costly than in many of Nigeria’s competitors.
- **Labor regulation:** Flexible labor regulations present a significant advantage for Nigeria. Unlike many other developing countries, Nigeria’s labor system is straightforward and not overly complex, allowing firms to employ the most efficient number of workers while also providing adequate protection to workers.
- **E-commerce:** The lack of electronic communication and e-transaction legislation has hampered growth in the Nigerian offshoring sector and has kept potential investors away. Information technology industries in developed countries are extremely protective of intellectual property and want to operate in countries that have a tradition of protecting and respecting intellectual property rights. However, the fact that Asian countries are also struggling with this means that Nigeria has some space to develop its own intellectual property protection regime.
- **Export processing zones:** Nigeria has a long experience with export processing zones (EPZs), and similar zones such as offshoring parks can play a facilitating role in the industry’s growth. Building on the experience of its “one-stop-shop” EPZs, Nigeria should consider similar streamlined mechanisms to attract information technology and other businesses interested in setting up in the country or outsourcing business functions to Nigerian offshoring firms.
- **Reputation:** Nigeria’s reputation in the international arena remains poor, with the Niger Delta crisis, kidnappings, and the country’s reputations for scams being the predominant news stories from Nigeria. Nigeria’s reputation will have to be addressed in order to attract significant foreign investment and successfully develop an offshoring sector.
Summary of Nigeria’s Competitive Position

Nigeria’s main strengths as a potential offshoring destination lie in its relatively low wage and cost structure. The country’s large size and youthful population are also assets for companies wishing to establish large-scale call centers and similar such operations. The country’s good record on contract enforcement and flexible labor market regulations all increase its competitiveness, as do recent steps to streamline business registration.

There remain several challenges, however, that the country will need to overcome before it can increase its role in the offshoring industry. These include a relatively low number of university graduates and their low productivity in comparison with competitor nations, the relatively high costs of telecommunications connectivity, and the limited availability of broadband technology. The country’s poor infrastructure, especially regarding electricity and roads, also challenge potential offshoring operations. Despite steps in the right direction, there remains tremendous scope for improving the business environment and improving the state of the country’s basic infrastructure.

Conclusions and Policy Recommendations

The following section proposes policy recommendations for developing an offshoring industry in Nigeria.

Potential Target Markets

Nigeria should begin by focusing on the lower end of the BPO value chain. Before it can venture into higher value added business services, it should explore the following areas in order to become competitive in offshoring.

- **Domestic Industry**: Nigeria can begin by developing its domestic outsourcing industry, creating call centers for domestic companies and government services as a first step to offshoring.
- **Back office processes**: Nigeria can compete effectively for back office jobs, such as accounting and data management. However, back office processes add less value, and Nigeria should eventually try to move into high value added services.
- **Customer contact**: This is a space in which Nigeria can effectively compete due to its large pool of human resources and English language ability.

Nigeria does not yet have the ability to focus on the knowledge services and research and development market segments, and firms looking to offshore these services are likely to look at more established markets. However, if Nigeria can develop a successful domestic outsourcing capability in higher value services such as research and development, it will be better able to attract international investors who are looking to move up the value chain.

Creating the Brain Gain

Nigeria can increase its reputation by leveraging its large overseas population as a network for outsourcing. It is estimated that 15 million Nigerians are living and working overseas around the world. Since personal connections play an important role in determining the choice of a particular country as an offshoring destination, the Nigerian diaspora could be used for a “brain gain,” where Nigerians living overseas create a channel for developing the reputation of Nigeria’s offshore service industry. The Nigerian government could encourage this by promoting dual citizenship, compiling a database of expatriate Nigerian professionals, and mobilizing its embassies to support such an effort.
Enterprise-level Strategies

Local enterprises wanting to provide services to foreign firms must make a concerted effort to market their unique strengths and develop focused business plans with clearly established goals for long-term growth. Local firms should be proactive in searching for local partners and should look internationally to expand both their funding resources and client base. Key issues to tackle include:

- **Cost competitiveness:** Firms should research the cost structures of competitors as well as the services provided and constantly aim to provide higher quality services at the lowest cost possible. It is important to achieve regular innovation and tailoring of services to client needs as efficiently as possible in order to retain a noticeable cost advantage.

- **Human resources:** In order to ensure that employees can meet customer service demands and keep up with new techniques and innovations, firms should initiate in-house or on-site certified training programs with a continuous focus on improving performance and the quality of services provided to ensure customer satisfaction and attract international investors.

- **ICT systems:** Local firms must ensure that they have well-developed information and communications technology systems. Unreliable ICT infrastructure hinders the ability of firms to provide services promptly, reliably, and efficiently. Companies should make detailed assessments of ICT requirements and address any resulting gaps as quickly as possible. Firms should also engage with public authorities to highlight where government support is needed in relevant sectors.

Government Policy Framework and Suggested Reforms

The government of Nigeria could play a useful role in creating awareness for both locals and potential international clients regarding opportunities within the country’s services industry. The recent efforts made to rebrand Nigeria—the “good people: great nation” campaign—are an excellent start. The government can work with private companies using the investment promotion commission and the country’s network of overseas embassies to promote a Nigerian role in the provision of international services. Other possible policy initiatives could include:

- **IT park development:** International experience suggests that tax incentives are likely to have limited impact. More important in Nigeria are measures to ease the constraints to doing business and the establishment of dedicated IT parks providing reliable power, high bandwidth and security to encourage multinationals and other international firms to locate to Nigeria.

- **People skills and availability:** Nigeria must refocus on education with resources specifically devoted to developing the service and information technology skills of students. The curricula of universities and schools could be revised to give students the specific skills that offshoring firms seek. This is a policy that has been successful in India and more recently Egypt.

- **Incentives for training:** The government can create incentives for firms to provide workers with suitable training programs that enhance the quality of services provided by the country.

- **Improved telecommunications and information technology infrastructure:** Improved infrastructure is a prerequisite for developing an offshoring industry. Fostering the development of ICT infrastructure in areas outside major cities will also yield benefits to Nigeria in the long run, as it will allow services to be delivered across the country. The government should encourage technologies, such as voice-over-Internet protocol, that lower communications costs.

- **Legal framework:** From a regulatory standpoint, the Nigerian government must also address the lack of a robust legal framework for offshoring, intellectual property rights, and e-commerce, which is currently deterring FDI. The legal framework should be conducive to emerging
industries and enable business to start up without presenting an array of administrative barriers. Although Nigeria has made positive steps in this direction, more could be done with respect to reforms such as property registration and reducing the time taken to pay taxes.

- **Outsourcing government services:** Government can provide a push to this industry by outsourcing services such as; data entry e.g. for health, education and land records, establishing a three-digit number for emergency services (e.g. 911 in the US), establishing a government information center to provide information over the phone on the most essential public services.

Such reforms would go a long way to making Nigeria an attractive country for foreign investors, and would considerably help Nigeria’s efforts to develop a strong offshoring industry. These lessons are also applicable across the region, and in this way the development of Nigeria’s offshoring sector could be an example to other African countries for how to successfully build a strong offshoring industry.

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1 This policy note is based on a longer World Bank report published in 2009 entitled “Transforming Nigeria into Africa’s Offshoring Hub.”
2 January 2010, Global Services Media.
7 McKinsey Global Institute, 2005, p. 28.