



# Economic Premise

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## Developing an African Offshoring Industry—The Case of Nigeria

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*The purpose of this note<sup>1</sup> is to raise awareness of Nigeria's potential as an African offshoring hub, and it is aimed primarily toward policy makers, potential private sector investors, and development partners. This note addresses the following questions: what can Nigeria do to take advantage of the benefits of global trade in services; how can the country brand itself as an offshoring destination for international investors; and what government policies are required to ensure that Nigeria plays a role in the growing ICT offshoring sector.*

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, 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.

### What Is Offshoring?

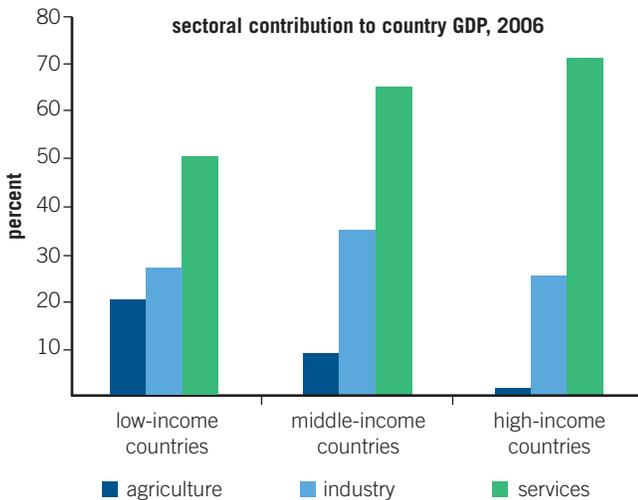
Outsourcing occurs when one company delegates responsibility for performing a function or series of tasks to another company. When the second company is based in another country, outsourcing becomes offshoring. Recent improvements in information technology (IT) and lower costs of data transmission have 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 entire value chain. In 2010, the global offshoring market was estimated to be around \$90 billion (Global Services Media 2010), and the market 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 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 (see figure 1). Indeed, engaging in services trade enables countries to potentially bypass the industrial development stage and engage directly in high value-added sectors (Ghani 2010). In Nigeria, for example, mobile phone subscribers greatly outnumber those with landlines, which has made investment in costly fixed-line infrastructure unnecessary.

**Figure 1. High-Income Countries Have Large Service Sectors**



Source: World Bank, World Development Indicators (2006).

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 (Farrell and others 2005, 19). 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 the United Nations Conference on Trade and Development (UNCTAD 2003) 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 (ILO 2003, 13). 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 (Farrell and others 2005, 28) estimates that approximately 225,000 jobs—or 1–2 percent of total jobs created in the United States—will be offshored on average per year, and that in total up to 11 percent 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, 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 (2004) in its *Making Offshore Decisions* report that more than 4,000 companies in 150 countries were then competing to provide offshored services to a handful of wealthy nations, and that number has likely increased since the report's publication. A more recent report from A.T. Kearney (2009) argued that Africa has the potential to redraw the global offshoring map by attracting more foreign firms than other regions.

### 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 (Kearney 2004, 2009) 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,

**Table 1. Offshoring Attractiveness Index**

Category	Subcategory	Key factors
Financial structure (40%)	Compensation costs	Average wages and median compensation costs for relevant positions
	Infrastructure costs	Electricity and telecommunications costs
	Real estate costs	Office rents per square meter
	Regulatory costs	Corporate tax rate and quantification of other regulatory costs
People skills and availability (30%)	Workforce availability	Population and total workforce
		Literacy rates and English-speaking ability
	Labor force quality	Proportion of population pursuing tertiary education
		Education expenditure as a percentage of GDP
Business environment (30%)	Reputation	Availability of information skills
	Infrastructure	Existing IT and business process outsourcing market size
	Regulatory policies	Quality rankings
	Economic stability	Connectivity, availability of telecommunications, electricity, and transportation
	Political stability	Security of intellectual property and piracy rates
		Barriers to doing business
		Fluctuation of exchange rates
		Corruption and governance

Source: Adapted from Kearney (2004, 2009).

people skills and availability, and business environment (see table 1 for details of the key elements). Financial structure is given 40 percent of the total weight because cost advantage was determined to be the primary driver of offshoring activities, while people skills and business environment each account for 30 percent of the remaining weight.

Nigeria is a good role model for Africa as a potential destination for foreign firms because it has a mix of strengths and weaknesses for these indicators. Its framework could be useful for other African countries that are interested in attracting foreign firms. The Offshore Location Attractiveness Index results are summarized in table 2, and the remainder of this section examines in more detail how Nigeria scores in each of its key categories.

### 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. Important factors to consider are:

- *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 deter 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 toward 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

**Table 2. How Attractive Is Nigeria as an Offshoring Destination?**

Financial structure	People skills/availability	Business environment
Compensation costs ●	Labor availability ●	Infrastructure ●
Infrastructure costs ●	Labor quality ●	Regulatory policies ●
Real estate costs ●	Reputation ●	Stability ●
Regulatory costs ●		
Factor rating (1–4) 3.5	Factor rating (1–3) 0.75	Factor rating (1–3) 0.75

Source: Authors' estimations.

competitive edge. In terms of adult literacy, Nigeria ranks ahead of many countries competing for a share of the off-shore 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 behind 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 underinvest 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 IT, 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, but this is considerably faster and less costly than 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 worker protection.
- *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. IT 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 (EPZs):* Nigeria has a long experience with 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 IT and other businesses interested in setting up in the country or

outsourcing business functions to Nigerian offshoring firms.

- *Reputation:* The Niger Delta crisis, kidnappings, and the country's reputation for scams have resulted in a poor international reputation. Nigeria's reputation will have to be addressed 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 operations. The country's good record on contract enforcement and flexible labor market regulations 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 the 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, particularly 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 business process outsourcing (BPO) value chain. Before it can venture into higher value-added business services and become competitive in offshoring, Nigeria should explore the following areas:

- *Domestic industry:* Nigeria can begin by developing its domestic outsourcing industry by 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 workers with 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 attract attention to its offshoring potential 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 offshore destination, the Nigerian diaspora could be used to facilitate 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 continuously and efficiently innovate and tailor services to client needs efficiently to retain a noticeable cost advantage.
- *Human resources:* 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 ICT 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 marketing offshoring opportunities in the country’s services industry to potential domestic and international clients. The recent ef-

forts 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 that can provide 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 IT 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 in the Arab Republic of Egypt.
- *Incentives for training:* The government can create incentives for firms to provide workers with suitable training programs that expand and improve the quality of services provided by Nigeria.
- *Improved telecommunications and IT 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, because 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 foreign direct investment. The legal framework should be conducive to emerging industries and enable businesses to start up without the challenges of multiple 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, for example, for health, education, and land records; establishing a three-digit number for emergency services (such as 911 in the United States); and 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 a role model for other African countries on how to successfully build a strong offshoring industry.

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### Note

1. This policy note is based on a longer World Bank (2009) report, *Transforming Nigeria into Africa's Offshoring Hub*.

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