Kenya's Off-Shoring Advantage: An Emerging BPO Cluster in East Africa

Joel Bryce, Stephen Hartley, Zahara Kassam, Naseem Saloojee, Brian Williams

May 2011

Submitted as final paper for Microeconomics of Competitiveness course at Harvard Business School; Professor Michael Porter.

Executive summary

Since 2004, Kenya has been growing at a high rate as the country has sought to stabilize the macroeconomic environment and diversify the economy. However, the country faces severe weaknesses in the areas of rule of law and factor conditions (especially education and infrastructure). Key priorities the country must focus its attention on in order to enhance the competitiveness of its national business environment include: intensifying the country's anti-corruption program; continuing with judicial and legal reform to create a better environment for doing business; strategically expanding and improving port, road, air and sea transport systems; and improving the transition rate of students from secondary to tertiary educational opportunities. Kenya is heading into higher value industries almost despite its business environment and at a rate much faster than its regional neighbors. However, the bright points in Kenya's growth trajectory are overshadowed by the factors constraining the country from realizing its full potential.

Indeed, just as the country is expanding into high value industries like business process outsourcing and cut flowers, basic contract enforcement, corruption, and human capital severely limit the extent to which these clusters can really compete on a global level. The business process outsourcing cluster in Kenya is a perfect example of this interplay: blessed with tremendous endowments (neutral English, cheap labor, high quality internet access), Kenya has made impressive progress but is still constrained by lack quality coordinating institutions and access to education and training to improve human capital. Despite these challenges, Kenya's BPO cluster is well positioned for future growth given the likely arrival of a large anchor MNC (IBM) and the creation of the BPO park. Overall, Kenya's growth trajectory will remain positive and could even reach world-class potential if the constraints identified in this paper are resolved.

Part 1: Country Level Analysis of Kenya

Basic Country Facts

Geography and Climate. Kenya is a nation in Africa along the Indian Ocean bordered by Somalia and Ethiopia to the north, Uganda, Rwanda, Burundi, Ethiopia and Lake Victoria to the west, and Tanzania to the south. Kenya is considered part of the East Africa region. Kenya lies south of the Sahara desert and experiences a tropical climate most of the year. Kenya's geography is split between thousands of acres of plains, where large animals roam, fertile highlands, and the Great Rift Valley, which cuts through the middle of the country.

History. Kenya's civilized history dates back to 500 BC when the ethnic groups that make up Kenya's present tribal system arrived in the country. These tribes include the Samburu, Luo, Turkana, and Maasai, which make up Kenya's modern population. Mombasa, a city along Kenya's east coast, was a major trading post for Africans, Arabs, and Persians even as far back as the first century AD. Kenya's colonial history dates from the establishment of the Imperial British East Africa Company in 1888. From 1895-1905 the British engaged in large infrastructure projects, including the Kenya-Uganda railway, using primarily Indian labor. Indian laborers stayed in Kenya and today form a large community. During the early 20th century, many British and other European farmers settled in Kenya to create large coffee and tea plantations. By the 1930s, approximately 30,000 European settlers lived in Kenya. After a brief rebellion by the Mau Mau tribe from 1954-1956, the British allowed for local elections. Though hoping for a loyalist victor, the British had to settle with Jomo Kinyatta of the Kenya African National Union (KANU) party taking power. Kenya officially became independent on 12 December 1963. That same year, the Kenyan Army defeated ethnic Somalis who wanted Kenya to join with Somalia.

Kenya remained a separate entity and adopted free trade policies, setting it apart from most of its African neighbors.

Political System. Kenya's political system is a presidential representative democratic republic where the president is both the head of state and the head of the government (thereby holding the traditional prime minister role as well, similar to the US). Kenya has a multi-party system with legislative power vested in the National Assembly. Most recent elections occurred in 2007, and were deemed flawed by the international community when incumbent Kibaki held on to the presidency even though rival Raila Odinga had won a majority of the vote. Violence ensued and peace finally came in 2008 when a coalition government was formed, creating a new prime minister role for Raila Odinga with some limited responsibilities. Kenya, before 2007, had a history of successful democratically elected governments, with no instances of coups from the military or other parties. Kenya's regional government is semi-autonomous with both elected and centrally-appointed officials holding power.

Other Important Facts. Kenya's capital city of Nairobi is the seat of government and also acts as a commercial hub for all of East Africa. Nairobi is home to East Africa's biggest airport and houses the headquarters of all the major aid organizations (including the UN) as well as major foundations (like Rockefeller, Gates, and Ford). Kenyans speak several tribal languages but the primary official languages are Swahili and English. Kenya's 2010 estimated population was 40,046,566, and its currency is the Kenyan Shilling (83.9 KES = $1). UNDP estimates that 16% of Kenyans are HIV positive.

Economic performance

Kenya is the largest economy in East Africa and is a regional financial, communication and transportation hub. After growing at sub-par levels following the 2007 political crisis, a prolonged drought and the global financial crisis, Kenya's real gross domestic product ("GDP") growth accelerated to 4.5% in 2010 (Economist Intelligence Unit, 2011).

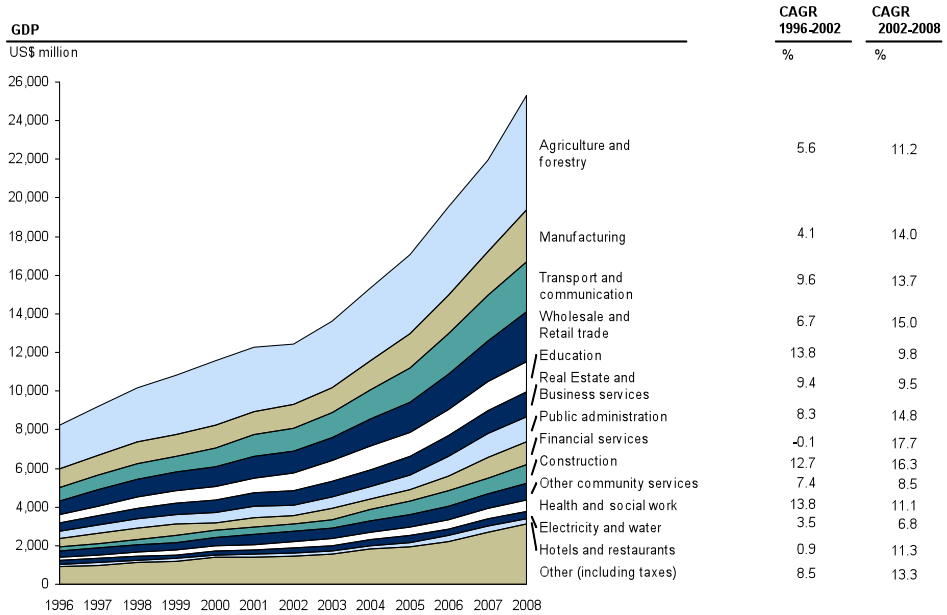
Following independence, GDP grew at an annual average rate of 6.6% from 1963 to 1973. However, from the late 1970s to the early 1990s, GDP growth declined and then stagnated. During this time, the government was increasingly intruding into the private sector, while import substitution policies made the manufacturing sector uncompetitive. Tight import controls and foreign exchange controls also made the domestic investment environment unattractive for both domestic and foreign investors (U.S. Department of State).

In 1993, a major program of economic reform and liberalization eliminated price controls and foreign exchange controls, as well as initiated the privatization of several state-owned companies. However, the economy fell into a recession in the late 1990s, until 2003, when President Mwai Kibaki introduced the Economic Recovery Strategy ("ERS"). From 2003 to 2007, GDP grew 6% on average as the country attempted to restore economic growth, stabilize the macroeconomic environment, reduce poverty and improve governance to enhance economic efficiency and effectiveness (Government of Kenya, 2007). As such, GDP growth in Kenya outpaced the global average and caught up to the sub-Saharan Africa average, but still lagged behind that of its neighbors, namely Ethiopia (12%), Uganda (8%), Rwanda and Tanzania (7%) (World Development Indicators).

Kenya's GDP has been dominated by agriculture, but strong growth in other sectors since the introduction of the ERS shows increasing diversity in the economy. Since 2002, sectors such

as agriculture, financial services, transportation and communication, manufacturing and tourism have grown at a compounded annual growth rate ("CAGR") greater than 10% (Kenya National Bureau of Statistics). Kenya has a lot more room to grow via efficiency gains, as low levels of labor productivity persist across the economy. With ~80% of employment in the informal sector, many companies in Kenya have found themselves entangled in a low-productivity trap.

Figure 1: Kenya GDP by Activity Source: Kenya National Bureau of Statistics.



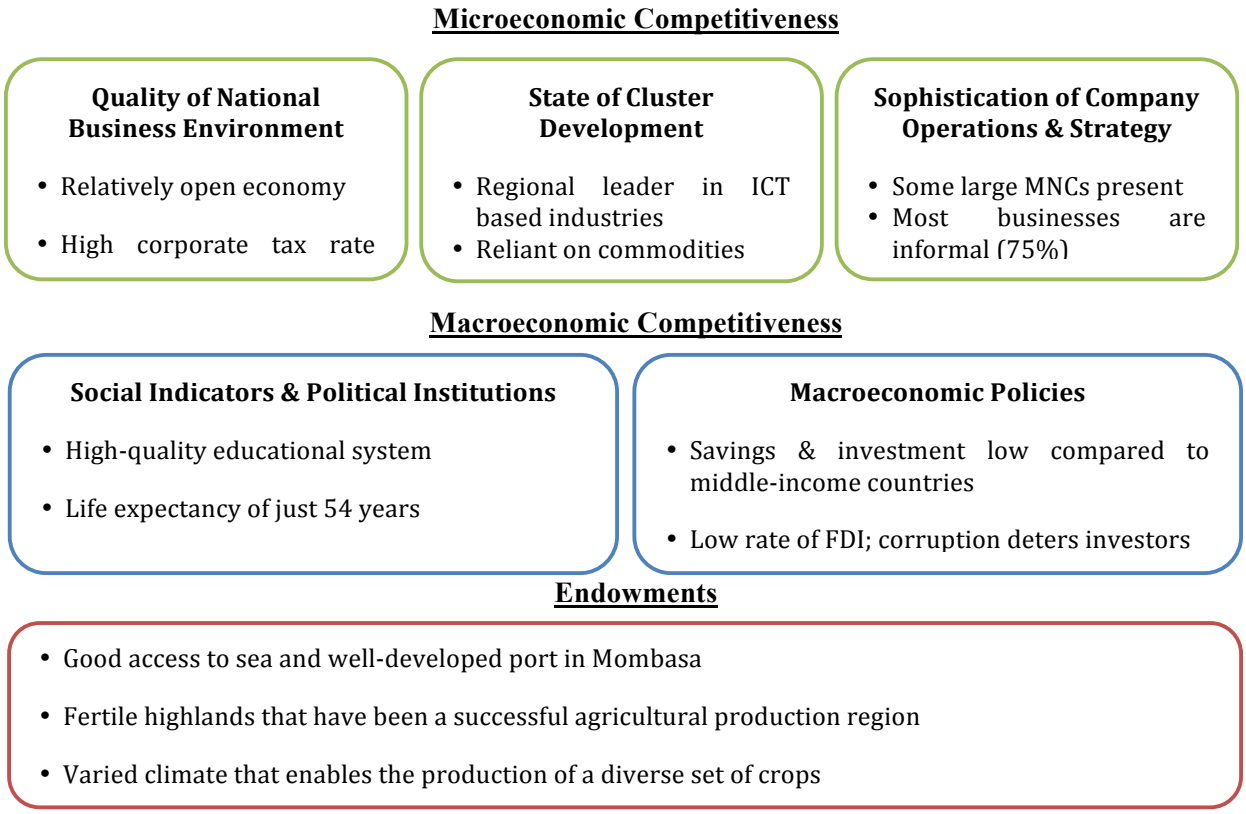
It is hoped that Kenya's Vision 2030, introduced in 2007, will help the country transform into an industrialized middle-income nation by 2030. The Vision's aim is to achieve, and sustain, 10% per annum economic growth; drive equitable social development while creating a clean and secure environment; and realize a result-oriented and accountable democratic system.

Determinants of Competitiveness

Kenya has an open, export-oriented economy with some strong clusters (albeit shrinking), but suffers from weak infrastructure and rampant corruption, as well as a small

college-educated population. See figure 2 below for a summary of Kenya's determinants of competitiveness:

Figure 2: Determinants of Kenya's Competitiveness: Overview



Endowments

Kenya enjoys a wealth of inherited endowments that has helped drive its economic growth. For one, Kenya has good access to the sea. With its well-developed port in Mombasa, Kenya has evolved into a commercial and transportation hub for East Africa. Second, the Kenyan highlands comprise one of the most successful agricultural production regions in Africa; this is where Kenya's principal cash crops – tea, coffee and horticultural produce – are grown. Across Kenya, the climate varies from tropical around the coast to temperate inland, to arid in the north/northeast, allowing for a variety of crops to be grown.

The country also offers visitors spectacular scenic diversity and abundant wildlife. The opportunity to see the Big Five animals and experience the Great Migration while on safari has drawn an average of 1.1 million tourists a year to Kenya between 2005 and 2009. Tourism is now the country's principal source of foreign exchange.

Macroeconomic Competitiveness

Macroeconomic policies: Kenya's investment levels have averaged about 18.5% over the last 10 years, which is above average for sub-Saharan Africa, but about 2 points lower than the average in East Africa, and 3 points lower than Malaysia, a fast-growing middle-income country. To pay for these investments, Kenya maintained a savings rate that averaged 15.4% in the 2000s, which while on par with the rest of East Africa, is almost 20 points lower than Malaysia's average rate of savings (Economist Intelligence Unit). It will be imperative for Kenya to boost its national savings to ensure domestic funding of its ambitious investment program. Although Kenya has been an important destination in East Africa for foreign direct investment ("FDI"), its attractiveness has eroded due to slow structural and regulatory reforms, allowing its neighbors to draw foreign investment away from Kenya in recent years. Low savings and FDI will significantly limit the capital available for future investment in Kenya's economy.

Figure 3: Gross Fixed Investment in Kenya (% of GDP)

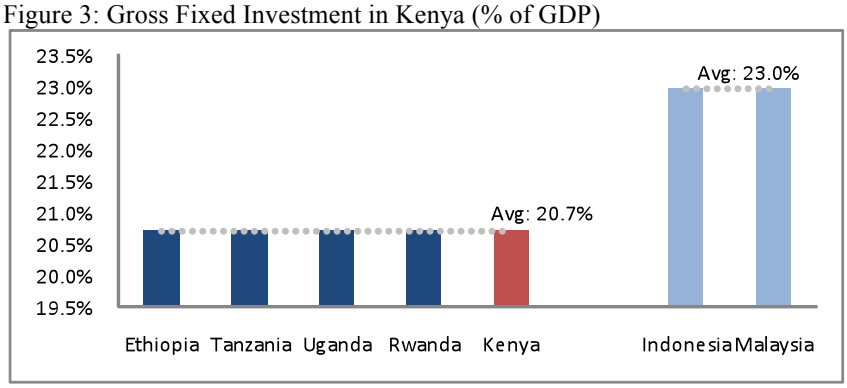
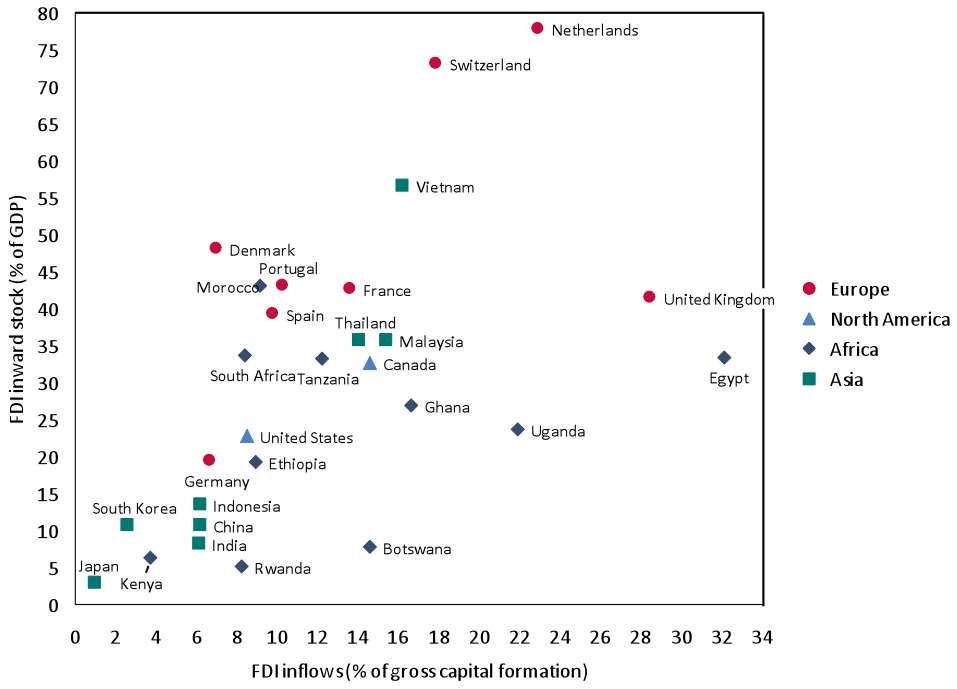


Figure 4: Level of Foreign Direct Investment



Kenya has seen its exports grow over the past decade, driven by a significant increase in the export of mineral fuels and horticultural products, while traditionally strong export drivers such as coffee and tea have started to dwindle. Despite this growth in exports, however, Kenya has seen its trade deficit worsen over the past 10 years, given the import of high value goods (primarily energy) and the export of primary agricultural products. In response, the country has begun exploring opportunities in higher value-add services, such as business process outsourcing and financial services. This trade imbalance, coupled with shortfalls in aid and remittances, has contributed to a widening budget deficit, from -1.4% in 2005 to -5.8% in 2009. During this time, the government has made an active effort to shift resource allocation to priority development areas such as agriculture, infrastructure, education and health care.

Social indicators and political institutions: With a Human Development Index value of .470, Kenya is above the sub-Saharan African average of .389. The country is ranked 128 out of 169

countries, the highest among those ranked as Low Human Development (United Nations Development Program, 2010). Its ranking is helped by the strength of its education system, the quality of which the Global Competitiveness Report ranks 56th (out of 139 countries) (World Economic Forum, 2010). In Kenya, the first 8 years of primary school are provided tuition-free by the government, and in January 2008, the government began offering a program of free secondary education, as well (U.S. State Department). Consequently, the adult literacy rate is 86.5% and 15.5% of the population has at least a secondary education, both of which are high achievements within sub-Saharan Africa and amongst countries with similar income levels (United Nations Development Program, 2010).

However, Kenya's human development rankings and overall competitiveness are held back by a number of other factors. While recent economic growth has helped reduce absolute poverty, 47% of the population still lived below the national poverty line in 2010 (United Nations Development Program, 2010). Moreover, the richest 10% of households own about 36% of total wealth, while the poorest 10% own less than 2% (Government of Kenya, 2007). With regard to health care, life expectancy is just over 54 years due to a high prevalence of communicable disease. The country spends just $72 per capita on health (vs. $819 per capita in South Africa), and has a high mortality rate amongst infants and children under 5 years of age (United Nations Development Program, 2010). The security situation in Kenya is also worrisome, with high concern about crime and violence (World Economic Forum, 2010).

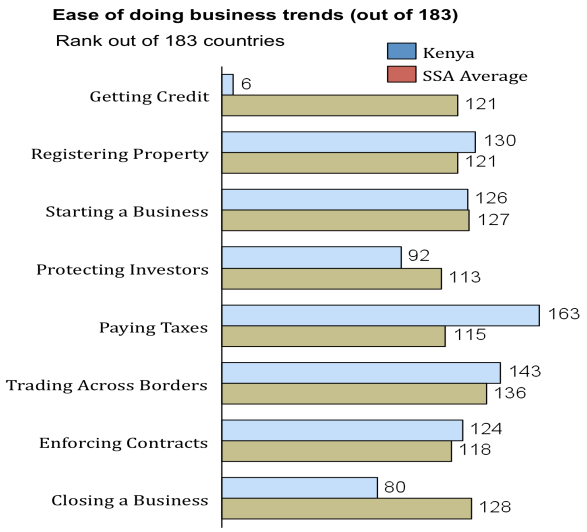
Some of Kenya's most challenging weaknesses pertain to its rule of law and political instability. According the World Bank's World Governance Indicators, Kenya's rule of law is in the bottom 25th percentile worldwide, while its political stability has been poor (even before the

2007 elections) and was perceived to be worsening, before the grand coalition government peacefully introduced a new constitution in August 2010 (Worldwide Governance Indicators). Large and ever-increasing concerns about corruption in Kenya continue to plague the country's ability to provide a competitive business environment. According to Transparency International, Kenya's Corruption Perception Index score is 154 (out of 180 countries), lower than the sub-Saharan Africa average and all of Kenya's East African neighbors (Transparency International). As mentioned previously, Kenya has one of the lowest rates of foreign direct investment in the region, and the direct costs of corruption (such as bribery to obtain a business license) remain a key deterrent for potential investors. Oversight institutions such as the Kenya Anti-Corruption Commission ("KACC") have been created to help drive good corporate governance; however, these institutions are often subject to the influence of executive powers. More effort needs to be focused on devolving power from the executive branch.

Microeconomic Competitiveness

Kenya's Global Competitiveness. Kenya's overall global competitiveness ranking decreased to 106 for 2010-2011. In 2009-2010, Kenya ranked 98. Respondents to a survey on Kenya's business environment ranked corruption as the largest constraint, followed by access to financing, inefficient government bureaucracy, and inadequate infrastructure. As a comparison, Ethiopia's competitiveness ranking was 119 in 2010-2011, Tanzania was 113, and Uganda was 118 (World Economic Forum). Kenya's Ease of Doing Business rankings are worse than its overall competitiveness ranking, except in the area of access to credit. On most accounts, Kenya scores worse than the Sub-Saharan average:

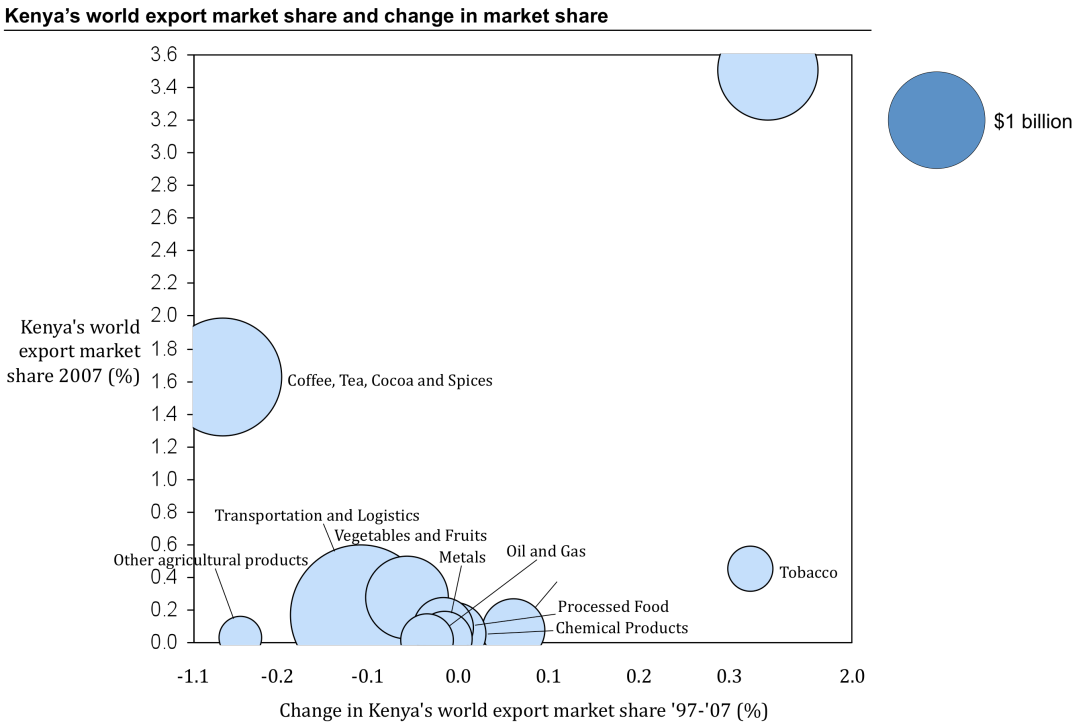
Figure 5: Ease of Doing Business Rankings for Kenya



The constraints that Kenya's bureaucracy places on businesses are apparent from the data underlying the Ease of Doing Business report. Starting a business in Kenya requires 11 procedures, compared to just 9 for Sub-Saharan Africa (SSA) on average. Kenya's corporate tax rate is the highest in the region at 33.1% (over 10% higher than the SSA average). Kenyan organizations have to make 41 unique payments to the government each year. Finally, it takes 72 days to register property in Kenya, compared to just 32 days in OECD countries.

Despite these constraints, Kenya continues to export a considerable amount of commodities. Cut plants and tourism are Kenya's leading clusters, occupying the bubbles to the top right hand side of the figure below. These industries are achieving considerable international market share (~3% world wide) and continuing to grow (see **figure 6** below for a complete picture):

Figure 6: Kenya's world export market share by cluster

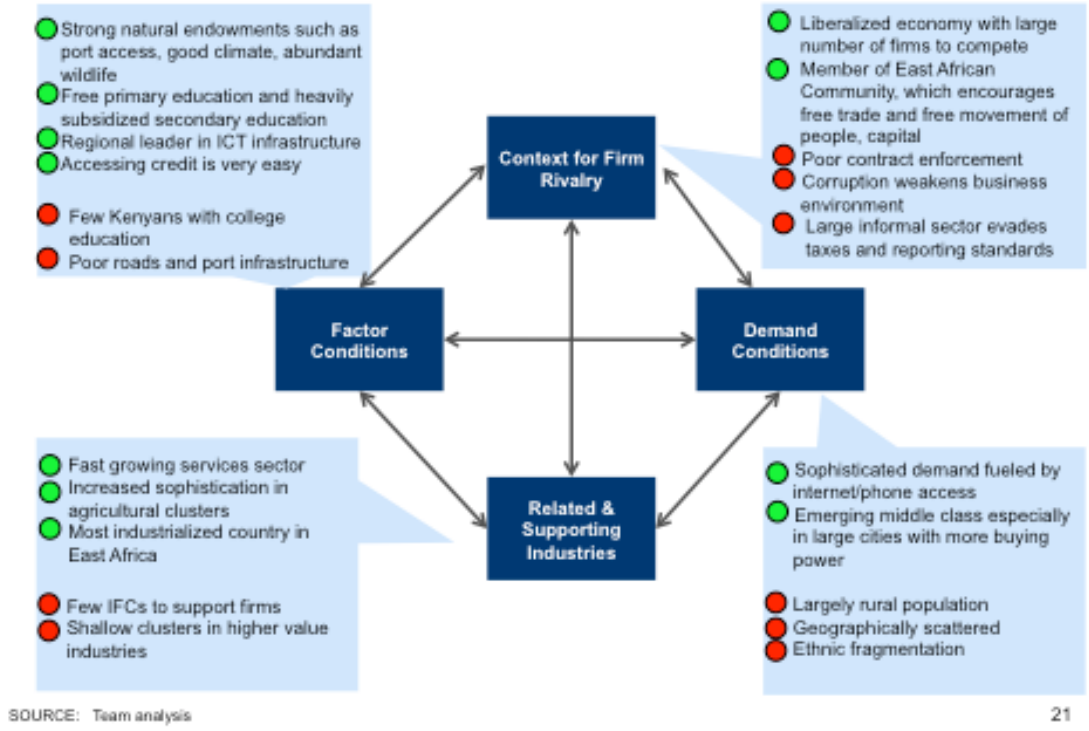


Source: IOC data

Kenya's National Business Environment. Kenya's overall business environment was evaluated using the diamond framework[1] which includes analyzing local demand conditions, the context for firm strategy and rivalry, factor inputs, and related/supporting industries. Kenya's national diamond shows positive and negative issues in each aspect of the diamond. Kenya enjoys relatively strong demand conditions given its sophisticated ICT infrastructure and high internet penetration (regional high of over 10%). Related and supporting industries are also favorable via regional comparisons: Kenya is home to the regional tea auction, its agriculture has gone through

some structural transformation toward horticulture, and its finance/ICT clusters are the best in the region (see **figure 7** below for a picture of Kenya's national diamond):

Figure 7: Kenya's National Diamond



Given the state of Kenya's overall competitiveness, the most important issues to focus on are factor conditions and context for firm strategy and rivalry. It is within these areas of the diamond that Kenya faces the greatest challenges.

Factor Conditions. Kenya is undergoing structural transformation in its economy (moving toward higher value goods and services), but its quality of education and infrastructure are not keeping pace. These two factors are the most important conditions underlying the state of

Kenya's business environment and they are constraining Kenya's growth trajectory. In Kenya, only 60% of students who complete primary school enter into secondary education. That number gets smaller when it comes to tertiary education: only 30% of eligible high school graduates enter tertiary education due to low budget allocation. Meanwhile, most students who do not make it into universities end up working in the informal sector at low-skill, low wage jobs (Economist Intelligence Unit, 2008).

Kenya's infrastructure is holding the country back from fully taking advantage of its favorable geographic location. Indeed, most of Kenya's roads are unpaved, which causes severe problems during frequent rainstorms. Kenya has a very low paved road network density (1.9 km/1000 sq km), ranking even lower than Uganda, even though Uganda has lower GDP/capita than Kenya. Kenya also has poor rail line density and only moderately high quality ports. While Kenya's port infrastructure is moderate, the import/export regime is highly prohibitive: delays in handling goods from the Mombasa port cost thousands of dollars to local entrepreneurs. The Kenyan government has been slow to privatize major infrastructure assets, like the Port Authority and the Railways Corporation, leading to losses in efficiency. In a country dependent on commodity exports, logistics are a very important factor in Kenya's economic progress.

Context for Firm Strategy and Rivalry. Kenya's government is the largest hindrance to firm rivalry and strategy in Kenya. As mentioned earlier, the business environment in Kenya is not conducive to competition, transparency, or economic growth. The key factors holding back firm growth are corruption, labor laws, and taxation. All of these have led to a sizable informal sector, which further distorts the competitive environment.

Easily the most important hindrance to firm strategy and rivalry in Kenya is corruption. Corruption hinders the court system, contract enforcement, and other aspects of the economy. In fact, the Kenyan legal system is often circumvented by local actors because it is so corrupt. Indeed, independent commissions have been appointed to sift corruption in Kenya's courts, but they have proven ineffective because they are often just an excuse to purge judges disloyal to the ruling party. Contract enforcement is also impacted by corruption, as the costs to implement a contract average at 47% of the contract's value (EIU Kenya Country Profile 2008).

Meanwhile, Kenya's labor costs are unnaturally high, which discourages foreign direct investment as well as the growth of local SMEs. Kenya has the highest wage rates in the region, which are set by a federal organization to stay even with public sector wages (which are unusually high as well). Unions in the public sector also influence wage rates in the wider economy. Taxation impinges on the business environment, further discouraging FDI. Corporate tax rates of 31% are the highest in the region. The restrictive business environment in Kenya has made the informal sector advantageous for millions of Kenyans (75% of the labor force). The informal sector distorts the economy by making the formal sector even less attractive. Low barriers to entry in the informal sector are an easy, short-term alternative to the formal sector. However, constraints on credit, assets, and other factors due to informality make this sector ultimately largely inefficient.

Country-Level Recommendations

Based on these facts, our team recommends that Kenya continue to fight corruption through independent bodies with president-level backing. Kenya must also make contracts easier to enter and enforce. Given the woeful state of the judiciary, Kenya's ministry of commerce

should create an independent body solely focused on ensuring legal enforcement of business contracts, especially for foreigners. Furthermore, the government must prioritize infrastructure for future public spending and encourage more privatization. Finally, Kenya would benefit from government subsidies for tertiary education since cost is the biggest hindrance keeping Kenyans from attending school and learning more skills that will make them marketable in the changing landscape of Kenya's industrial marketplace.

Part 2: Analysis of Kenya's BPO Cluster

Introduction to Business Process Outsourcing

For purpose of the present paper, Business Process Outsourcing (BPO) is defined as the hiring of an external company to handle business activities that ordinarily could have been conducted in-house. These services can be provided locally, but they are increasingly being conducted "offshore," as numerous functions are outsourced to low-cost locations like India, the Philippians, etc. In 2008, global BPO as an industry employed approximately 2.5 million people worldwide (Nasscom and McKinsey). The largest players were India, employing 1.6 million (65% of global employment) and the Philippians, employing 400K (16%); the rest of the world employed approximately 500K (19%). Current estimates for India's BPO employment stand at approximately 2.2 million, while data for the rest of the world is not known.

In terms of market size, global BPO exports in 2007 were $24 billion. However, there is approximately $196 billion in addressable demand that is not yet met. This is comprised of five primary market segments: Rules-based Decision-Making, Basic Voice, Basic Data, Knowledge Services, and Specialized Voice. Rules-based decision-making is defined as data activities that are based on business rules and guidelines. For example, the most commonly outsourced rules-

based decision-making includes processing accounts payable and insurance claims; in 2008, the addressable global BPO demand of this segment was $77 billion[2]. Basic voice involves scripted activities requiring minimal training, such as telesales, taking sales orders, etc. ($67 billion in addressable global demand in 2008). Knowledge services are defined as activities not governed by standard rules and that require deep domain knowledge, such as research requests or automotive engineering ($67 billion in 2008). Basic data is simply understood as straightforward activities such as data entry, data conversion from one format to another, reconciling databases, etc. ($37 billion in 2008). Lastly, specialized voice is defined as specialized interactions that cannot fully be scripted and require some domain knowledge (e.g., cross selling, help desks, credit card collections) ($13 billion in 2008).Thus, given the size of the market and addressable demand, there is an opportunity for emerging economies looking to provide BPO services to the developed world. Kenya is one country that has recognized and taken advantage of this opportunity.

History of BPO in Kenya[3]

Kenya's BPO cluster essentially began to form in 2005 when Nik Nesbitt founded KenCall, Kenya's first call center that met international quality standards. The first few years were fairly difficult ones for KenCall as perception of poor quality and insufficient infrastructure stifled KenCall's marketing efforts. However, in early 2007, BPO was named one of the six flagship clusters in Kenya's Vision 2030. As a result, the BPO and Contact Center Society, the BPO cluster's first Institution for Collaboration (IFC), formed in March 2007 and membership quickly grew to 33 members. Later in 2007, a second IFC was formed, the Kenya Information

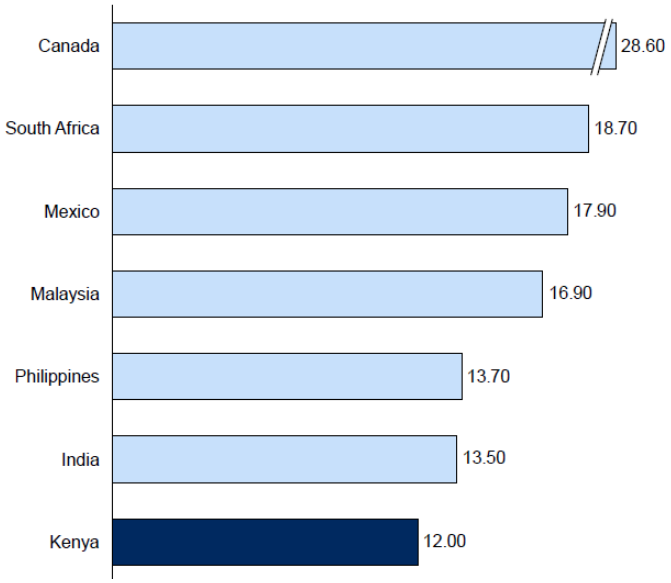
[3]Information from entire section comes from interviews by case team.

and Communication Technology (ICT) Board. While a part of the Ministry of Information & Communications of the Government of Kenya, the ICT Board operated like an IFC in the cluster. At approximately the same time, the World Bank began subsidizing Kenyan BPO firms' bandwidth costs, so that Kenya could compete with other global BPO players. As a result of these subsidies, multiple BPO providers entered the market primarily providing basic data and basic voice services. In March of 2008, KenCall won the Best Non-European Call Center at the CCF European Call Center award, a significant milestone not only for KenCall, but also for the cluster.

Another milestone came in May 2009 when the first undersea fiber-optic cable – SEACOM – connected South and East Africa. In June 2009, construction of the East African Marine System (TEAMS) fiber optic cable was completed, and in July 2010, the Eastern Africa Submarine Cable System (EASSy) fiber optic cable was completed. Fiber-optic connection caused Kenya's BPO bandwidth costs to drop significantly, and as a result the World Bank subsidies expired. Key governmental milestones came in August 2009, when the ICT Board officially launched its "Kenyan BPO Value Proposition" and thus began aggressive worldwide marketing efforts, in June 2010, when the government pledged $12 million in annual funding for BPO-related training and industry development, and in March 2011, when the government held its first Center of Excellence, a program that "trains BPO trainers." Despite cluster progress, one of greatest milestones will come when construction of the 7,500-seat BPO Park is completed (expected 2012 or 2013).

Kenya provides many advantages that differentiate it from other global BPO destinations and thus make it a suitable choice for companies looking to outsource their business processes (Team Interviews). First, Kenya offers a lower total (fully loaded) cost of setting up and running BPO services compared to competing regional locations, such as South Africa, or global locations such as India or the Philippines (**Figure 8** to the left)[4]. Despite the lower cost, Kenya still provides excellent quality of service, particularly in voice-related offerings (i.e. sales, customer support, etc.). Second, Nairobi is where all BPO players are located; it is also the East-African hub of many NGOs and international organizations (i.e. United Nations), making Nairobi well established and an easy place for expatriates to work. Third, Kenya has a relatively strong infrastructure. With its modern fiber optic cables, well-developed internal transportation infrastructure, and strategically located ports, companies should encounter fairly few infrastructural challenges when establishing operations in the country. Fourth, and finally, Kenya offers strong capabilities in the English language. All students are taught English in primary school, as it is one of the two official languages of the country (the other being Swahili).

Figure 8: BPO Labor Costs



When benchmarked against other accents, the Kenyan accent is notably clearer and easier to understand than competing BPO locations. Similarly, with its colonial history and strong tourism industry (with nearly 2 million visitors per year), Kenya has a distinct western cultural

[4] No actual cost data is publicly available, but price in the industry consistently tracks costs; Source: DataMonitor and HBS case on KenCall

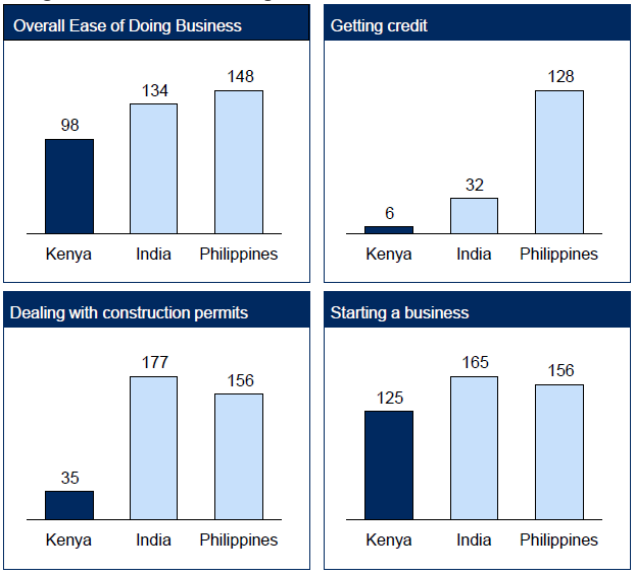
understanding and influence. However, despite these advantages, Kenya still faces the perception of poorer quality or more difficult business environment.

Kenya's BPO Business Environment

When Benchmarked against the BPO industry leaders – namely, India and the Philippines – Kenya favors quite well in terms of overall ease of doing, access to credit, dealing with construction permits, and starting a new business (see **Figure 2** below)[5].

In terms of overall ease of doing business, Kenya ranks significantly higher than both India and the Philippians. Similarly, in terms getting credit (a key issue for local firms looking to outsource their BPO services and grow their top-line), Kenya ranks 6th in the world. On its own, Kenya's relatively challenging business environment is unlikely to be an impediment to BPO sector development, given the even weaker positions of industry leaders India and the Philippians. Thus, given Kenya's BPO cost advantage, and other assets discussed above, the cluster is positioned to achieve high growth rates if the right policies are enacted and effectively implemented.

Figure 9: Ease of Doing Business



(June2010 Ease of Doing Business Report)

Kenya's BPO Cluster & Key Players[6]

Kenya's cluster primarily participates in three main segments: Basic data, basic voice, and rules-based decision making. Specialized voice and knowledge-based services are in the nascent stage of development. While the cluster is comprised of many small players, the largest and most established players are KenCall, Horizon Contact Centers, Direct Channel, and Ken-Tech Data Systems. As mentioned, KenCall was founded in 2005 and has 300 seats[7]. It offers mainly basic voice and data services, but has begun to move into specialized voice; for example, KenCall has recently engaged in technology training for Cisco and Microsoft products. Horizon Contact Centers was founded in 2008 and has approximately 1,200 seats. Its service offerings include basic inbound and outbound voice and basic data processing; while it has begun advertising mid-to-high end services, such as payroll and IT support, it is unclear whether Horizon is able to effectively deliver such services. Direct Channel is a South African company that opened a BPO facility in Nairobi in 2008. While it has only 150 seats in Kenya and offers mainly basic inbound and outbound voice (with a particular emphasis on sales, customer service and after-sales support), it has the advantage of leaning into the expertise and knowledge of its South African parent organization. Finally, Ken-Tech Data Systems was founded in 2006 and has a strong focus on basic data and IT solutions, but has recently begun to expand into basic inbound and outbound voice services.

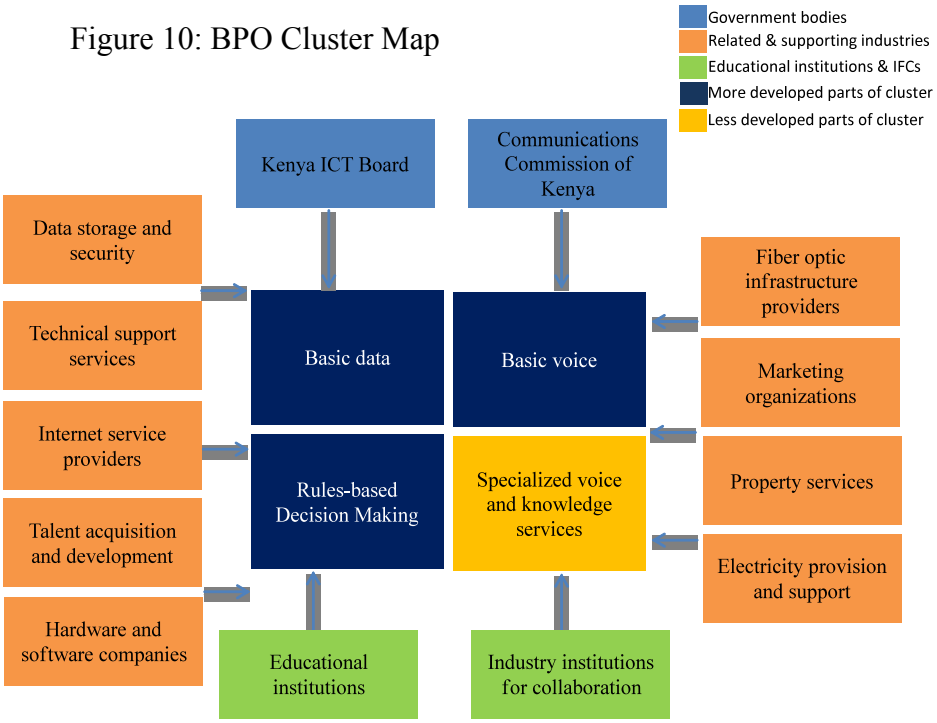
There are many related and supporting industries that feed directly into the cluster (see **Figure 10** next page). These include: *data storage and security* – which is a fairly fragmented cluster comprised of many small players; most BPO firms store back-up information in-house as

---

[6]Source: Case team interviews and company websites.
[7]Call center size is typically measured in seats. This does necessarily equate with number of agents. For example, KenCall has >500 agents while Horizon has substantially fewer than 1,200.

a result; *technical support services* – again, a fairly fragmented cluster with many small players; *internet service providers* – which is comprised of many players who mainly buy capacity from SEACOM and TEAMS. The major firms in this space are Safaricom, Zain (Airtel), Africa Online, Nairobi Net, Kenya Data Network, Jamii, Telkom Network, Access Kenya, Essar, and Wanainchi Online; *talent acquisition and development* – a fairly nonexistent cluster until the recent development of the Centers of Excellence (discussed above); *hardware and software companies* – a cluster comprised of larger organizations such as Microsoft, Intel, IBM, and Google; *fiber-optic infrastructure providers* – including TEAMS, SEACOM, and EASSy; *marketing organizations* – a cluster that essentially is made up of large local advertising companies (i.e. Scanad) but few truly pure-play marketing organizations; *property services* – a fairly established cluster in Nairobi given the expatriate community and presence of international organizations; *electricity provision and support* – a similarly established cluster but is plagued by frequent power supply shortages resulting in power outages and the need for back-up generator support for all BPO players.

Figure 10: BPO Cluster Map



There are primarily two government bodies that directly support the BPO Cluster. The Kenya ICT Board, which primarily acts an IFC (see *IFCS: Strengths and Weaknesses* below), positions and promotes Kenya as an ICT destination, advises the government on ICT-related policies and programs, provides capacity building activities including training and skill development, and manages development and implementation of new ICT projects. The Communications Commission of Kenya (CCK) regulates telecommunications, IT, broadcasting, and multimedia in Kenya.

There are four primary educational institutions that support BPO in Kenya. *The School of Computing and Informatics (SCI)* at the University of Nairobi seeks to be "a leading center of excellence in research, research and development (R&D) and advanced education in computing" in Kenya (SCI, University of Nairobi website). However, cluster firms do not believe that its programs offer sufficient training for their entry-level positions and thus are forced to re-train new hires. The *Kenya Industrial Research and Development Institute* is a quasi-governmental organization that undertakes research and development in engineering, energy and the environment, ICT, textiles, and food technology[8]. Despite this mission, BPO firms are unsure if the organization has produced any relevant research related to BPO; thus its research may not effectively disseminate into cluster activity. *The Nairobi Technical Training Institute (NTTI)* seeks to provide "technical industrial and vocational entrepreneurship training," but like SCI, does not meet industry quality standards (KIRDI website). *The Multimedia University College of Kenya (MMU)* aims to be the "leader in quality training, consultancy and research in the ICT sector"; while it has the best reputation among cluster participants, its graduates still require significant on-the-job training (MMU website).

In terms of IFCs, the only BPO-specific one is the Kenyan BPO and Contact Center Society. The Society's vision is to "develop a strong and sustainable BPO industry sector in Kenya." While it seeks to represent members' collective interests by forging public-private partnerships and lobbying the government, it has a very poor reputation in the cluster (see *IFCS: Strengths and Weaknesses* below). The Kenya Private Sector Alliance seeks to create a world-class private sector through advocacy and promotion of members' interests; BPO derives tangential benefits from the organization but the IFC does not support BPO directly. Similarly, the Nairobi Central Business District Association (NCBDA) was formed to serve the basic needs (i.e. security, cleaning, and other services) of businesses operating in Nairobi, but does not represent the specific interests of the BPO Cluster. Lastly, the Telecommunications Service Providers Association greatly strengthens clusters that support BPO (i.e. ISP, telecommunication infrastructure, etc) and thus offers indirect support to firms in the BPO cluster.

Analyzing Kenya's BPO Cluster Using the Diamond Framework[9]

Over the last 5 years, the Kenyan BPO cluster has displayed great strides in terms of formation, coordination, and growth; however, there are many key components of the diamond framework that must be addressed. Regarding *factor conditions*, there are a few positives and negatives. Kenyans have a neutral, anglicized accent thus offering a superior alternative to South Africa, India, or the Philippines. Secondly, the government of Kenya has recently begun a "digital villages initiative" in which over 250 strategic villages will be connected to the internet via digital centers which will have computers and internet access. Thus, Kenya's human capital will become increasing familiar with digital technologies and increasingly computer literate.

[9] Source: Case team interviews.

Third, as mentioned, Kenya is connected to telecommunication technology via modern fiber optic cable lines, thus is positioned with the infrastructure needed to strengthen the cluster. But Kenya's factor conditions also have some drawbacks. First and most important, Kenya's BPO-related university and training programs are not sufficient to adequately source talent. As a result, firms often need to re-train new hires and staff. Second, Kenya is plagued by high electricity costs and electricity supply that is inconsistent at times.

Regarding the *context for firm rivalry*, Kenya shows a few key weaknesses. Competition is lacking in certain segments of the cluster; for example, the basic data segment is fairly fragmented with limited differentiation among players, whereas in basic voice, there are only a small and concentrated handful of key players. As a result, there are varying levels of quality compared to world standards. Also, tax incentives are not available to all players in the cluster. Firms located in the special economic zones receive significant tax incentives, whereas firms not physically located there do not receive such incentives. As a result, firms' cost structures are significantly unbalanced resulting in many firms being unable to compete on key contracts. Despite these weaknesses, the BPO Park, slated to be completed in 2012/2013, would extend tax breaks to all firms and offer a strategic location for firms to open operations. Also, MNC presence in the country is growing, causing increased firm rivalry to win these contracts (most recently, IBM announced plans to open offices in Nairobi).

Regarding *demand conditions*, the cluster is underperforming. There is a limited local market for BPO services, and the demand that is present is quite unsophisticated (i.e. data clean-up or voice transcription). While the perception is certainly changing in recent years (most notably as a result of KenCall's efforts), many large Kenyan companies view local BPO

operators to be lacking in quality; they typically perform BPO functions in-house as a result. This perception is present in the minds of executives in international companies as well.

In terms of *related and supporting industries*, the cluster's strength lies in the fact that BPO is one of the government's key sectors to focus on for the next number of years. As a result, the ICT Board is well funded and ensures that the cluster is well supported and marketed. However, despite its financial commitment, the government has done very little to coordinate the cluster, deliver on its promises, or facilitate sharing of information. No credible cluster information exists (i.e. market size, market share, growth rates over time, key players, etc). The information that does exist – such as data stored by the Kenya Revenue Authority, CCK, or Kenya National Bureau of Statistics – is not shared publicly or with relevant parties. Similarly, the government has failed to build the 7,500-seat BPO Park as promised; as construction plans continue to get pushed back further and further, cluster firms are hesitant to believe that it will actually be built. Despite the government's poor support of the cluster (beyond financial backing), the IFCs have many strengths but also significant shortcomings (see below).

IFCS: Strengths and Weaknesses

As mentioned, there are two IFCs in the BPO cluster in Kenya. Both have a few notable strengths, but overall are not well perceived by cluster firms. The ICT Board is a government body which focuses on ICT promotion and development; its primary role for BPO is to assist in marketing Kenya to international investors and represent issues emerging from the cluster to the government. Through interviews with companies in the cluster, the Board's strengths and weaknesses became quite apparent. In terms of strengths, the Board convenes cluster stakeholders, receives their feedback openly, develops cluster service-level agreements (SLAs),

and defines a strategy for the cluster each year. The ICT Board was responsible for the facilitation of the installation of the three fiber optic cable lines, and it has spent time, energy and resources trying to position Kenyan BPO internationally. However, companies feel that it has not clearly defined what the cluster's value proposition is relative to other countries/regions, thus making its marketing seem unfocused. Also, its objectives and timelines as an organization are not communicated to cluster participants, so it is not always clear if it is executing on its annual deliverables. Lastly, it is perceived as slow and bureaucratic to cluster participants.

The BPO and Contact Center Society is supposed to be the industry association for the cluster that promotes education, advocates for standardized reporting, and coordinates players in the cluster. However, despite its initial efforts to lobby to get the ICT Board created and initially bring together all cluster members, it has accomplished very little. It is viewed as inactive (i.e. does not advocate for the cluster), corrupt (i.e. promoting the interests of certain "connected parties" and driving leaders' own personal agenda), and independent (i.e. does not engage stakeholders in its activities).

Cluster Challenges

As has been alluded to earlier, the cluster faces many challenges, however none that are insurmountable. Each of the limitations discussed in the *Diamond Framework* analysis must be addressed in order to strengthen the cluster and position it for the growth expected in Kenya Vision 2030.

Cluster Recommendations

With these challenges in mind, the government should implement the following policy recommendations. Regarding *factor conditions,* the government has recently set aside $12 million for BPO skills development. Rather than setting up another training institute that the local cluster players do not value, it should speak with firms in the cluster and have them lead the initiative. The money should go to short-term, BPO-specific, private-sector led training courses at local universities that leverage best-practice international knowledge. In order to strengthen the emergence of the cluster, there needs to be significant human capital investment that is well respected by the cluster. Also, in terms of factor conditions, the government should ensure the timely completion of the BPO Park and provide 100% power back-up generation capabilities (as India does) there to incent international firms to offshore their operations to Kenya.

Regarding *context for firm rivalry*, the cluster needs to be strengthened relative to international quality standards. The perception of poor quality must be addressed. Thus, the government should require that all BPOs, that wish to receive international marketing through the Kenya ICT Board, obtain international certifications of BPO quality. To further encourage competition, the government should extent the EPZ tax incentives to all firms regardless of their location. In order to introduce stronger competitive dynamics, all firms must be given an equal starting point in terms of cost management.

Regarding *local demand conditions*, the government should create specific incentives for companies that employ local BPO operators; these could involve preferential access to government contracts or certain tax breaks where relevant. Also, the concept of anchoring is an important one in MOC, thus the government should help the cluster secure a large local contract that signals to other companies in Kenya of the legitimacy of the BPO cluster. This would provide the added benefit of causing the cluster to work together in delivering the service. Given

that not one BPO firm could handle a contract of more than 1,000 seats, such a contract would force the cluster to begin coordinating efforts and sharing information.

Regarding *related and supporting industries*, Kenya ICT Board must continue to play a coordinating role in the short-term. However, it must convene private stakeholders regarding the creation of a new BPO association (to replace the BPO society), commit resources to its creation and encourage local BPO operators to do the same. This organization should be lead by a credible individual who has clout in the cluster but also does not have the vested interest in only one BPO firm's success. He or she should be compensated based on how well this IFC strengthens the cluster, coordinates efforts, and facilitates information sharing.

Sequencing is an important element in cluster development, thus Kenya should first focus on creating a new IFC, followed by development of a BPO training facility, followed by bringing all BPO organizations to a point of international quality recognition. These steps, if implemented successfully, would greatly strengthen this emerging cluster in East Africa, and position Kenya's BPO to be an attractive off-shoring destination for major firms across the world.

Conclusion

Kenya is a promising study in country and cluster level competitiveness. With incredible endowments and potential, there are only a few factors now keeping Kenya back from explosive growth rates that would put it on par with the BRIC countries and allow Kenya's standard of living to rise to a middle-income level. However the last few constraints to Kenya's growth may also be the most difficult: cleaning up government corruption and investing in long-term assets like education and infrastructure are not always politically feasible in the near-term. If Kenya continues to make the right investments in its future and eradicate the corruption in its

government, the country's growth will increase dramatically and the BPO cluster will become a top out-sourcing destination worldwide.

Bibliography

BPO Analysis Section

Isenberg, Daniel. "KenCall – Can Nik Nesbitt's Venture Succeed in Kenya?" HBS No.809-114. Boston: Harvard Business School Publishing, 2009.

Kahumbura, Cynthia. Preciss International. Interview by author, Nairobi, Kenya, March 18, 2011.

Kaka, Noshir, Shailesh Kekre and Saipriya Sarangan. "Benchmarking India's Business Process Outsourcers," Nasscom and McKinsey & Company, http://209.172.180.99/clientservice/bto/pointofview/pdf/MoIT8_Nasscom_F.pdf, accessed March 2011.

Karanja, Patrick. Business Leader, Horizon Contact Centers. Interview by author, Nairobi, Kenya, March 18, 2011.

Kenya Vision 2030: A Globally Competitive and Prosperous Kenya (Nairobi, Kenya, 2007), http://www.vision2030.go.ke/, accessed April 2011.

Makau, Boniface. Economist, ICT Taskforce. Interview by author, Nairobi, Kenya, March 18, 2011.

Manickam, Lakshmana., General Manager, KenTech Data Systems. Written interview by author, Nairobi, Kenya, March 18, 2011.

Muhia, Miriam. Member, ICT Taskforce. Interview by author, Nairobi, Kenya, March 18, 2011.

Muthee, Stephen. CEO, Dapron Information Management. Written interview by author, Nairobi, Kenya, March 18, 2011.

Muthee-Gitiba, Diana. CEO Adept Technologies. Written interview by author, Nairobi, Kenya, March 18, 2011.

Nduva, Lawrence. Manager, Kenya ICT Board. Interview by author, Nairobi, Kenya, March 14, 2011.

Nesbit, Nik. CEO, KenCall. Interview by author, Nairobi, Kenya, March 17, 2011.

Osiako, Gideon. General Manager, Records & Archives Management Systems (RAMS). Written interview by author, Nairobi, Kenya, March 18, 2011.

World Bank Doing Business Report, The World Bank Group, accessed March 2011.

Country Analysis Section

Ease of Doing Business Report: Kenya, *The World Bank*. www.easeofdoingbusiness.org, accessed March 2011.

Economist Intelligence Unit, *EIU Country Forecast: Sub-Saharan Africa Regional Overview*, March 2011, http://www.eiu.com, accessed April 2011.

Economist Intelligence Unit, *EIU Country Profile: Kenya 2008*. http://www.eiu.com, accessed March 2011.

U.S. Department of State. "Background Note: Kenya." U.S. Department of State website. http://www.state.gov/r/pa/ei/bgn/2962.htm, accessed March 2011.

The Government of Kenya, *Kenya Vision 2030: A Globally Competitive and Prosperous Kenya*, October 2007, accessed February 2011.

World Development Indicators, The World Bank Group, accessed February, 2011.

Kenya National Bureau of Statistics. "Gross Domestic Product by Activity," Kenya National Bureau of Statistics website, http://www.knbs.or.ke/, accessed March 2011.

Economist Intelligence Unit, EIU Country Data, http://www.eiu.com, accessed March 2011.

United Nations Development Programme, *Human Development Report 2010; The Real Wealth of Nations: Pathways to Human Development*, http://hdr.undp.org/en/media/HDR_2010_EN_Complete_reprint.pdf, accessed February 2011.

World Economic Forum, The Global Competitiveness Report 2010-2011, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf, accessed February 2011.

Transparency International, Global Corruption Report 2009: Corruption and the Private Sector, http://www.transparency.org/publications/gcr/gcr_2009, accessed February 2011.