Theme 2 – Incentives accorded to the BPO sector

This theme synthesizes the incentives accorded to the BPO sector. It is based on a study conducted in South Africa, India, Mauritius and Kenya. The study found an interesting relation between the incentives each country has to offer the Business Process Outsourcing sector and the success and growth rate of the industry in the respective countries. The active role of that a Government plays clearly determines the pace at which the industry grows and the global recognition as an outsourcing destination that a country gains. Successful countries in outsourcing are backed with substantial budgets and other incentives as detailed below.

South Africa

The public sector in South Africa has made a long-term commitment to the BPO sector, supported by the Office of the President. There is attractive financial and non-financial incentives. A government-backed BPO support programme, launched in 2007, aims to enhance South Africa's competitiveness and includes a budgeted R1.1 billion in investment incentives. The plan focuses on:

- A broad-based marketing strategy.
- A government support programme which includes an investment grant and training subsidies.
- A developmental pricing framework for telecommunications.

The BPO specific incentives to invest in the country include:

- Investment incentive grant of R37,000 to R60,000 per seat
- Training and skill support grant; up to R12,000 per agent

However, the investors are yet to take advantage of these incentives because of the strict qualification criteria. For example, one has to have created a certain number of jobs in order to qualify.

The private sector associations in South Africa also receive an incentive from the government. The BPO Association (BPeSA) and the Regional Associations get a good percentage of their funding from Government. This makes the associations much more active and visible, which in turn helps them to sell the country.

India

India provides the following package of incentives:

- The Government of India gives a 100% tax holiday for the first 5 years, 50% for next 5 years, and up to 50% for balance 5 years in an IT-BPO sector
- All IT-BPO related businesses enjoy exemption from excise duties, service and sales taxes
- All the fiscal benefits are restricted to prescribed zones with a minimum area of 25 acres
- License application procedures are easy. They do have a single window clearance.

Mauritius

Mauritius is a very interesting case. It had incentives like other countries but abolished them. The argument was that the country was that the BPO companies benefited more while the country hardly benefited from the investment. The only incentive that Mauritius left is a 15% corporate tax, which is one of the lowest globally.

Kenya

In Kenya, the following tax incentives are granted to EPZ companies:

- 10 year corporate income tax holiday and a 25% tax rate for a further 10 years thereafter (except for EPZ commercial enterprises)
- 10 year withholding tax holiday on dividends and other remittances to non-resident parties (except for EPZ commercial licence enterprises)
- Perpetual exemption from VAT and customs import duty on inputs – raw materials, machinery, office equipment, certain petroleum fuel for boilers and generators, building materials, other supplies. VAT exemption also applies on local purchases of goods and services supplied by companies in the Kenyan customs territory or domestic market. Motor vehicles which do not remain within the zone are not eligible for tax exemption
- Perpetual exemption from payment of stamp duty on legal instruments
- 100% investment deduction on new investment in EPZ buildings and machinery, applicable over 20 years
- 100% foreign ownership

Any BPO firm setting up operations in EPZs is entitled to the above benefits. There are however many BPO firms outside the EPZs. It is hoped that when the special economic zones in Vision 2030 are established, BPO firms will be accommodated and will enjoy the EPZ package of incentives. There is however one apparent contradiction which needs to be addressed. While firms are allowed 100% foreign ownership in the EPZs, the license from CCK requires a maximum of 80% of foreign ownership.

According to KICTB, the government is considering substantial incentives to encourage the growth of the BPO sector. These incentives include:

(a) Tax incentives
   - Reduced income taxes for both expatriates and key national employees
   - Corporate tax holidays for BPO firms, with reduced tax after the holiday
   - BPO firms can obtain EPZ status, with a tax holiday followed by reduced tax rates

(b) Custom duties
   - VAT exemptions for local purchases of key inputs

(c) Set-up & training subsidies
   - Subsidies as specific set-up costs
   - Subsidies for relevant training programmes
   - Discounts for rents in BPO specific locations

(d) Reduced regulatory/ burden
   - Speeding up the process of setting up new BPO providers
   - Simplifying hiring and firing processes

One of the key incentives that BPO operators expected was bandwidth subsidy. This is because of the high cost of satellite bandwidth, which makes Kenya not able to compete on fair terms with other BPO destinations globally. The Government of Kenya successfully negotiated for a BPO "Bandwidth Support Capacity Purchase Scheme" support line in the Financing Agreement signed with the International Development Association for the Kenya Transparency and Communication Infrastructure Project (TCIP). According to this scheme, for every incremental bandwidth above the level at 31st December 2006, KICTB would pay the difference between the actual cost and US$ 500 per 1 Mbps. This tariff level (US$ 500 per Mb/sec) was deemed to be at par with competitive destinations (e.g. India) and was meant to allow operators to focus on business development related activities and expenses in order to grow.

Results so far indicate that only 23 companies applied out of which only 7 have received the subsidy. According to KICTB, one of the key reasons for the small number of beneficiaries is that many of the vendors did not provide the required supporting documentation as per the World Bank MoU requirements. The key documents required include a list of directors, 2 passport size photographs of each director, copy of ID/passport of each director, copies of Memorandum and Articles of Association, copy of VAT certificate, copies of PIN for the company and the directors, copy of tax compliance certificate and copy of certificate of incorporation. In addition, many companies did not attend the subsidy 'educational' forum and did not/have not applied. Following the poor response and imminent arrival of fiber cables in June, KICTB has successfully applied for an extension of the period to 31st Dec 2009.

Discussion Q1. We know that investors need to feel comfortable that the government is fully committed to develop the BPO sector. After the sub-marine cables, what set of incentives will be required and how should we package them to be a more attractive destination for investors while at the same time ensuring that the BPO sector delivers value to Kenyans?

Discussion Q2. We know that people skills are a critical factor in the attractiveness of a destination and are crucial for the success of the industry. In the A.T. Kearney Global Services Location Index, "people skills and availability" accounts for 30% of the index. At the moment, Kenya's training incentives are not very clear/specific. What incentives should Kenya create on human resource development and what would be the implications for both the public and private higher education institutions?

Discussion Q3. How do think we should address the foreign ownership component? Why?

3