

9

The Enabling Environment for ITES

Martine Julsaint Kidane

Introduction

This chapter is based on UNCTAD research from the 2009 volume of its annual publication, *Information Economy Report*.

It also presents some of the findings of an UNCTAD multi-year expert meeting, which focuses on services, development and trade, and the regulatory and institutional dimension. We have been looking at what regulatory and institutional frameworks are important for the development of services, and more particularly, infrastructure services. Here, the discussion that will be most relevant will be in relation to telecom services as supporting services to IT and IT enabled services. The chapter also touches on the role of trade and GATS negotiations as well as the current financial and economic crisis and its impact on IT and IT enabled services.

Offshoring

The offshoring of services generally can generate efficiency gains from international specialisation and trade for the global economy as a whole. Offshoring reduces transaction and other costs of trading over distance, and has become more and more feasible over a range of services sectors. So the extent and types of services that can be traded have increased. For importing companies this implies access to services at lower cost and allows them to focus on areas where they enjoy a comparative advantage. For exporters of services, offshoring can imply the creation of opportunities for employment, diversification, export revenues, knowledge transfer, economic upgrading and so on.

In the context of this potential for offshoring of services, governments are now seeking to design effective policies to boost related exports, both by local and foreign firms established in their countries.

The benefits to the firms that engage in offshoring include lower labour costs, positive economies of scale, and round-the-clock operations. They can also have access to quality, which is one area where regulation can be quite important and where regulators can intervene. However, there are concerns including the possible

loss of autonomy and loss of control by the firm on a number of activities, and also the leaking of confidential information. There is possibly insufficient protection of intellectual property, perhaps a lower quality of service (due, in particular, to lack of exposure to Western business) and also the changing nature of local laws.

The setting up of institutions in countries wishing to export services is important: it will provide stability and it will reassure investors who wish to come to these countries, or firms who want to offshore activities to these countries.

There are some benefits for the outsourcing destination, and the focus should be on tapping into these benefits. Outsourcing can contribute to the achievement of a number of the Millennium Development Goals by the impacts related through poverty alleviation, the employment of women (the gender dimension) but also technology transfers. Of course there are also some concerns, including the risk of footloose behaviour in the area of outsourcing or services. Often, the linkages between affiliates and local firms may remain small, and we know that offshoring is sometimes ‘captive offshoring’ between a firm and affiliate – and so the positive impact on the local economy could be diminished.

Research has shown that some of these concerns are misplaced. For example, the issue of job displacement in the markets where the companies are outsourcing services seems to be unfounded, to a certain extent since outsourcing does respond to a need of those markets. Also, quality and privacy concerns do not appear to be as significant as initial concerns seemed to predict. Finally, it is important to say that outsourcing is not necessarily a North–South issue because a lot of the trade offshoring is taking place on a North–North basis.

Lessons learned

What lessons can be learned from those countries that have been successful in tapping into this offshoring business. What did those countries have? What were their advantages? Competitive costs were one thing, but also language, education, skills, ability to develop global networks, and adequate and reliable infrastructure (this last one is particularly important in relation to telecoms). Importantly, the countries that have been successful also demonstrated that they have effective regulatory frameworks, which is a point that we will return to.

Among the challenges for the countries that want to enter into this business are the need for quality infrastructure, adequate legal and regulatory frameworks, and sufficient human resources.

IT and ITES

The definition of IT and IT enabled services is not always clear. UNCTAD makes the following distinction: IT services are programming systems, integration, application, testing and so on, whereas IT enabled services encompass front office services, back office services and knowledge processing services. Different levels of skills are required for these different services. It is not necessarily only the higher skills, but also the medium and lower skills that can be useful in providing some of these services; this will be important for developing countries.

As indicated earlier, both IT and IT enabled services can be offshored; this can be done internally (from a parent to an affiliate) or externally (to a third-party service supplier, which can be either domestic or foreign owned). There seems to be a slight distinction between IT and IT enabled services in that 'captive solution between a parent and its affiliate' tends to be more important in the context of IT enabled services; on the other hand, those countries engaging in IT services may possibly have more scope for having their local firms benefit as opposed to the affiliate of a foreign firm.

To give a broader figure, global imports from offshoring of IT services and business processing were estimated at approximately US\$93 billion in 2008.

Turning to the enabling environment, the multi-year expert meeting that UNCTAD has been holding since 2009 is examining what regulatory and institutional frameworks can help develop services sectors. The focus has been on infrastructure services, which includes everything from telecoms, water and transport to financial services. We know that these infrastructure services play a key role in supporting markets for other services including telecoms services and IT enabled services.

Maximising the positive contributions of these infrastructure services requires good regulation and institutions able to promote domestic supply capacity, but also a competitive environment and sustained trade in investment flows. However, research has shown that there is no single good regulation, and so the states maintain an important role as enabling agents for the development of these services sectors. The current financial crisis has been important because it demonstrated that governments cannot merely establish regulations at one point and consider the work done; they often have to adapt, come back and re-regulate, in keeping with developments in the markets. The March 2010 session of the UNCTAD expert meeting focused on co-operative mechanisms, whether North-South or South-South, which can be crucial in developing efficient regulatory institutional frameworks.

In these infrastructure services sectors, governments had traditionally sought to control the markets, often providing the services themselves. They have now moved towards regulatory oversight, but in some cases where a competition cannot be established – for example, because of national monopoly elements and given services sectors – then governments do retain a role in the provision of services. The key regulatory

issues that need to be addressed by regulators are ownership and management in the sector, competition, pricing, quality of service and universal access. There are several elements relating to telecoms that would be important for the promotion of IT enabled services, particularly producing competition (because we know that competition often pushes towards the best available services), fair pricing and quality of service. In order to have efficient IT enabled services, we need adequate telecoms services and the regulator has a role in setting some benchmarks and in promoting the development of quality services.

Regulatory reform

UNCTAD's 'ICT Regulatory Toolkit', which is available to governments,¹ contains tools like directions for issuing licences, codes of practices and guidelines, but also there are enforcement mechanisms in case of breach of legislation or regulation. In the last session of expert meeting, the telecoms sector was set forth as an excellent example of regulatory reform promoting the development of the sector. In the context of telecoms, there were basically two waves of regulatory reform.

The first one focused on opening up the sector to competition in light of the rapid technological changes that had occurred in the sector, which caused most of the monopoly elements to disappeared, making competition possible.

In the telecoms sector, regulators were rapidly established over a relatively small number of years, and now there are independent regulators in over 160 countries. As a result of these reforms and technological development, there has been much progress in telephony services in particular. In fact the MDGs target in this regard has already been met, although there does remain a gap between developed and developing (and LDC) countries. So there is still work to be done by regulators in promoting this sector.

The second wave of reform that we are now witnessing has more to do with network convergence, which is also an important element in ensuring that the latest technology available for the provision of IT enabled services has reliability and quality of service. Infrastructure sharing, and services-neutral and technology-neutral licences are the mechanisms that regulators are now are seeking to put in place in order to promote the telecoms sector. In this sector, we have seen that policies, legislation and regulation need to be dynamic in order to accommodate the technological changes. Other important phenomena here are the impacts of climate change, and the need also for regulations to address this issue.

The telecom sector has shown resilience in the wake of the crisis, and this is possibly a very good thing in terms of IT enabled services. This resilience can in part be attributed to the good regulatory environment that countries have created for this sector.

Two country examples

Tanzania has been a pioneer in adopting new convergence regulations. Despite its LDC status, it has established a converged regulatory framework, which is characterised by both service-neutral and technology-neutral licensing. This has allowed Tanzania to make remarkable progress in delivering telecoms services, indicating that where there is political will even a smaller or less advanced country can put in place such a regulatory framework. In Tanzania, this has resulted in the country receiving a tele-penetration rate of 33 per cent, which is quite high compared to other African countries. Now Tanzania is to become a connecting hub for the East African region, including through the development of sub marine cables. Many other countries may have opportunities in this area when they put in place the right regulations.

In Singapore the strategy was to rely on market forces to provide effective and high quality services, along with a transparent decision-making process, and an effective and speedy dispute settlement mechanism in order to have a vibrant telecoms sector. The Singapore regulator has found it possible to monitor activities of foreign operators as well as those of domestic service suppliers, and in the area of telecoms has been able to balance the various concerns related to privacy and to consumer protection. The Singapore regulator is also a key actor in terms of industry development, which in the view of the regulator's office has created synergies that allowed it to guide the industry using both a carrot and a stick approach. In the development of the country's next generation broadband network, the regulator's office relied on incentives provided by the government, but also on regulation, in order to achieve the expected results.

In terms of the enabling environment, significant time, financial and human resources are needed to put in place the regulatory institutional frameworks. It is also important that regular interaction occurs between the regulators and the trade negotiators; regulators have a set of objectives that they try to promote, which are not necessarily the same as those of trade negotiators, so in order to have a coherent development of export in the services sector it is important that they interact. Inter-agency collaboration is also important, as is co-operation between regulators from different countries. IT and ITES offshoring, supported by adequate regulatory institutional frameworks, can significantly contribute to national income, growth, employment and poverty reduction.

Trade commitments can sometimes be undermined through protectionist domestic regulation – hence the importance of interaction between regulators and trade specialists, so that the objectives of the regulators (which might be universal access, quality of service or the extension of service) do not lead to trade protection. A challenge for developing countries is that often they are still developing their regulatory systems and putting them in place – so when we have trade negotiations that precede the development of regulatory institutional framework, we want to make sure that these two do not clash. Careful co-ordination needs to be undertaken at national level.

Linkages

In the current WTO services negotiations, many countries, including developing countries, are less than satisfied with progress in terms of the Mode 4 commitment, but there is a clear relationship between Mode 4 (where service suppliers move to the market) and offshoring (where the work is moved to the service suppliers). The question for developing countries may be whether there is a possible trade-off. If there is no progress on Mode 4, will it at least be possible to have progress through offshoring, so that the qualification and skills in developing countries and LDCs can reach the markets where they are needed?

The crisis in IT enabled services

The trend seems to be that services exports have declined, although less so than merchandise exports: services seem to have resisted better. This negative trend, though, seems to be only in the short term; we can expect that, in the longer term, offshoring of services will again pick up relatively quickly, particularly because the economic crisis will induce firms to go more towards efficiency and in this context, offshoring may be an important option for them to consider. The impact of a crisis may be only in the short term; in the medium to long term, things should pick up again. There seems to be diversification in terms of the countries that are providing these services.

Conclusion

The development benefits of outsourcing in this area are not automatic. There is work to be done at a national level in terms of strengthening domestic service supply capacities, but also at an international level including through negotiated trade commitments. International partnerships can also be useful in terms of expanding export markets, including increasing domestic capital, and establishing credibility – and the Diaspora has an important role that it can play in helping to promote the services of a country abroad. It is key that the government retains a proactive role in terms of identifying their country's natural advantage and developing it to boost competitiveness. But it should also be focusing on building and maintaining appropriate infrastructure for the export of these services, and becoming more and more responsive to the needs of the private sector, tapping the Diaspora to build domestic energy and, finally, setting up the appropriate regulatory frameworks and institutions and maintaining political stability.

Note

1. Available to download at: <http://www.ictregulationtoolkit.org/en/Publication.1334.html>

Section Four

Human and Institutional Capital

The importance of skills and talent comes as a recurring necessary condition for the development of the IT/ITES sector. Different skills levels will be required depending on where a country wishes to be on the value chain. Even at the lowest point in the value chain, services require a greater emphasis on skills development than manufacturing because the skills themselves are the product (e.g. language skills in call centres), rather than simply what goes into producing the product, as is the case with goods. Chapter 10 provides examples from Mauritius and Kenya on how human capital requirements are being addressed.

For the industry to take off, skills are not sufficient. Potential investors must be made aware of the existence of these skills and of the general enabling environment. Promotion is important, but services cannot be promoted along the same lines as goods. The focus of almost all public as well as private sector organisations is on traditional products. In many instances, attracting foreign direct investment or promoting exports of services relies heavily on promoting the country as a location, not just the products made by individual firms. For example, in health care, patients are attracted by the reputation of the country as a provider of quality care, and in IT firms tend to look for clusters of capability before they invest. Hence, the reputation of the country needs to be established alongside the promotion of services supplied by firms. Is this best done by government or by the private sector or by both working in tandem?

In Chapter 11, we share the experiences of the Caribbean, Malaysia, and Uganda. In the Caribbean, in Barbados in particular, the private sector has taken the lead by organising in a coalition of services. A common complaint in many emerging economies is that firms in the services sector do not think as an industry. An important step towards establishing a particular location as an attractive sourcing destination is to group the service providers so that they can make their voices heard. In Uganda as well attempts are being made to build an IT cluster while Malaysia has set up a public funded institution to promote professional services.

Role of private sector

It is very important to get the private sector on board at a very early stage of sector development. For many services sub-sectors a coalition of services can play an important role in co-ordinating the response of a large number of very small providers and ensuring that a small number of very dominant providers does not push forward

its agenda to the detriment of the smaller providers. In the absence of such an organisation governments tend to defend unwittingly the position of the big players. Indeed, WTO commitments in many countries have been made without the private sector being fully involved. This absence of dialogue may result in a situation where negotiators are bemused at the lack of dynamism on the part of the private sector to exploit 'hard-earned benefits' from negotiations whether at the WTO or in economic partnership agreements (EPAs).

While it is acknowledged that the private sector has an important role to play, it can also have a negative impact if there is a monopoly incumbent that tries to capture the regulatory process and is resistant to reform. The private sector can play a very positive role when it seeks to exploit opportunities to increase efficiency and identifies where regulations are constraining it from achieving efficiency.

An issue that has yet to be resolved concerns the funding of the support organisations. Ten coalitions were launched in the Caribbean but only the three that receive external funding (Barbados, St Lucia, and Trinidad and Tobago) are fully operational.