Local content

In some African countries, up to 40% of the weighting in the awarding of public contracts is now assigned to the quality of a bidder's proposal on local content. Foreign firms are increasingly edged out, finds Michael Dynes


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A new wind of change is sweeping through Africa. As governments gear up to overhaul and extend the continent's dilapidated infrastructure, the days when foreign firms could march in, bid for contracts, outmanoeuvre the domestic competition, build oil facilities, power plants, roads and hospitals, and then exit – taking most of the profits with them and leaving behind virtually no local capacity to operate and maintain them – are fast receding.

Efforts to boost local content have been gathering momentum in the oil and gas sector – particularly in Nigeria and Angola – for many years. During the past decade, attempts have also been made to establish a similar trend in the mining sector. With governments across Africa significantly increasing budget allocations to help bridge the infrastructure deficit, that process is now underway in the construction sector. Foreign companies hoping to bid for the new generation of African infrastructure projects ignore this development at their peril.

From Nigeria's hydrocarbons sector, to the supply of water infrastructure in Angola, the expansion of the mining industries in Tanzania and Zambia, and the construction of new power stations in South Africa, firms bidding for contracts are under mounting pressure to dramatically increase the amount of goods and services provided by local suppliers. In some African countries, up to 40% of the weighting in the award of public contracts is now assigned to the quality of a bidder's proposal on local content.

Playing catch up

The need to increase the amount of local labour, goods and services in the delivery of infrastructure in Africa is now widely recognised by development finance institutions, the World Trade Organization and UN agencies. The 2005 Paris Declaration on Aid Effectiveness highlighted the central role local content plays in economic development. But as a report by the London-based Institution of Civil Engineers (ICE) found in 2008, "as things stand, procurement does little to benefit consultants, contractors, suppliers and manufacturers in less developed countries."

The ICE report found that much of the funding invested in African infrastructure does not benefit local contractors, suppliers and workers. It added, however, that "decisions taken at the project identification and planning stage can have a big impact on the development of local content objectives". Local skills and supplies also saves on foreign exchange. It also found that increased local content heightened the sense of local ownership, "increasing the prospects that the facility will be maintained".

Africa's extractive sector typically contributes greatly to export earnings and little to growth. Minerals account for an average of 46% of total African exports but only about 13% of GDP. This high impact gap averages out at about 34% for Africa as a whole, but in some countries such as Nigeria, Zambia, Algeria and Guinea, it can be above 50% – reflecting the extractive sector's enclave status. Multinational corporations generally dominate the sector, leading to low local content, which the African Export-Import Bank (Afreximbank) estimates at around 10% for the continent as a whole.

Afreximbank is trying to redress this gap by financing increased African participation in the extractive sector, and has provided more than US $3 billion in credit approvals to African firms over the past decade. The primary beneficiaries of the initiative have been African companies providing excavation services, engineering and logistics, import and export traders, and maintenance and drilling companies from Algeria, Côte d'Ivoire, Nigeria, Zambia, Ghana and Zimbabwe.

Afreximbank not only found that boosting local content helped to increase the sector's relative contribution to economic growth, but it also helped to facilitate technology transfer, reduce foreign exchange costs, mitigate risk and increase returns. "Afreximbank has demonstrated that African local content can be profitably financed," Benedict Oramah, the bank's Executive Vice President, told the annual UNCTAD conference in Mali in 2009.

Cairo-based Afreximbank launched a scheme to promote local content in the African extractive industries designed "to raise the sum of rent, interest, wages, salaries, and profits in the production and sale of minerals returned to Africa," after identifying what it calls the "high impact gap" between the sector's respective contribution to exports and gross domestic product.

But few African countries have clear policies for the promotion of local content, and many of those that do face formidable hurdles trying to implement them. The World Bank and African Development Bank estimate that significantly less than 40% of all public works contracts in Africa are awarded to African firms. That figure is much lower in the case of tide aid – where donors provide project funding provided the recipient uses donor-country suppliers.

Moreover, foreign contractors have traditionally been granted various fiscal concessions by African governments, such

Expert insight by Stella Dogubo-Ovai

Most companies are beginning to comply [with the local content law]. However, my own take is that, in the senior management cadre, we still fall short. The excuse, perhaps, would be that we still lack the capacity to man some of the sensitive and strategic areas. We still don't have the needed capacity to match those aspects of operations in the nation's oil and gas industry. It is a question of capacity building. There is a provision in the law that gives Nigerians three years to build capacity. But, we are still addressing the issue of workforce. To train a petroleum engineer, you need six years. For now, we don't have the human capacity to match 80%. I don't think three years will be enough. At the end of the day, we are still at the mercy of the technical partners who we compel to transfer 80% of operations. They own the technology. The financial sector is not doing enough. And I am telling you this as a private sector person; they are not doing enough. They need to sit up.

Stella Dogubo-Ovai is a Nigerian contractor to the International Oil Companies (IOCs)

as waivers on duties and value added tax on imported materials, which are rarely – if ever – extended to local suppliers. This has helped to create an uneven playing field that has disadvantaged local contractors, impeding both their development and their ability to join the competition for the bigger and more lucrative contracts.

Many African countries are, however, now in the process of reforming their public procurement regimes with the assistance of the development finance institutions like World Bank and the African Development Bank. In countries like South Africa, where black economic empowerment schemes targeting public procurement have been in place for more than a decade, this policy is well advanced and is producing significant benefits for local firms.

In countries like Tanzania and Zambia, where efforts underway to ensure that local companies grow on the back of the expansion of the extractive sector are more recent, there still remains a long way to go. In Nigeria, which only passed its Local Content Development Act promoting local firms' access to construction and supply contracts in April 2010, and where the Petroleum Industry Bill promoting local participation in the oil and gas sector is still awaiting legislative assent, that process has barely begun. The rest of Africa is now playing catch-up.

Partner up to deliver

Speaking at the World Economic Forum in Davos, Wale Tinubu, CEO of Oando, a leading indigenous oil and gas local content company, said that he saw a very bright future for home-grown African companies to capitalise from the growth opportunities presented by the trend towards higher local content and sourcing as a result of the continent's new growth spurt.

"The good news is that Africa is a net exporter of energy. But the challenge in Nigeria is how to create systems that feed the internal energy market as opposed to exporting the bulk of our oil and gas. We at Oando have in the last ten or 15 years been able to build a $3bn corporation right across the value chain. We are taking gas that is normally flared, creating new power opportunities, and in the process creating wonderful job opportunities and bringing people back from the diaspora," he said.

Nigeria is receiving substantial investment, there has been reform, and local corporates are now taking off. The banking sector is expanding, enabling local corporates to be financed, and they in turn are doing deals with international corporates.

"I don't particularly feel that the development of the continent is going to be driven by multinationals," said Tinubu. "We have got to be able to create our own home-grown corporates that bring African solutions to African problems."

Michael Warner, Director of Local Content Solutions, a niche consultancy specialising in training local content regulators and developers in emerging markets, told *Africa investor* the trend towards increased provision of local content in Africa can be a powerful force. "Local content regulations can be protectionist. But they can also be a force for sustainable industrial development," Dr Warner said.

> The World Bank and African Development Bank estimate that significantly less than 40% of all public works contracts in Africa are awarded to African firms

"If you set local content targets too high, exceeding the ability of local industry to meet them, then you may start awarding contracts to firms that are not competitive on price, schedule or quality," he added. "Then there is a risk that local content will foster protectionism. If those targets are set within or marginally above the capability of local industry, you are more likely to incentivise local companies to invest in improving their performance, enabling them to bid for bigger, more complex contracts in the future. It is a very delicate balancing act."

If the rewards of increased African local content are considerable, so too are the risks. Nigeria's oil for infrastructure swaps with China ran into big trouble when Chinese funds were diverted into joint venture partners' private bank accounts via predatory local content vehicles.

Local content partners seeking rents, rather than adding value, are likely to increase costs and decrease competitiveness. Increased local content is not a lifeline for moribund companies chasing fat profits and an easy life.

"Giving preference to local suppliers makes economic and financial sense – but only where they can deliver on price, schedule and quality," said Warner, adding that alliances between domestic and international companies can be one of the most effective means of turning local content policies into effective economic development strategies.

As Africa embarks on the first sustained attempt to improve its physical infrastructure in decades, there are scores of examples from the hydrocarbons and mining sectors showing which local content strategies are able to provide the jobs, training and economic development that the continent craves. Putting the right local content strategies in place in infrastructure contracts will largely determine whether it succeeds or fails.

Going local

In Nigeria, local road contractors now have the opportunity to bid for federal government trunk road refurbishment contracts, whereas previously they could only bid for repair contracts for minor roads. There are hundreds of kilometres of federal roads in dire need of attention, and Abuja not only wants these works completed as rapidly as possible, but also wants to grow its own domestic capacity in road construction and maintenance in the process. Following the passage of the 2010 Nigerian Local Content Development Act, local content waivers will no longer be granted to foreign companies operating in the construction sector after 2012.

Zambia and Tanzania have both created National Construction Councils to promote the development of the local construction industries in their respective countries. In Ghana, Tullow Oil has announced that it has awarded more than 800 contracts – worth in excess of $65 million – to local Ghanaian companies in an effort to increase the local content capacity in a country it expects to be working in for the next 30 years.

In South Africa, MikroPul, an environmental engineering company, won a ZAR 100m ($14.2m) contract in July 2010 to supply turbine hall ventilation and related equipment for the new Medupi and Kusile power stations – beating off stiff domestic and foreign competition. MikroPul will complete the contract, the biggest ever awarded to the Johannesburg-based firm, by using 88% local content provided by black economic empowerment firms.