Nigerian Local Content: Challenges and Prospects

By Jean Balouga*

Introduction

The need for resource-rich Nigeria to assume control of the exploration, exploitation and production activities in the oil and gas sector and to harness the potentials of this most strategic industry in order to generate more value-added, seems to be receiving much desired attention from all the stakeholders.

This need is equally expressed in Nigeria's desire to domicile a substantial amount of the average $18 billion per annum exploration and production spending and stem the tide of capital flight which, over the years, has made Nigeria a junior partner in her joint venture arrangements with the International Oil Companies (IOCs).

For a country with over four decades' experience in oil and gas exploration and production activities and proven recoverable reserves of about 37 billion barrels, her inability to use the resource wealth as a means for national development and poverty reduction has perhaps been the greatest challenge facing successive administrations.

These challenges have their expression in how Nigeria can derive maximum benefits from oil and gas operations through optimal use of local competences and resources as practiced in Indonesia, Brazil, Norway and Venezuela, for example. Although these countries started oil exploration and production activities after Nigeria they have largely recorded remarkable success in their efforts to grow the local content in this strategic industry. The question is: why has Nigeria been unable to surmount her own challenges?

The Policy

The Nigerian Oil and Gas Development Law 2010 defines local content as "the quantum of composite value added to or created in Nigeria through utilization of Nigerian resources and services in the petroleum industry resulting in the development of indigenous capability without compromising quality, health, safety and environmental standards". It is framed within the context of growth of Nigerian entrepreneurship and the domestication of assets to fully realize Nigeria's strategic developmental goals. The scheme, which has the potential to create over 30,000 jobs in the next 5 years, is geared to increaseing the domestic share of the $18 billion annual spending on oil and gas from 45% to 70%, in addition to enhancing the multiplier effects on the economy, through refining and petrochemicals.

The local content policy action started in 1971 through the establishment of the Nigerian National Oil Corporation, (NOC). NOC was established as a vehicle for the promotion of Nigeria's indigenization policy in the petroleum sector. It later became Nigerian National Petroleum Corporation (NNPC) in 1977 through NOC's merger with the petroleum ministry. NNPC flagged off the actual local content initiative through acquisition of interests in the operations of the IOCs. These interests grew to about 70%, with the responsibility of controlling all acreages and other activities.

Although conscious efforts were made in the past through Regulation 26 of the 1969 Petroleum Act, enforcement of local content policy, the springboard for sustainable economic transformation of Nigeria, was mere paper work. For an industry that contributes 80% of Nigerian government revenues and 95% of its foreign exchange this is entirely unacceptable to the Nigerian government hence the clamor for change.

Objectives

Government's objectives for the local content policy initiative are quite noble but have remained unrealized. These objectives include the expansion of the upstream and downstream sectors of the oil and gas industry, the diversification of the sources of investment into the sector such that some of the funds would begin to come from local sources, the promotion of indigenous participation and the fostering of technological transfer. Other objectives are the increase in oil and gas reserves through aggressive exploration; employment generation for all categories of Nigerians; increased production capacity, and perhaps most importantly, the integration of the oil and gas industry into the mainstream economy through local refineries and petrochemicals

Challenges

Nigeria's rising profile in oil and gas production was rather fast and steady such that she soon became a formidable force within OPEC. Oil exploration, which started onshore has tremendously improved the nation's daily production capacity to about 2.3 million barrels per day, and raised her proven reserves to about 37 billion

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barrels.

However, despite Nigeria's ever-growing profile and wealth, the country remains one of the poorest, and technologically backward, nations in the world. This is basically because the much-taunted wealth has not translated into improved welfare. One reason for this is that over 90 percent of the yearly industry expenditures escape the domestic economy as capital flight.

Despite the ever growing number of local oil service companies the latter's annual gross earnings still account for less than 5 percent of the sector's aggregate annual contracting budget. Even the local media has been denied the much desired opportunity to advertise the activities of upstream companies in Nigeria. Some of these companies, including Nigeria LNG prefer to spend huge media budgets running into millions of dollars on foreign media like CNN, upstream journals and magazines. They hardly spend 20 percent of such annual budget on Nigeria media.

Following enormous investment in human capital by the Nigerian National Petroleum Corporation (NNPC) and some of its joint venture partners over the years, a new crop of highly competent and experienced Nigerian engineers, geologists and geophysicists has emerged. Today, some of them have established private oil prospecting and oil services firms, which are classified as indigenous contracting firms. However, their inability to get a share of the action at the upstream may not necessarily be due to incompetence, but rather due to a dearth of funds.

Nigerian banks lack the financial base to make any meaningful impact on local content development. The biggest Nigerian banks are tiny banks when it comes to energy financing. Most Nigerian banks operate in dilemma-laden territory as most indigenous contractors have no proper business structure. Others are not really in the business because more often than not the person who gets the contract is not the one looking for finance. Other obstacles are a thin industrial base, lack of adequate power, water and other infrastructure to support an expanded manufacturing base, lack of small and medium-sized enterprises and an underdeveloped capital market.

The BGL study notes the argument of some industry stakeholders that over 70 percent of the contracts awarded to Nigerian companies are executed overseas, thereby defeating the primary objective of Nigerian content development which is to develop in-country capacity by executing contracts in Nigeria using Nigerian local resources.

Other problems of local companies revolve around executive capacity and critical mass with technical and financial wherewithal. Generally, most local companies are small, fragmented and incapable of packaging or attracting loans. Few of them can deliver turnkey projects without resorting to some form of partnership agreement for equipment, expertise or technical support.

There exists the so-called "Knowing-Doing gap" in Nigeria, that is the disconnect that exists between policy formulation and policy implementation. This term describes the absence of a critical link between strategy and action. Public policy initiatives and actions in Nigeria have persistently been incapacitated by this gap, with many government programmes and projects ending in downright failure. Inadequate think through, weak institutional capacity, lack of political will to carry through change, inconsistency in government policies, lack of support from relevant stakeholders and corruption are some of the causes of this gap.

The implication of this is that the future of the Nigerian people is currently being controlled by foreigners whose main objective could be to post better returns on investment.

Government's Efforts

The Nigerian local content initiative did not take off until recently. The Obasanjo administration's renewed efforts at making a difference in the appalling state of Nigerian content were evident in the privatization of the Nigerdock and the repositioning of the Nigerian Petroleum Development Company (NPDC), an arm of NNPC. Already the privatization of Nigerdock has proved the company's capability as a serious player in emerging deepwater offshore activities with its success story in constructing the Bonga Buoy (the world's largest).

Another milestone recorded in the effort at growing the nation's local content level is the Globestar yard's fabrication of the jacket for the Amenam platform, Saipem yard's Okpoho platform and ChevronTexaco's Meren-X well jacket and helipad fabricated by Transcoastal Nigeria. These developments have helped to create jobs, build capacity and stimulate the nation's economy.

Fabrication is probably the most developed manufacturing area in the Nigerian petroleum industry. For several years, many structures and parts have been fabricated in yards located mainly in Warri, Lagos and Port Harcourt. This has come to stay, but it suffers a number of limitations. Limited capacity installation and technological innovation could continue to plague the industry even as it is striving to mature into relatively more demanding deepwater fabrication.

Transportation in the oil and gas industry covers road haulage, marine transportation and pipeline transmission. Airline transportation relating to the industry is still firmly in the hands of foreign companies. Local and international companies are active in marine transportation services for swamp and offshore operations. Road haulage is the most popular means of transportation for onshore operations because of the poor state of rail transportation in the country. The full implementation of the *cabotage* law is, therefore, expected to provide more opportunities for local participation.

Investment in Nigeria's oil industry currently amounts to about $18 billion annually. This investment trend is expected to continue annually beyond 2012. The creation of the Nigerian content support fund is timely. This fund is designed to operate a free zone concept and provide working capital for local companies, thereby bringing down the cost of funds.

Post consolidation, Nigerian banks as syndicates have offered between $200 and $600 million in $1.2 billion projects. Other projects have been solely funded by Nigerian banks with no international participation. Pre-consolidation, Nigerian banks were offering $60 million participation in $1.0 billion of the oil majors' key projects.

Based on the directives of the NNPC, Nigerian engineering and service companies, as well as fabrication yards have invested hundreds of millions of dollars on skill acquisition and enhancement, and capacity expansion. Yet despite all these efforts, bottlenecks in the system still prevent meaningful fabrication work being awarded to Nigerian firms. If these projects are awarded to the existing Nigerian yards not only can they demonstrate their ability to deliver to international standards of quality and safety but they also can substantially build long-term industrial capacity, provide employment and global competitiveness which is currently in the hands of the overseas yards.

Perhaps government's most outstanding effort so far is in the development of a unique blueprint for the successful implementation of a Nigerian content policy in the oil and gas industry. This policy is referred to as the Nigerian Oil and Gas Development Law 2010. One of the outstanding features of this blueprint is the conceptualization of a proper definition of Nigerian content, which enjoys general acceptability in the industry. Going by this definition the mistake of confusing local front with local content will be substantially reduced as local content seeks to reward local investment and competence at the expense of mediocrity. This policy, which makes it imperative that exclusive consideration be given to Nigerian indigenous service companies which demonstrate ownership of equipment, Nigerian personnel and capacity to execute jobs in the Nigerian oil and gas industry, is fashioned after the Norwegian model. It presents a template for companies' classification and a value matrix to measure local input. It also spells out the responsibility of the respective institutions charged with the effective delivery of the Nigerian content.

The Way Forward

The high cost of funds is a factor that jeopardizes indigenous oil service companies' ability to compete effectively with their counterparts from Europe and the United States, who are well endowed with capital. This untoward development has reduced Nigerian banks, not yet cut out for long-term projects and with a penchant for quick business and immediate returns, to mere 'cash centres'.

Policy makers in Nigeria's oil and gas industry must seriously consider the idea of establishing a strong energy bank that would empower local contractors/investors. This would increase their level of participation and give them the necessary experience that would engender technology transfer.

Technology transfer should be well programmed and aggressively pursued if economic, military and political advantages are to be guaranteed. So far an increased number of Nigerians in managerial and professional positions in firms involved in upstream and downstream operations has been observed. However, the evidence of technology transfer is yet to be seen. Nigeria, therefore, needs her own unique strategy of technological progress pursued with all seriousness if Nigerians are to make any meaningful impact soon.

Another factor that made nonsense of past efforts at improving local content (and is still a challenge to current efforts) is the nation's inability to develop her infrastructure. Coupled with this is a lack of a sound iron and steel industrial base, lack of foundries and effective machine tool manufacturing. These are all part of the fundamental challenge, which the government must address through its privatization programme.

Government must remove the inconsistencies in the local content act, sincerely respect the local content blueprint and follow its carefully, especially in the awarding of contracts for deepwater and other projects in the oil industry. Such a policy should ensure that the refining sector and indeed the whole of the downstream sub-sector is commercialized and further opened to private sector participation. It should also ensure that the country's existing refineries run efficiently. This will be best achieved if core investors are brought in to acquire majority shares in the plants and to take over their management, following Indorama/EPCL, Nigeria. The policy should pursue the active participation of the private sector in refining, with investors encouraged to set up refineries aimed largely at the export market.

A strategic objective of the local content policy should be to get exploration and production companies already active in the Nigerian upstream, and new entrants, to be committed to downstream business including the development of energy infrastructure and assets. The concept of extended enterprise (virtual integration, outsourcing, collaborative R & D), in short, networking must also be emphasized.

More investments would have to be channeled into the gas sub-sector. More projects utilizing gas to produce energy-based derivatives such as the Escravos Gas-to-Liquids project and the Natural Gas Liquids project are required. Policies in the Gas Master Plan must be pursued vigorously.

The Nigerian Content Consultative Forum (in charge of networking in the oil and gas industry), the Nigerian Content Division (an arm of NNPC) and the newly created Nigerian Content Development and Monitoring Board, NCDMB, (charged with the responsibility of strictly enforcing compliance) must work in tandem for the success of the local content policy.

Historically, the factors which have created the chasm between policy substance and implementation are mainly inadequate think-through, weak institutional capacity, absence of the required political will to carry through change, lack of support from relevant stakeholders and corruption. The NCDMB should not be allowed to become captive to such factors.

Finally, the sincerity of government about the local content issue must be reflected in attractive fiscal policy (see Ghana) or measures such as reduction in import duties for steel and chemicals and other consumables as well as tax holidays for indigenous oil and gas and related firms, all of which may gender a competitive spirit in our local fabrication yards.

Conclusion

The present state of Nigeria's needs is a clear indication that a responsible and dynamic approach to sustainable local content development needs to be adopted by government policy makers and upstream operators to guarantee a better future for the nation's oil and gas industry. Technological development does not occur just by chance; rather it is a product of a nation's sound economic management, policy re-engineering, good governance and a social value system that rewards hard work and creativity.

Having a few companies committed to Nigerian content and pursuing local content programmes is not enough. Support for local content policies must be nation-wide. It must be accepted by all and should become embedded in every operator's business philosophy.

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