

# **International Experience in Supplier Development**

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## 1. Overview of the Different Rationales for Supplier Development

Countries may have different reasons for engaging in Supplier Development. For the majority, the basic arguments such as the Economic Multiplier will be seen as compelling. That is, that the revenue from sub contractor's activities supplying foreign investors may have a bigger impact on the economy than the activity of the foreign investor. For example, in 2003, ExxonMobil group recorded \$70.7bn in contributions to governments and \$132.7bn to suppliers.<sup>1</sup>

The use of local suppliers/contractors will increase local employment, skills, and may even lead to technology transfer and improved capital provision for local small and medium sized enterprises (SMEs). To an extent, the trend towards global strategic sourcing, highly prevalent in the oil industry, may work against the use of local suppliers. In fact, this trend has favoured low cost/high quality in countries such as China, India and Singapore. In the oil and gas sectors the cost of brokering a deal involving Transnational Corporations (TNCs) and their primary or first tier contractors may be high. For example, in Trinidad and Tobago, BP calculated the cost of having their lead contractor enter into a joint venture on the Cannonball gas field with a local contractors at \$3.3 million above the cost of the same work in Houston.<sup>2</sup> While there are then technical and financial constraints on local content, the value of the technology transfer should be far greater than any initial cost implication.

It is too simplistic to evaluate Supplier Development in terms of immediate contract value capacity and competence building must be considered also the transferability of the newly gained competences to other sectors and activities.<sup>3</sup>

Often supplier development is used as a means of reducing social imbalance and not as an economic tool in the strict sense. For example, in the gold mines of South Africa, a voluntary code has been introduced. This uses a charter scorecard which ensures that development opportunities are provided for "Traditionally Disadvantaged South Africans" who predominate in the mining industry though seldom rise to the level of engineer or manager. Clearly goals other than the basic economic ones are being pursued here.

## 2. Methods Applied Specifically to Extractive Industries

Many of the approaches to supplier development currently in use are dependent upon resources from Trans National Corporations often match funded by donors. One format for such co-funded projects are the creation of centres of excellence staffed by local people. A good example of this approach would be the FEED centre in Port Harcourt Nigeria. This is Shell's front end engineering

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<sup>1</sup> Source [www.exxonmobil.com/corporate/files/corporate/Charts\\_and\\_tables.pdf](http://www.exxonmobil.com/corporate/files/corporate/Charts_and_tables.pdf)

<sup>2</sup> Source [www.bp.com/genericarticle.do?catagoryId=2012451&contentId=7002543](http://www.bp.com/genericarticle.do?catagoryId=2012451&contentId=7002543)

<sup>3</sup> When designing supplier development programmes in sectors such as oil and gas networking events for SMEs should be built in as these can lead to the formation of bidding groups for contracts and embryonic clusters.

support centre and cost some \$15 million. This provision is further enhanced by a \$30 million revolving credit facility provided by IFC and Diamond Bank. In 2006, SPDC handed over management of two Lonestar Rigs to local contractors. This increased the capacity of the Nigerian company which had shown great potential. Between 2004 and 2006 well engineering local content rose markedly from 46 per cent to 56 per cent in the same period 85 percent of drilling fluid contracts and 75 percent of drilling tool supplies was sourced locally. This was in part due to the Shell commitment to Nigerian content which may have derived from the Nigerian Content Directive which is quite prescriptive about local content. In Trinidad and Tobago, BP are positively discriminating in favour of local suppliers and absorbing a \$9 million premium to encourage local content in platform engineering.<sup>4</sup>

The adoption of supplier development programmes by Operators can be achieved in a number of ways by Governments. In the case of Trinidad and Tobago, contractors are required to contract local firms, in Nigeria Legislation is in place to ensure local content, in Brazil and Malaysia, state organisations set specific targets for local content. Many producing countries are the subject of WTO observers. This will undoubtedly impact the ability to subsidise local suppliers to help them to become competitive.<sup>5</sup>

Whilst this interventionist approach to supplier development has proved effective in many ways, it is centred on the immediate needs of specific companies this may prevent the development of transferable skills and capacities which might give access to other markets. There is also the question of sustainability. Many TNCs or their suppliers do not want to deal with low order SME suppliers and so the development support tends to go to the already successful.

At the opposite end of the spectrum is the approach taken by the United Kingdom and the Norwegian government to the extractive industry in the 1970's. Basically this was in the form of observation and monitoring of the North Sea Operators activities and then giving training and development to local companies to enable them to tender for contracts with the Operators. Whilst the impact of this approach was somewhat limited it did satisfy the WTO Trade Related Investment Measures (TRIMS). Additionally, it created scope for both countries to introduce major educational projects to supply suitable graduates to the Operators. Further, in this early period, some of the best non-aggregated metrics for local content were established by the UK's Offshore Supplies Office. The findings of an Aberdeen University study confirmed that most supplies were coming from US based affiliates of the Operators whilst non-core provision such as catering and insurance were sourced locally<sup>6</sup> this remains a feature of this sector to the present day. If a mandatory or voluntary code for local content is to be employed, limits placed on local content by qualification and certification must be taken into account. Problems can often be overcome by dealing not at the Operator level but at the main contractor level.

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<sup>4</sup>Source [http://www.wbcsd.org/web/publications/case/bppt\\_full\\_case\\_web.pdf](http://www.wbcsd.org/web/publications/case/bppt_full_case_web.pdf)

<sup>5</sup>Source: <http://archive.revenuewatch.org/reports/Inter-sectoral%20Linkages%20and%20Local%20Content%20in%20>

<sup>6</sup> Reported in Wade Locke, and Strategic Concepts Inc April 2004 page 7 "Exploring Issues Related to Local Benefit Capture. Discussion paper for Petroleum Research Atlantic Canada

A second approach which is common is the use of Regional Development Agencies, or similar bodies, is to develop SMEs by enhancing their technical skills, managerial competence and financial acumen. The United Kingdom is an example of this approach using the Business Link network to deliver training and consultancy to smaller enterprises. Areas of need are identified by the Regional Development Agencies and the whole programme is coordinated by the Department of Trade and Industry. Similar programmes are run throughout the EU although the delivering agency may be different, say Chambers of Commerce or Regional Government. This form of Supplier Development is supported by networking events such as Regional Promotion and Trade Fairs. There are some inherent difficulties with this approach. Robust metrics for measurement of the return on public money spent in this way are very difficult to define. The period of time over which one should assess the impact of the initiative is unclear.<sup>7</sup> This inevitably leads to misinformation. The business and technical needs analysis for the SMEs can often be inaccurate and therefore lead to wrongly targeted development. Very often, the SME is not aware of its development needs and may be equally unfocused.<sup>8</sup> The last point on this “blanket” approach is cost. The approach is very expensive requiring many staff and Regional facilities from which they can operate.

### **3. Approaches Used in the Non-Extractive Sectors**

There are variations on these two approaches which are often hybrids of the two. In Costa Rica, the sourcing department of the investment promotion agency (IPA) is made up of highly qualified engineers who provide local sourcing solution for inward investors. Not only does this body find local suppliers, but it negotiates with inward investors on training and development needs and provision. This quasi governmental IPA (its home is in the Ministry of industry and Economics) was very influential in the decision by Intel to locate in Costa Rica.

The most successful hybrid programme to date was undoubtedly that developed in Ireland where and economic revolution was achieved in slightly over a decade. Between 1985 and 1996 major growth was achieved through supplier development in several sectors: plastics, metalwork, tooling, pressed parts, plating, electronic sub assembly, cabling, instrumentation electronic testing and mechanical engineering services. All of these were new sectors for the Irish Republic. Local share of multinational purchases rose from 5% to 22% of total TNC purchases. This represents an increase in local procurement of 260%. The number of SMEs participating went up from 30 in the pilot scheme to 300.

Many central and eastern European countries have followed this approach in several variants. The Czech model shown in Figure 1 is typical of this highly focused hybrid approach. There are

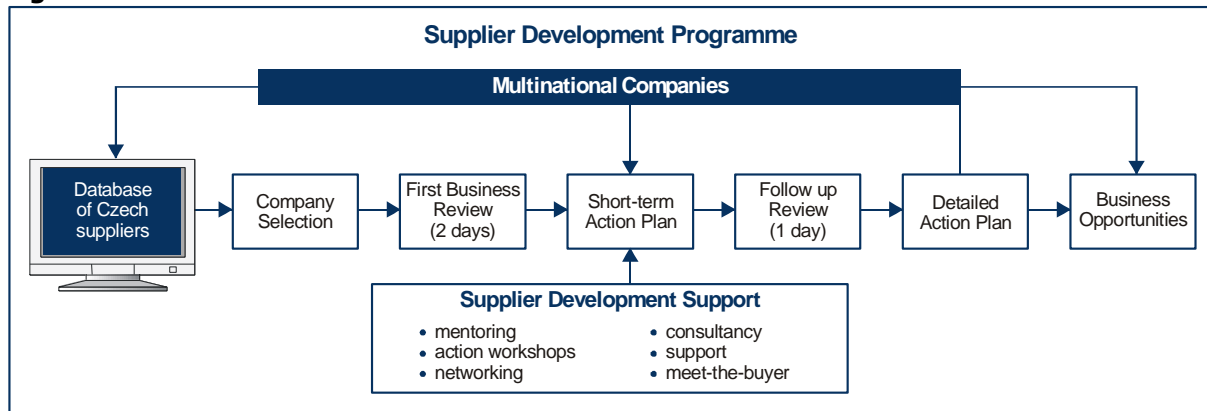
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<sup>7</sup> The business (contract) cycle varies sector to sector. When dealing with Japanese Automotive companies the enquiry to contract period can be as long as three years. In the Oil and Gas sector tender periods are often only a matter of months sometimes weeks.

<sup>8</sup> Varney and Braun (KPMG) work in the Czech Republic and later in Serbia showed clearly that companies did not see their own deficiencies in terms of suitability to become suppliers to TNCs. (Knowledge Transfer Conference Istanbul 2005

three key stakeholders in this method. Trans-national (or “multinational”) companies, the Government of the country and the SME community working in the selected sectors for the Supplier Development Programme. These three act together to determine what issues are critical for local content, how shortfalls in competence from SMEs can be addressed and what barriers in the business environment need to be overcome to ensure that local content increases. In these respects, this is identical to the Irish approach.

**Figure 1**



Most importantly this approach creates opportunities for third and fourth tier suppliers to have contact with TNCs so that they can present themselves as good potential members of transnational supply chains. In addition to this, linkages are made between SMEs and universities to provide technical assistance, technology transfer is encouraged and SMEs are encouraged and assisted to seek other markets for their products or to apply their technologies gains from the programme in other sectors including export.

The Serbian programme which is another variation upon the Irish model, is specifically designed to improve export performance by SMEs through TNCs and to reduce imports at the same time. Both the Czech and the Serbian Programmes have been highly successful. <sup>9</sup>

#### 4. Some Characteristics of Successful Supplier Development

- Financial products- variety of loans, leasing, venture capital, credit guarantee funds, micro loans, export credit insurance etc.,
- Joint venture support
- Management – guidance on business and financial planning, tendering advice, regulatory navigation advice, marketing
- Technical support particularly on quality standards, lean manufacturing, etc.

<sup>9</sup> Within eighteen months of the completion of the Czech programme \$46 million dollars worth of additional business attributable to Supplier Development was achieved. In Serbia \$30 million of contract were awarded to companies participating in Supplier Development before the end of the pilot.

- Improved human capital through human resources department
- Matching and merging business to business networks.
- Meet the buyer events
- Sourcing database to match local suppliers with investors<sup>10</sup>
- Introductions of participant companies for joint tendering and possible cluster initiation
- Development of national quality standards

## 5. Current Local Content Initiatives in Kazakhstan

Legislation has been passed for local content encouragement and the KazContract Agency has been in existence since 2002 and is charged with the development of local content. There is also the Kazakh Content Increase Programme, a partnership between government sponsored vocational and enterprise support programmes and a company sponsored competency development initiative between the Kazakhstan government and Karachaganak Petroleum Operating B.V. (a consortium between the BG Group, Eni, Chevron and LUKOIL)<sup>11</sup> is aimed at industrial infrastructure projects (especially industrial estates and export zones) and oil company investments to support local suppliers.

In these ways the Government has encouraged local content in the oil and gas industry and as discussed in previous sections of this note has met with some success but perhaps less than Nigeria or Trinidad and Tobago, Timor-Leste. Lessons can be drawn from other countries, Malaysia, Timor and others shown in *Appendix 1*.

## 6. Conclusions

Macro solutions have been tried to improve local content in Kazakhstan with varying degrees of success. Many of the reasons cited for not using local suppliers are addressed by the hybrid micro approach described here. We propose that a hybrid supplier development programme pilot should be introduced in Kazakhstan which would improve local content by improving the competitiveness of Kazakhstani SMEs by increasing competency in both technical and managerial aspects of business. In addition, a pilot scheme will introduce networking within supply chains which often leads to the most sustainable forms of clusters.<sup>12</sup> There are numerous spin off benefits which only come from this approach. Some of these are links between smaller businesses and University researchers, technology sharing between SME, direct contact with TNCs.

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<sup>10</sup> CzechInvest have a field in their database which identifies companies looking for joint venture partners.

<sup>11</sup> BG 2002 Social and Environment Report-Case studies [www.bggroup.com](http://www.bggroup.com)

<sup>12</sup> ACStyria is a very fine example of this effect.

**Table 1: Overview of International Supplier Development Initiatives**

Economic criteria	The United Kingdom	Norway	Denmark	Australia	Brazil	Malaysia	Nigeria	Angola	Trinidad and Tobago
Accountability	1970s: establishment of the Offshore Supplies Office (OSO).	1965: Norwegian Petroleum Law enacted; emphasis on joint ventures, gov. equity participation & local content. 1970s: establishment of state oil company Statoil & Nirska Hydro. 1972: establishment of Goods & Services Office (GSO).	No local preference or purchasing policy in place, yet a single company (DUC) was provided exclusive license of North Sea oil exploration.	Australia has no local content policy in place, yet operators are encouraged to use local suppliers & manufacturers. 1984: the Industrial Supplies Office (ISO) is established to act as facilitator for project developers & local industry. 2001: the Australian Industry Participation Framework states gov. policies to support local content in large investment projects.	1953: Petrobras is created and granted exploration & production licenses throughout Brazil. mid-1990s: Petrobras' monopoly is eliminated and the National Petroleum Agency (ANP) is established to regulate petroleum activities in Brazil and ensure local benefits of oil projects in a context of competitive leasing system of oil blocs.	1974: the state oil company, Petronas, is established. Petronas has been key vehicle to foster local content; it set registries of licensed oil & gas local companies.	Since 1999: gov. has taken action to increase local content in domestic oil & gas industry. Local Business Development/Global Procurement Unit was established. 1997: establishment of the Onne Oil & Gas Free Zone.	1976: the state oil company, Sonangol, is established. Sonangol made exclusive concessionaire for oil exploration in Angola; allowed to enter into associations w/foreign companies on oil exploration, development, & production	2004: gov. adopted the Local Content and Local Participation Framework Policy for the energy sector, along its entire value added chain.
Metric/Definition	1960s: discretionary licensing of oil blocs. 1970s: OSO monitoring of direction of trade of oil companies (value of contracts w/impact on local employment & valued added creation in manufacturing & sub-contracting). 1990s: Entry into EU refocus on development of export markets.	1972: Article 54 of Royal Decree of 1972 directed gov. to support local companies provided they were competitive in prices, quality, schedule & service. 1990s: Article 54 was rendered invalid as Norway accessed the EU; emphasis changed to support intl. expansion of local oil industry.	The Danish Energy Administration does not calculate capture rates or levels of local content in industry.		ANP specifies detailed local content percentages on the purchase of goods and services for exploration & development of on-shore and off-shore operations.	Petronas' monitoring of local companies defined by (i) local equity participation; (ii) employment creation & use of local inputs Production Sharing Contracts (PSCs) with Petronas' participation include recommendations on the purchase of goods & services locally to maximum extent possible.	Local Business Development/Global Procurement Unit monitors (i) awarding of contracts to local firms; (ii) farming out of oil fields to Nigerian oil companies; (iii) technology transfer initiatives; (iv) local content development fairs/events.	Since mid-1990s, Sonangol underwent restructuring & became holding with autonomous subsidiaries. Sonangol has currently pivotal role in the supply & service sector of the local oil industry.	Local content is defined in terms of ownership, control, decision-making, and preferential access to financing. International companies are required to commit to contracting local firms. Education & training of workers is critical element under policy framework.
Efficiency Considerations	OSO focused on ensuring a competitive domestic industry through range of programs offered to local contractors.	Initial conditions were favorable. When oil was discovered (1960s), Norway had considerable industrial technical capacity. Statoil was pivotal on technology transfer and personnel training.	Large platforms & structures usually supplied by European companies; Danish suppliers strong in services and suppliers of medium-size structures & equipment	Reports from the US Department of Commerce on Australia's Oil & Gas Field Equipment Market are optimistic on local content shares in projects.	1970s: Petrobras used numerous foreign contractors in early years of off-shore development. In the 1980s the focus was on development of domestic technology using licensing agreements w/intl. suppliers.	Malaysia has developed a considerable supply industry that currently competes for projects around the world.	In cooperation with international oil companies the gov. is trying to meet efficiency oil producing standards & local content targets on the use of local technology.	Numerous Production Sharing Arrangements w/participation of world oil majors and Sonangol are currently in place.	Govt. has engaged business community in supporting broad based job training efforts, small business capacity building & technology development.
Information Dissemination	OSO was an independent agency set up expressly to help domestic firms in oil sector.	GSO was an independent agency set up expressly to help domestic firms in oil sector.			The local oil sector was kept closed for decades; Brazilian labor & companies were hedged while developing skills & capabilities.		Local content initiatives are widely known.	Sonangol has established in its webpage a resource link on opportunities for local suppliers.	Govt. has established database on projects' status and opportunities for local suppliers.
Acknowledgement of spin-off effects into non-oil economy	Limited.	Govt. actively focused on in-country research & technology development in general.			Petrobras has an aggressive investment program in oil production, but also high-tech. refineries, pipelines, etc.		Limited.	Sonangol's business interests are in oil & non-oil economy.	Govt. strategy is also focused on the development of opportunities in the non-oil economy.

Sources: Appendix II, Alvesson et. al. (2003), INTSOK (2003), Neff (2005), and Wade Locke (2004).