



Briefing Note 9

Community Content: the Interface of Community Investment Programmes with Local Content Practices in the Oil and Gas Development Sector

There is growing understanding among major oil and gas development companies that a timely community skills and supply-chain analysis is valuable to understanding how existing 'community investment' programmes, might interface with their broader initiatives to enhance 'local content' (i.e. the capture of employment and procurement opportunities by nationals and nationally-based firms). Prospects of closer interface between these two currently disparate business activities provides a new avenue for competitive differentiation among oil companies. Successful 'community content' strategies are essentially about building local capability over the long-term, and ensuring that community-based skills and micro-enterprises, as well as small and medium sized firms who employ community members, are marketable in sectors outside the volatile and capital-intensive upstream energy industry. This paper is aimed at public and private sector decision-makers closely engaged in oil and gas development sector in developing countries, as well as the private sector development (PSD) and small and medium scale enterprise (SME) support units embedded within international development agencies. Illustrations are given from Nigeria (a low-income country) and Trinidad and Tobago (an upper-middle income country). The paper falls into three parts: the growing importance of local content in the oil and gas development sector; the challenges for company-driven community investment programmes; and the interface of community investment with local content.

➔ The Growing Importance of Local Content in the Upstream Energy Sector

The principal contribution of the capital-intensive oil and gas sector to the economic and socio-economic advancement of developing nations is through payments to the state in royalties and taxes. This national income then supports the execution of public expenditure and savings policy. Also voluminous in dollar terms (although less comparable to government oil rents in these heady days of \$60 a barrel) is expenditure by oil and gas companies on staff salaries and benefits, and on the procurement of equipment, goods and services. For example, in 2005, the Shell Group of companies paid \$18 billion in taxes to governments, and made capital investments of \$17 billion, of which \$9.2 billion was for procurement from low and middle income countries.¹

The message from governments across the oil-producing developing world is that local content capture from the energy sector needs to rise, and that oil and gas companies could, and should, form part of the solution.

In a number of oil-rich but economically-poor countries the state has failed to efficiently translate oil wealth into raised living standards and long-term economic sustainability (literature on the 'oil curse' abounds). Receiving less attention has been expenditure by oil and gas companies on goods and services. However, many of the same countries have equally failed to deliver on the scale of local content 'capture' by nationals and national firms that many had hoped for. For example, in Nigeria the oil sector assumes 20% of GDP and 65% of budgetary revenues.² Even with this dominance of the sector, and notwithstanding public investments of \$10 billion per annum in the same sector over recent years, around 80% of the value of work on oil and gas development projects is still carried out abroad.³ Likewise, in Trinidad and Tobago, where 40% of GDP is taken by the energy sector,⁴ current levels of 'capture' by local firms is around 10%⁵ across the value chain, and 20% for capital expenditure.⁶

The message from governments across the oil producing developing world is that local content capture needs to rise, and that oil and gas companies could, and should, form part of the solution. The regulatory environment in many such countries - petroleum development legislation, mining codes, model production sharing contracts, industrial diversification policies etc. - are being readjusted to increase economic derivatives from the energy sector. Targets recently set by the Federal Government of Nigeria, for example, ambitiously raises local content minimum thresholds from 45% in 2006 to 75% by 2010.⁷ In Trinidad and Tobago, new policy proposals are under consideration to raise the local content component of capital expenditure in the sector by an average of 10% per year, and 15% per year for operating expenditure.⁸

Public Policies on Local Content'

Two quite distinct public policies for achieving higher local content targets stand out. First is where the state requires oil companies to give greater preference to those nationals and national suppliers who can compete internationally on cost, quality and timeliness, what can be termed **local participation**. The policy is commonly delivered through the negotiated terms of host country agreements between oil companies and government, and manifest as, *inter alia*, requirements for joint ventures between foreign and national sub-contractors, lower pre-qualification and tender appraisal criteria than normally applied, and higher incremental operating costs, eg the costs of importing machinery and semi-finished materials which are not available in the country.

To illustrate, the model production sharing contract adopted in Trinidad and Tobago states that the oil production operator "...shall give preference to national Subcontractors where such are competitive with foreign bidders in skills, availability and price and meet the technical and financial requirements".⁹ More

stringent local participation policy, such as the Oil Industry Charter for Transformation in South Africa, sets a target for 'historically disadvantaged South African' (HDSA) companies to own 25% of the total equity in the operating assets of the oil sector by 2011.¹⁰ The proposed Nigerian Content Development Bill requires a minimum of 95% of managerial, professional and supervisory grades of oil and gas companies to be Nigerians, 100% of risk insurance to be taken out with insurers registered in Nigeria, and 100% of legal services to be secured from Nigerian legal practitioners.¹¹

A weakness of many of these policies is that strong market forces already operate in what is largely a globally-sourced industry. It is likely therefore that, with all else equal, local firms and individuals that are able to compete against international competition will already be within the vendor databases used by operators. The problem is that not many national firms can currently compete at this level.

The strongest local participation policy is probably that which promotes joint ventures between national and international firms, be that at the operator level (as in the South African example above), or within the higher end of the supply chain, as is increasingly the case in Nigeria and Trinidad and Tobago regarding engineering design work.

A second overall local content policy is potentially more progressive. A number of governments propose that a 'step change' in local content capture is only likely to be achieved by consciously building the capability of national and local skills to access the opportunities, what can be termed **local capability development**. Exercising this policy may involve considerable undertakings on the part of oil and gas operating companies, including:

- direct and prolonged technical assistance to national and local suppliers to improve quality and reliability (or facilitating this assistance through additional payments to lead engineering contractors to carry through the same type of capability building);¹²
- payment of premiums or subsidies to overcome some of the higher costs incurred in capabilities development. bp Trinidad and Tobago recently contributed US\$9.5 million to enable the engineering design and fabrication of off-shore gas platforms within the host country instead of the United States;¹³
- additional insurance premiums (or the shouldering of uninsured risks) associated with supporting local suppliers and sub-contractors who may deliver sub-standard work whilst their capabilities are developed, placing schedules or production at risk;
- investing in the physical infrastructure (buildings, utilities etc) needed to support the development of local businesses in the energy sector. The Shell cluster of subsidiaries in Nigeria recently contributed US\$15 million to the establishment of a Front End Engineering Design (FEED) centre in Port Harcourt in the Niger Delta; and

→ providing financial products (venture capital, short-term debt secured against contracts, credit guarantees etc.) to support growth in local supplier firms. The Anglo American 'Zimele' private equity model is one example familiar to some (see Box 1).

Box 1

'Zimele' Black Empowerment Supplier Programme¹⁴ (Anglo American)

'Zimele' – a name derived from Zulu meaning to be independent and stand on ones own feet - is an enterprise development and economic enhancement programme of Anglo American started in 1989. Key features include:

- ⇒ facilitating black economic empowerment (BEE) in South Africa through the creation of commercially viable and sustainable local enterprises;
- ⇒ providing finance through minority equity participation and the provision of loans;
- ⇒ assisting in the development of entrepreneurship and the creation of wealth through the transfer of business skills, management and expertise;
- ⇒ assistance with marketing the business to Anglo American's business units; and
- ⇒ promoting of good corporate governance and business ethics.

Equity investment by the initiative requires that an 'exit strategy' for Zimele be incorporated into the shareholders' agreement. It is envisaged that the venture – with the guidance and support of the Zimele team – will be able to "stand on its own feet" within a period of five years, enabling Zimele to sell its equity stake in the company at a profit.

In 2005 investments by the Zimele programme in local SMEs generated R561 million (\$79m) in turnover. The programme has invested in 54 SMEs to date, of which 28 are current investments. Since its inception, the initiative has transacted a cumulative R26 billion through various black empowerment procurement initiatives. Zimele's activities have recently extended beyond South Africa, providing assistance to companies in Zambia and Kazakhstan.

A noticeable weakness with both local participation and local capability development policies, and in the implementing strategies adopted by companies, is the assumption that the capture of additional economic value from the upstream energy sector can only come from increasing employment, training or local firm participation or capability development *in that sector*, what has been termed 'on-project' strategies.¹⁵ Insufficient attention is being paid to the broader canvass of 'project-linkage' and 'off-project' strategies on offer.

Opportunities Beyond the Project

Project linkage strategies build on the opportunities presented by capital and operational expenditure in the upstream oil and gas development sector, enabling workers, suppliers and sub-contractors to transfer their new capabilities to other markets. This includes both intra-sector transfers – within the upstream oil and gas development sector or from the upstream sector to the downstream energy sector (eg power, refining, chemicals) - and inter-sector transfers, from the energy sector to the construction sector, information and communications technology, tourism and leisure, manufacturing, high value agriculture, urban retail etc.¹⁶ This broadening of what is understood by a local content policy is illustrated by new proposals from the Ministry of Energy in Trinidad and Tobago, namely: “to create and enhance capabilities that are transferable to other sectors within T&T; and create and support cluster developments with other industries that have a natural synergy with the energy sector and which may have the capacity to diversify and/or sustain the economy after the resource is depleted”.¹⁷ Cluster industries that embrace inter-sector transferability might include machine and welding shops, technology and IT products and services, hospitality and catering services, mechanical engineering, materials and personnel transport (both land and sea transport), lodging and facilities maintenance, and business tax advisory services and accounting.

Off-project strategies involve companies contributing to local content capability development outside of a particular employment, supplier or sub-contractor contract, such as through community investment programmes or a company foundation.

Collaborative Local Content Programmes

Because project linkage and off-project local content strategies draw on the resources of oil and gas companies not always immediately relevant to the core activities of the business, and because in many cases these initiatives provide a broader ‘public good’ through their close alignment with national economic priorities, there is frequent opportunity for collaboration with external agents. A growing number of examples of strategic partnerships to deliver local participation and local capability development can be identified between oil and gas companies; between these companies and their lead contractors; and between oil companies, government departments, sub-national public bodies, international donor and the charitable sector. Examples include partnerships between government-sponsored vocational and enterprise support programmes and a company-sponsored competency development initiative (such as the Kazakh Content Increase Programme jointly developed by the Kazakhstan government and Karachaganak Petroleum Operating B. V. (a consortium between the BG Group, Eni, Chevron and LUKOIL),¹⁸ or between government industrial infrastructure projects (especially industrial estates and export zones) and oil company investments to support local suppliers

(such as the common user supplier base proposed for Timor Leste by the Clough/AMEC joint venture under ConocoPhillips (see later in this paper).

Public Sector Incentives

Beyond a willingness to partner with oil companies, emergent local content public policy is increasingly aimed at introducing the right incentives for the private sector. Examples include:

- ➔ the inclusion of local content performance targets (eg employee succession targets, national supplier and subcontractor targets) within the evaluation criteria of bids for new oil and gas development concessions, or within tenders for major construction and maintenance contracts;
- ➔ a fiscal framework that allows the cost of risk insurance for local content participation and expenditure on local content capability development to be recoverable against taxes;
- ➔ constructing new infrastructure that supports local content development, eg industrial estates, port facilities, information and communications infrastructure;
- ➔ developing the national education system so that it generates the right skills at the right time in the right energy services sectors;
- ➔ provision of business services and financial products for local enterprises to overcome some of the technical and financial barriers to entering the supply chain;
- ➔ establishment of (i) a physical or electronic market place to facilitate supplier and sub-contractor transactions, (ii) a databank of supplier capabilities and capacities, and (iii) a registration and pre-qualification vendor system for national firms;
- ➔ legal enforcement of local content quotas punishable by fines or, in the extreme case, imprisonment. Both are being proposed in the draft Nigerian Content Development Bill, with an operator, contractor or sub-contractor who is in breach of the Act liable to a fine of 10% of the project sum, the operating license being withdrawn or, for certain breaches, imprisonment for five years;¹⁹ and
- ➔ public endorsement of good local content practices by highly placed government officials and politicians.

What these new, more stringent, local content policies, requirements and incentives suggest is that ‘local content matters’; that the governments of developing nations increasingly wish to derive more than just production revenues and tax dollars from oil and gas companies, and that there may be real competitive advantage for those companies that meet and go beyond minimum compliance.

In summary, what the new local content policies, requirements and incentives suggest is that **local content matters**; that the governments of developing nations increasingly wish to derive more than just production revenues and tax dollars out of oil and gas companies, and that there may be real competitive, as well as reputation advantage, for those companies that meet and go beyond minimum compliance.

➔ Community Investment

Coming at the question of local content capture from an entirely different direction are the community affairs managers within oil and gas operating companies, and those working on issues of sustainable development. Here the underlying motivation for the operator to invest scarce resources beyond its core business interests is altogether different. The expenditure of pre-tax profits and retained earnings on investment in community projects in proximity to facilities is about building for the business an informal 'social license to operate'. The risks to a company's reputation from publicized community hostilities, or the very real impacts on work schedules and production rates from industrial action by locally-based workers, from blockades or sabotage, or from the threat of violence, can have a measurable effect on company cash flow, insurance costs, production volumes, and staff and security costs. Community incidents can also affect the prospects for the business to grow within the host country. Taking an extreme example, attacks on Shell's Forcados and EA oilfields in February 2006 have left the oilfields shut down for over a year, with the loss of 16% of the country's total production capacity.²⁰ Community investment programmes currently suffer from three principal weaknesses: poor sustainability, low levels of relevance and inadequate political visibility.

Sustainability

Questions over the long-term sustainability of community investment projects and their developmental outcomes have emerged from both official and not-for-profit development assistance agencies, as well as from within most of the large integrated oil companies. The Shell Petroleum Development Corporation (SPDC) in Nigeria, for example, recently moved to longer-term project funding arrangements with affected communities in the Niger Delta, under what are called Global MOUs.²¹ These are negotiated partnership agreements designed to build community and local government ownership over time, thus preventing projects from failing once their funding term comes to an end. Using a different tactic, but with the same sustainability goal, bp's operations in Trinidad and Tobago support a Social Investment programme aimed at the Mayaro community. This community lies near to the company's off-shore production facilities and is affected by onshore oil and gas transportation and processing. bp's Social Investment programme has a strong focus on youth education (including scholarships) and support for micro-enterprises, with the aim of generating the skills and opportunities for sustainable employment. In addition, the company gives financial support to the University of Trinidad and Tobago, is developing an accredited Petroleum Geosciences programme at the University of the West Indies, and provides staff for lecturing and mentorship to secondary and tertiary level institutions.²²

For the most part, the current contribution of community investment programmes to skills and enterprise capability development lies largely 'off-project'.

Continuing with this last example, although an increasing portion of bp's expenditure in Trinidad and Tobago on community investment programmes is directed to enhancing local skills and community-based enterprises, these new capabilities do not necessarily ensure access to the employment and procurement opportunities of the company.²³ This is typical of community investment programmes driven by oil companies, where the opportunities following skills and enterprise capability development lie largely 'off-project'. This raises a fundamental question: would the closer integration of community investment programmes with the local content capability development programmes of the parent oil company improve the prospects for long-term economic sustainability in affected communities?

Relevance

Assuring the relevance of community investment programmes to the business of oil and gas development is equally challenging. The term 'social license to operate' – a key motivation for community investment programmes – describes the notion that a discrete population of affected communities support (or at least do not strongly object to) the presence and operations of oil and gas development. For example, the private sector arm of the World Bank Group – the International Finance Corporation – recently introduced a new investment policy requiring the Corporation to assure itself of *broad community support* for a project prior to reaching a financing agreement.²⁴ Underpinning this policy is concern for the financial sustainability of the investment should project-affected communities see no benefits from the presence of the project. Community investment programmes thus form part of a financial risk mitigation strategy for both company and financiers.

Problems can arise if these programmes achieve no more than to fill gaps in public services that are the statutory duty of government authorities, or if they are perceived as charity or compensation by the local population. In these cases, community investment is unlikely to generate the reality of genuine additionality for affected communities: economic or social benefits that build the social license to operate of the company. In the absence of this reality, there is little to prevent local communities accepting a company's investment on the one hand, and yet maintaining hostility to the oil or gas development project on the other. Integrating community investment programmes with initiatives to improve local content capture for community members would seem to offer a solution, providing concrete economic benefits that position the company as central to the livelihoods of local people, and therefore ensure relevance of community investments to the oil and gas business.

Political Visibility

A third problem for community investment programmes is their low level of visibility by those government bodies, officials and politicians who influence decisions which materially affect the business growth prospects of the company. Such bodies include designated petroleum authorities and ministries of energy or petroleum, the cabinet office and the office of the Prime Minister. Closer integration of community investment programmes with a country's changing

local content participation and capability development policies, as well as with its broader economic and industrial diversification priorities, would provide additional visibility and thus competitive advantage. Advantages can be gained not only against other international oil companies, but also with the newly competing national oil companies from Asia and Latin America (see Box 2). Recent public endorsements by senior politicians provide evidence of the reputation advantage afforded to foreign oil companies who succeed in aligning their procurement practices with the local content and economic priorities of the state.ⁱ

Box 2

New Competition from Overseas National Oil Companies

Asian and Latin American nationally-owned oil companies - CNPC/Petrochina of China, ONGC of India, Petronas of Malaysia and Petrobras of Brazil - are now competing in markets previously dominated by international oil companies (IOCs) and their domestic national oil company (NOC) partners. In Africa for example, foreign NOCs are either exploring or producing in Angola, Equatorial Guinea, Tanzania, Chad, Senegal, Mozambique, Nigeria, Kazakhstan, Iran and Libya.^{25, 26}

It is argued that these NOCs bring with them certain competitive advantages over IOCs:

- ⇒ lower costs of capital;
- ⇒ higher liquidity due to option to forego dividends;
- ⇒ greater risk taking, underpinned by implicit and explicit sovereign guarantees;
- ⇒ more willingness to invest in down-stream facilities, especially refined products (for example Chinese NOCs are involving in refining businesses in Sudan and Nigeria);
- ⇒ offers to domestic NOCs to invest through joint ventures in downstream business back in their own country; and
- ⇒ 'trade and aid' linkages between oil exploration and development concessions and official development assistance (for example, the 'package deals' negotiated by India in Nigeria, which combine infrastructure grants with signatory payments for new oil and gas concessions,²⁷ and the grant assistance provided by Petrobras to aid the reconstruction of Angola).²⁸

To counter these changes in the market, established international oil companies need to find ways to retain a competitive differentiation. Greater reliability, a lower fixed cost base, and more sophisticated deep water technology are part of the story. Being better able to sustain production rates in economically deprived regions, with the potential for community hostility, adds further advantage.

Presently, the environmental, social and corporate governance standards adopted by these newly competing NOCs falls below that of the more established international companies, and thus affords IOCs a competitive advantage. But, with 85% of private finance in emerging markets now subject to the World Bank/IFC Social and Environmental Performance Standards (via the Equator Principles), with NOCs working in joint ventures alongside IOCs and as such having to adopt higher environmental and social standards, and with inter-governmental (eg OECD) and international NGO pressure on NOCs to raise their standards, these newly competing NOCs may soon find that they have to abide by higher environmental and social standards. If the playing field for environmental and social performance is shortly to be levelled, IOCs will need to find alternative ways to differentiate themselves from the competition. Creating synergies between the company's national procurement expenditure and its community investment programmes is one option.

➔ Community Content

Community content is the interface of community investment programmes with local content. The approach involves the strategic deployment of local participation and local capability development opportunities arising from an oil or gas project, directed to strengthen the sustainability, relevance and political visibility of community investment programmes. Ultimately, community content is about realising a competitive advantage for the oil company in the eyes of both the local population and the country's guardians of economic policy.

Community content programmes can be considered a 'merit good', ie. non-specific in nature but targeted at those affected by oil and gas development projects and thus to some degree exclusionary. Community content therefore differs from conventional local content programmes, which are less exclusionary and more a 'public good'.

When set in the context of global sourcing in the oil industry, a nation's local content participation and capability development programmes can also be considered a 'merit good' - a privilege for those citizens and firms within poorer countries who are eligible to discriminate against international competition under WTO Special and Differential Treatment (SDT) measures for developing countries relating to the Agreement on Trade-Related Investment Measures (TRIMS). Figure 1 identifies countries eligible under WTO rules to discriminate in the procurement of local goods against international competition. The figure highlights three categories of countries: (i) developing countries afforded a five year transition period for compliance with TRIMS from January 2000 (a period which has theoretically expired); (ii) developing countries which have requested extensions to the current transition period;²⁹ and (iii) Least Developed Countries, which currently enjoy a seven year transition to December 2007, possibly extended to 2020 under the WTO Hong Kong Ministerial Declaration of 2005.³⁰ Figures 2 to 6, identify the countries within which the world's largest five integrated oil and gas companies currently have hydrocarbon exploration activity. Further analysis of the implication of TRIMS and current WTO negotiations will be the subject of a subsequent Briefing Note in this series.

Community content is the strategic deployment of local participation and local capability development opportunities arising from an oil or gas project, specifically directed to strengthen the sustainability, relevance and political visibility of community investment programmes.

i Examples include: (i) the Minister of Energy in Trinidad and Tobago, on the occasion of BHP Billiton awarding a major fabrication contract to a local firm (2004); and (ii) keynote address by Prime Minister Mari Alkatiri, Timor-Leste, on the occasion of the inaugural acreage release (2005), both cited in: Warner, M. et al (2006) Enhancing the Role of Lead Engineering Contractors in the Local Economic and Social Performance of Oil & Gas Developments in Poor Regions: Bayu-Undan Gas Recycle Project, Timor-Leste, London: Overseas Development Institute (www.odi.org.uk/iedg/Business_Development_Performance/Papers/ODI_Engineering_AMECrep_BayuUndan.pdf)

Community Content Strategies

As noted, the upstream oil and gas development sector is highly capital-intensive. Opportunities for large-scale employment outside of construction periods are severely limited. There are also high barriers to entry for national firms if these are not internationally competitive. For community-based micro enterprises and those community members without a formal education or certified skill, the barriers to entry are even more serious, and potentially prohibitive.

On a national level, oil companies, with sufficient time, premiums, and through collaboration with governments, international donors and their lead contractors, can often build supplier capabilities and skills sufficient to overcome

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many of the barriers to entry. However, at the community level the gap between current capabilities and the higher paid jobs, or high value supplier contracts, may be simply too large to bridge. Strategies for community content thus need to be designed differently from standard local participation strategies or more conventional local capability development. Four viable community content strategies are as follows:

→ **Long-term 'on the job' capability development:** three to five year programmes of capability development for immediate employees, suppliers and sub-contractors, designed to enable progression over time to higher-skilled jobs or higher-valued supplier contracts.

In the oil and gas upstream sector, the rapid rate of capital expenditure for the design, construction, fabrication and installation of platforms and pipelines does not lend itself to this type of prolonged assistance (assistance critical to moving, over time, capacities in local communities towards levels where they can compete openly for economic opportunities). The caveat to this is where capital expenditure is directed towards back-to-back, or overlapping engineering and construction work, thus providing a reliable flow of work sufficient to support commitments to long-term capability development. Examples might include the sharing of an engineering and design office, industrial estate or platform fabrication yard, where a number of operators place orders with the same firm. In Trinidad, for example, three gas field operators - bpTT, BG and EOG – have staggered their orders for local platform fabrication company with the same local company, TOFCO. The guarantee of a steady work flow here has been critical.

In addition to reliable flows of construction work, and possibly more suited to long-term community content capability development, is the operational phase of oil and gas developments, with opportunities such as security services, facilities and grounds maintenance, food and beverage supplies, cleaning services, transportation and administration. The competency development model adopted by the international engineering contractor AMEC with its local sub-contractors and staff on the Shell 'Malampaya' gas to power project in the

Philippines, is one example. Here, long-term support in HSE compliance and supplier reliability has enabled the majority of sub-contractor firms to win other contracts and access other markets in the same and synergistic markets.³²

→ **Short-term transferable capability development:** Long-term opportunities for capability development do not always exist as part of ongoing oil and gas field operations, for example, where supplier and sub-contractor services contracts are for periodic shutdowns, refurbishments or divestments. Further, volatility in global oil and gas prices, or periodic restructuring within companies, can quickly change the availability of the company's internal resources to support 'on-the-job' long-term capability development. For irregular construction contracts, for short-duration operation and maintenance (O&M) contracts, and where long-term O&M contracts run the risk of premature termination, the key to sustaining the economic benefits afforded to local community members and enterprises, is to orientate these parties towards other markets 'as quickly as possible'.

Building inter-sector transferability 'as standard' into short-term local community contracting would go some way to meeting both the long-term 'social license to operate' ambitions of oil companies and the policy aims of government to diversify local economies and generate self-sustaining economic growth independent of the volatilities of the upstream energy sector. At a minimum, companies can certificate their short-term contracted labour and explicitly aid them to seek alternative employment opportunities.

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They can also work with short-term suppliers and sub-contractors to reach minimum quality standards of direct relevance to other markets; help prepare marketing plans and guide market surveys; and join with other operators and government authorities to convene supplier/contractor forums and expositions to help community-based enterprises attract new clients.

→ **Vertical capability development:** initiatives that seek to bridge the gaps in skill and enterprise capabilities at the community and micro level by assisting individual 'established' small and medium scale companies - firms who supply the energy sector, but who source (or could be encouraged to source) a portion of their materials, employees and sub-contractors from the project affected communities. bp in Trinidad and Tobago, for example, provide a premium to one medium sized, foreign-cum-national joint venture to fabricate off-shore platforms. This allows the firm to employ and train people living within the vicinity of the fabrication yard.

→ **Cluster capability development:** proposals that contribute to capability development in skills and community-based enterprise which, although in part enables community members and

micro-enterprises to compete for jobs or supplier contracts on oil or gas development projects, also provides those who do not subsequently win contracts to access work with other companies in the sector, or in the down-stream energy sector, or in other markets altogether, eg construction, tourism. In cluster capability development initiatives, training and enterprise support needs to be calibrated to concurrently meet the needs of the oil development project **and** alternative employment and supplier markets. The key is to find synergies between the technical and material requirements of the upstream energy sector and these other markets, both the lower skilled opportunities, including vehicle maintenance, utilities maintenance, and catering, security and cleaning services, as well as higher order skills and services, such as computing, engineering design, construction and accounting.

This orientation towards synergistic markets means that skills and/or enterprise development programmes can be entered into by oil and gas operators ahead of the time that the opportunities materialise. This has two distinct benefits. It offers a strategy for oil and gas operators to contribute to the sustainable economic development of local populations during oil exploration phases or during the frequent lull in activity after the completion of feasibility studies but before financial agreements are reached. It is also attractive to other private

and public organisations who are unlikely to engage directly with the oil and gas operators, but who might value the development of capability in these transferable skills, products and services (and thus share the cost and risk burden). An example of this cluster capability development concept is given in Box 3.

Surveying Community Content Opportunities

Calculating where the opportunities lie in exercising community content is not easy. Most critical is a thorough skills and supply chain capability survey at the community level, matched to a long-term assessment of the on-project, project-linkage, and off-project opportunities relating to design, construction, operations and maintenance, and taking into consideration prospects for decommissioning, divestment and downsizing. Conducting a community content survey is essentially a question of understanding demand and supply. The method given in Box 4 provides stepped process for surveying the main opportunities.

Box 3

Illustration of Cluster Capability Development – Timor Leste³¹

The Clough AMEC joint venture was formed in part to bid for the principal operations and maintenance engineering services contract for the Bayu-Undan gas recycling project in the Timor Sea. A central element of the bid comprised proposals for a Common User Supply Base (CUSB) that would combine services to the offshore platforms with services to support ship maintenance and public sector infrastructure construction.

The approach afforded a degree of competitive differentiation. This element of the bid was considered by AMEC to have been a material factor in reaching the final stages of the procurement process with the oil company, ConocoPhillips, as well as securing final approval for the contact from the designated petroleum authority.

The initiative was to have adopted a partnership model. The key role proposed for government authorities in Timor Leste was to engineer the required expansion of utilities infrastructure to support the cluster of firms, and to afford Special Economic Zone status to the cluster itself. The proposal also included financial contributions to capital costs from both the operating company and the lead engineering contractors Clough AMEC JV, and from international donors; with the Clough AMEC JV establishing an operating company and lease holding/asset business to own and manage the base. This long-term equity commitment to the cluster was to act as a further competitive differentiator for Clough AMEC, enabling the capability of local and community-based suppliers to be built over the long-term, available for other bids as and when these arose.

Another advantage of the cluster was envisaged as a continuous supply of trained personnel, important in an industry where staff turnover is high. Further, economies of scale would enable the financing of shared infrastructure (eg information and communications technology infrastructure, port facilities and warehousing) as well as greater security for the cash flow of individual enterprises (eg establishment of short-term lines of credit from local banks secured against the pooling of invoices through a single clearing house).

Box 4

A 10 Step Method for Surveying Community Content Opportunities

Demand side

Supply side

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|---|--|
| <ol style="list-style-type: none"> 1. Identify short and long-term employment and supplier opportunities within the oil/gas company over the next five years (design, construction and operations), and grade each against the capabilities required. 2. Identify potential 'transferable markets' for both the short-term and long term opportunities (other operators, the down-stream energy sector, or other synergistic sectors) and grade the capabilities required. 7. Identify national and provincial economic and socio-economic public policies, budgets and existing programmes (and those of international donors) that align with these bridgeable opportunities and strategies, and assess whether partnerships are possible to support the company's efforts at capability development. 8. Identify the commercial and reputation drivers for the business from investments in community content, both from a 'social license to operate' (risk management) and a local content perspective. 9. Identify incentives that could be introduced through procurement procedures and contracts that would better utilise lead services contractors. | <ol style="list-style-type: none"> 3. Identify and grade existing capabilities within the population of project-affected communities and community-enterprises relevant to these on and off project opportunities, as well as in enterprises that already, or are likely to employ persons from these communities. 4. Identify the 'bridgeable gaps' and constraints to community members and enterprises accessing these opportunities. 5. Identify the key skills and enterprise capabilities required to bridge these gaps, be that with regard to quality standards, reliability, human resources, finance, infrastructure or institutional reform. 6. Identify the preferred strategies to develop these new capabilities, including: <ul style="list-style-type: none"> - long-term 'on the job' capability development - short-term transferable capability development - vertical capability development - cluster capability development 10. Identify interventions that the public sector could make that would incentivise operators to invest in community content, eg fiscal, regulatory, endorsements, commercial. |
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⇒ Conclusions

This paper lays out the concept of 'community content': its definition, motivations, implementing strategies and a survey method. We should not be so naïve, however, as to expect changes in local content and community investment practices to occur in the absence of the right dedicated incentives. Where these incentives might lie requires analysis along the policy and transaction 'chain', from local content regulations and policy, through production sharing model contracts, to procurement processes by oil and gas operators, and contracts at different supplier levels. This type of 'transaction chain analysis' is described in an associated paper.³³

Some of the incentives necessary to energise more creative community content practices include:

- company policy (and if necessary staff appraisal criteria) that encourages the external affairs departments and community liaison units of oil and gas operators to meet with and jointly plan community content programmes with a company's contracts and procurement managers;
- transitional funds provided by the company to ameliorate the reputation risk to the business of adapting current community investment programmes to the task of enhanced local content capture and capability development;
- new tendering procedures and performance payment mechanisms between operators and their lead services contractors, designed to incentivise these contractors to take on some of the responsibility for managing community content strategies (see examples in an associated paper from ODI);³⁴
- community content programmes that are aligned with national and local economic development priorities made eligible by the state for cost recovery against capital and operational expenditure; and
- participation in community content programmes by state authorities and international donors to ensure alignment with national and local economic priorities, provide expertise (eg. in SME development and financing) and help carry the cost burden.

We should not be so naïve as to expect changes in local content and community investment practices to occur in the absence of the right dedicated incentives.

Ultimately, community content is about realising a competitive advantage for an oil and gas development company in the eyes of both the local population and the country's guardians of economic policy.

Above all, community content is a means to satisfy two sets of interests. Public authorities are looking for ways to position the talents and resources of their dominant upstream energy industries as a catalyst for wider sustainable economic development. And, the established multinational oil and gas development companies need to maintain a visible competitive advantage against the globally competing national oil companies, and against each other. Elevating their contribution to local content capture and local capability development, and integrating these new practices with the need to sustain a 'social license to operate' through community investment programmes, offers just such competitive differentiation.

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Figure 1 WTO Agreement on Trade Related Investment Measures (TRIMs) for Local Content in developing countries: in relation to the hydrocarbon exploration and production activities of the five largest oil and gas companies (bp, Chevron, ExxonMobil, Shell and Total)

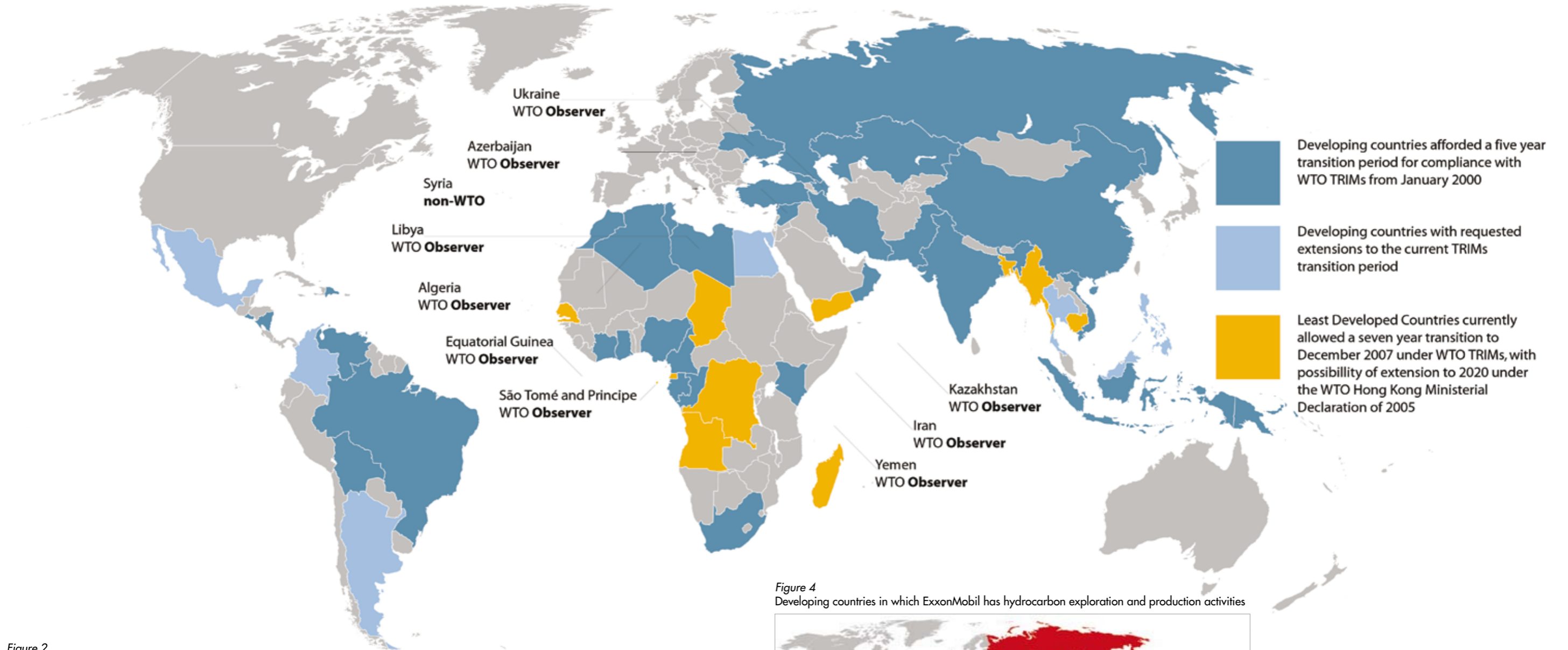


Figure 2 Developing countries in which bp has hydrocarbon exploration and production activities



Figure 3 Developing countries in which Chevron has hydrocarbon exploration and production activities



Figure 4 Developing countries in which ExxonMobil has hydrocarbon exploration and production activities



Figure 5 Developing countries in which Shell has hydrocarbon exploration and production activities



Figure 6 Developing countries in which Total has hydrocarbon exploration and production activities



Source: BP Financial and Operating Information 2002-2006
 Chevron Worldwide Operations www.chevron.com/operations/CountryOps.aspx (12 June 2007)
 ExxonMobil 2006 Financial & Operating Review
 Royal Dutch Shell plc Annual Review and Summary Financial Statements 2006
 Total in 2006