Nigeria's 52nd Independence Anniversary Symposium

REFORMING THE NIGERIAN PETROLEUM INDUSTRY: BETWEEN LOCAL CONTENT AND GLOBALISATION

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1st October 2012

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Context

- The Petroleum Industry- a local or global Industry?
- Background: The Nigerian Petroleum Industry Pre-NCDA /PIB
- Local Content: Policy and Legislation (the NCDA 2010)
- Industry Reform: The PIB and Local Content
- Local Content and Globalisation
- Helpful thoughts
- Conclusions

The Petroleum Industry- a local or global industry?

- Most important industry in the world- every other industry depends on it
- Oil must be extracted where it is found making it localised
- Huge environmental and social impact on (local) project corridors
- Highly capital intensive and high risk business thus reliance on foreign capital
- Highly profitable- huge tax revenue to government and return to investors
- Technologically driven with reliance on foreign technology and expertise
- Perception of wealth associated with the industry so must be seen to benefit ‘locals’ and local economy
- Local Content an emerging issue now factored into investment decisions

The Petroleum Industry- a local or global industry?

Some basic comparison

Factor	Oil Industry	Manufacturing Industry
Industry risks	Very high (40-100 %)	Low-high (1-40 %)
Lead-time	Very long (20- 50 yrs)	Mod-long (5- 15 yrs)
Scale of investment	Very large US$ bn	Mod–large US$ m
Location	Fixed – often difficult terrain	Mobile- often by choice
Cost of failure	Very large- US$ bn	Mod-large US$ m
Reward profile	Very large- US$ bn	Mod-large US$ m
Contribution to GDP	Large-very large (0-90 %)	Low-mod (1-10 %)
Role of International Mkts	V. high- Cartels, Econ. Blocs	Mod-high
Renewability	Non-renewable	Usually renewable
Ownership of Resource	State	Shareholders
Environmental Impact	High – V. high	Low – High

This table illustrates the basic differences based on assumptions only. Most of the factors also hold true for the Mining industry though with some differences. (Nwete 2004, p. 7)

The Nigerian Petroleum Industry Pre NCDA/PIB

Timeline

- Prior to Independence: geared towards the interest of foreign companies

- Formal Structure established by the Petroleum Profit Tax Act of 1959 and the Petroleum Act of 1969 as amended

- 1960 – 1977: No clearly defined drivers- status quo more or less maintained

- 1977- 1990: Some form of nationalistic tendency with the establishment of NNPC through the NNPC Act 1977 (OPEC influence?)-not much changed, NEPA 1972, PTDF ACT 1973 etc.

- 1990 – 2000: To encourage local participation and get ‘more’ revenue from O&G operations- the1996 Marginal field policy and PSC Act 1999

The Nigerian Petroleum Industry Pre NCDA/PIB

- 2000-2011: Oil Nationalism- local participation (NCDA 2010) and greater share of the revenue
- 2009 – 2012: Oil nationalism/increased local participation and greater share of the revenue- unbundling of NNPC etc.
- Few and lowly capitalised (local) and indigenous upstream and service companies
- Indigenous companies assets are mostly marginal fields abandoned by IOCs
- Indigenous companies usually have foreign interests (ownership) and also rely mostly on foreign service companies to support their operations
- Industry dependent on foreign technology despite over 4 decades of exploration and production

The Nigerian Petroleum Industry Pre NCDA/PIB

Statistics

- Upstream dominated by IOCs who amongst them account for over 80% of Nigeria's oil and gas production
- IOSCs account for about 85% of goods and service procurement for the industry
- High shortage of skilled workforce and an undeveloped supply chain
- Less than 10% of Senior Leadership positions occupied by Nigerians

About US$8 billion is spent in the industry annually on EPC, FEED , Conceptual Design and Seismic Studies related service. This figure is projected to hit US$15B in the next few years. Only a small percentage of this money is spent in Nigeria leading to loss of employment and attendant economic linkages- Ihua, Ajayi and Eloji (2009)**. This , it's is argued is because local (indigenous) firms lack the requisite skill, technical expertise, manpower and production capacity, and capability to compete favourably**

Local Content- Policy and Legislation- the NCDA 2010

What is Local Content?

The utilisation of local (host country's) goods, services and workforce in the oil and gas value chain (from exploration, field development to production; the objective being to promote local industries, create economic linkages, build local capacity, develop the workforce and minimise capital flight in the industry.

The Nigerian Oil and Gas Industry Content Development Act (NCDA) 2010 defines Nigerian (local) content as "*the quantum of composite value added to or created in the Nigerian economy by a systematic development of capacity and capabilities through deliberate utilisation of Nigerian human, material resources and services in the Nigerian oil and gas industry*"

Local Content- Policy and Legislation- the NCDA 2010

The government had adopted a local content policy from 2000 to 2010, when it enacted the NCDA in support of local content utilisation.

Key Provisions

- Accords certain preferential treatment to companies that qualify as "Nigerian Companies" pursuant to the Act

- To qualify as a Nigerian Company under the NCDA, the company must be incorporated in Nigeria under the provisions of CAMA with minimum of fifty one per cent (51%) of the issued shares held by Nigerian shareholder(s); whilst the remaining forty nine per cent (49%) of its issued shares may be held by foreigners.

- Establishment of the Nigerian Content Development Monitoring Board ("NCDMB") to give effect to the Act. The NCDMB monitors the development of local content in the Industry.

Local Content- Policy and Legislation- the NCDA 2010

Key Provisions Contd.

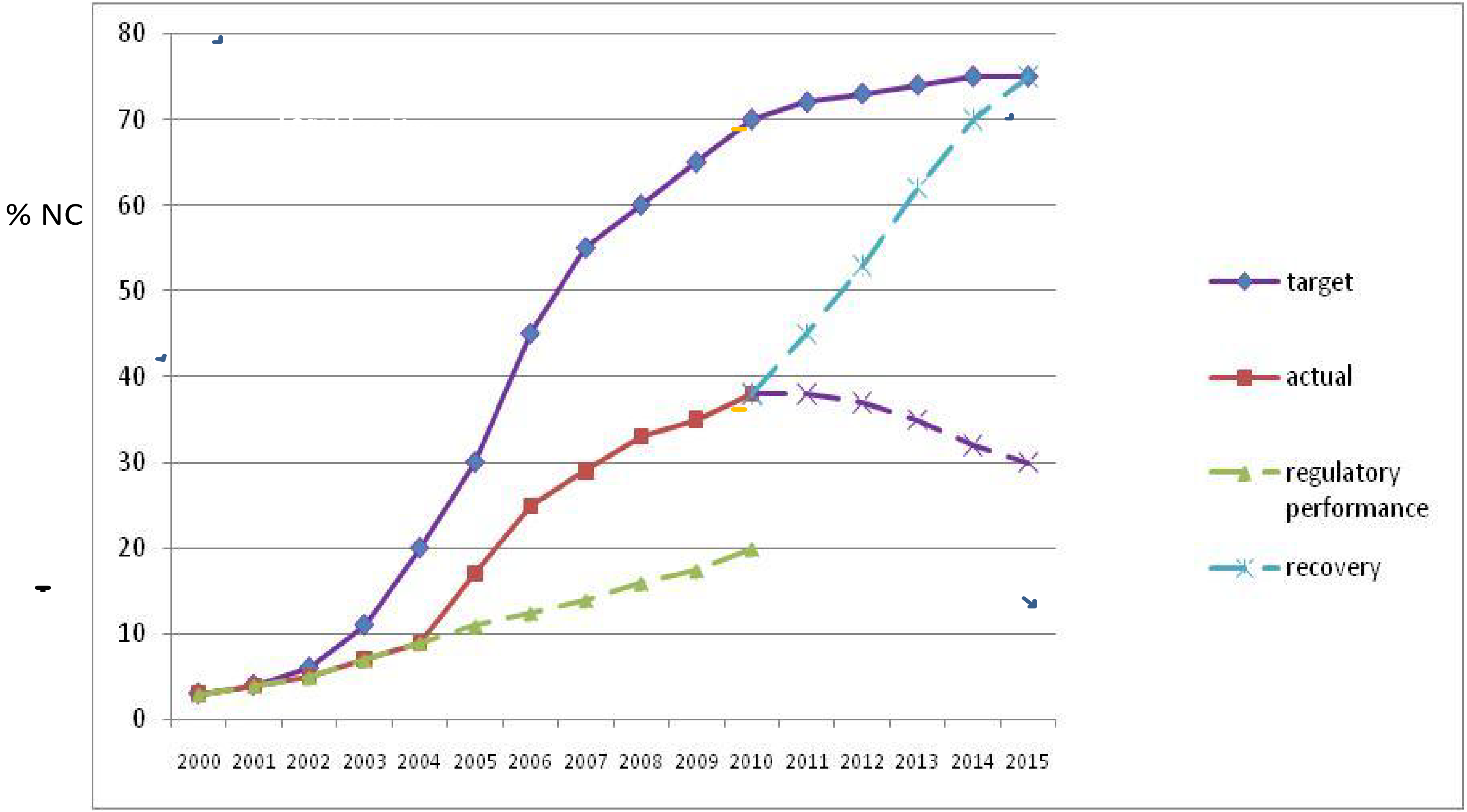
Issue	Provisions
NCDF	Companies to pay 1% of total contract sum awarded in the upstream sector into the Nigerian Content Development Fund (NCDF) - deductible at source
Fabrication/welding	All fabrication and welding activities must be performed in-country.
Incentives	Tax incentives granted to companies that establish facilities, factories, production units or other operations within Nigeria for the purposes of manufacturing goods or providing services which were previously imported
Foreign Companies	Subsidiaries of foreign companies to own at least 50% of the equipment used for execution of work in the country
Company accounts	Operators, contractors/subcontractors to maintain bank account(s) in Nigeria in which it shall retain a minimum of 10% of total revenue accruing from Nigeria operations
Employment	Only Nigerians shall be employed in the junior/intermediate cadres/ corresponding grades in the industry. Maximum of 5% of management positions to be reserved for expatriates.
Succession Plan	Companies to submit succession plans for positions not held by Nigerians. Nigerians to understudy expatriates for 4 years after which the position shall be ‘Nigerianised’
Nigerian Content Targets	Nigerian content targets established for various categories of Spend. See Target versus Actual slide

Local Content- Policy and Legislation- the NCDA 2010

Key Provisions Contd.

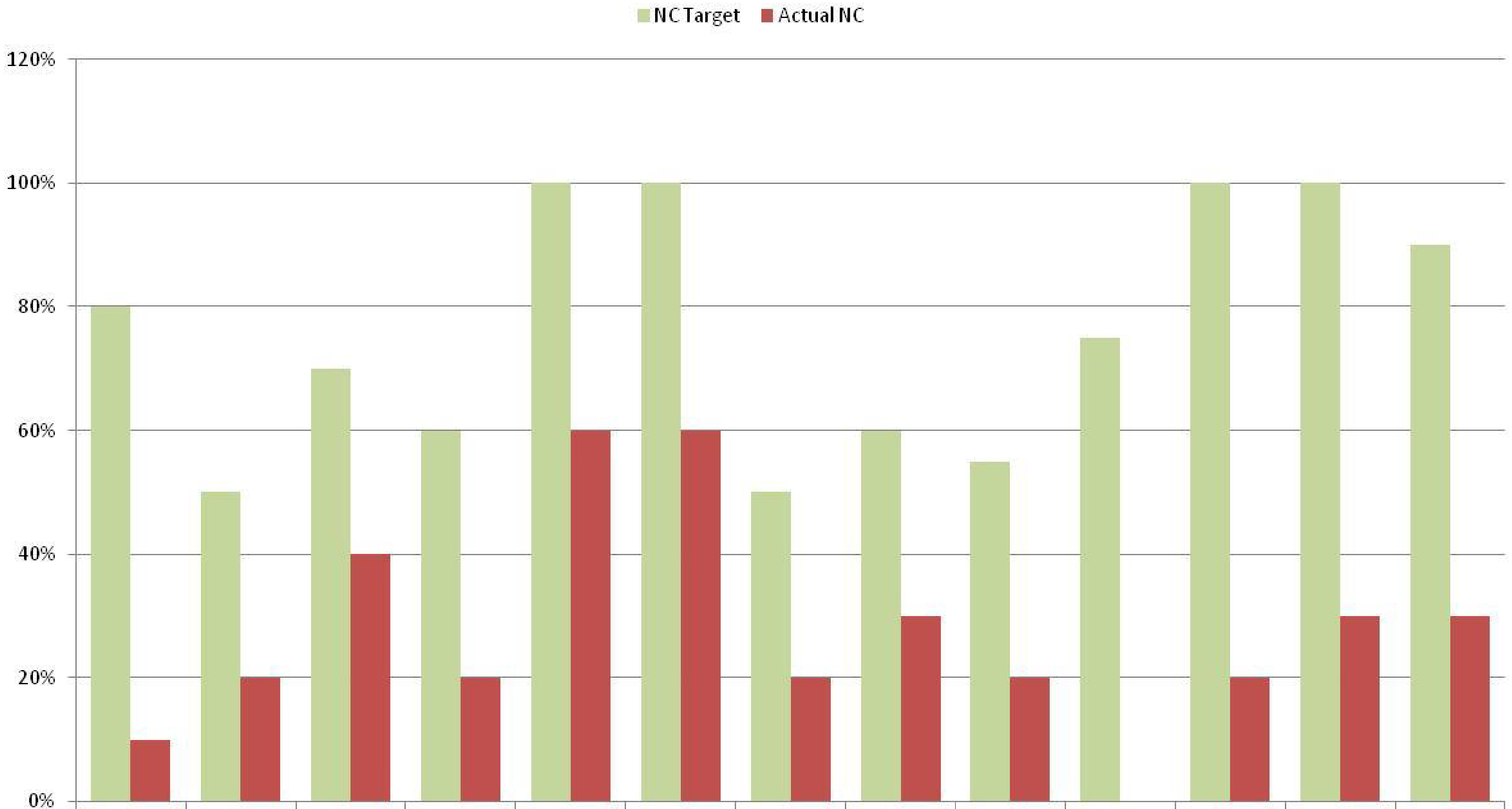
Issue	Provisions
Nigerian Content Plan (NCP)	Submission of NCP as an essential component of bids for any license, permit or interest in the oil and gas industry. NCP to contain provisions to ensure that 'first consideration' is given to indigenous operators, goods and services and Nigerians in employment and training.
Contract award	Contract award not to be based solely on the principle of lowest bidder provided the Nigerian company's bid does not exceed the lowest bid price by 10% . Where bids are within 1 % of each other at the commercial stage, the bid containing the highest level of Nigerian content shall be selected, provided the Nigerian content in the selected bid is at least 5% higher than the next bid.
Technology Transfer	Programme of planned initiatives aimed at promoting the effective transfer of technologies from Operators/alliance partners to Nigerian individuals and companies to be submitted to the board
Professional services	Legal, Insurance and Financial (where practical) services to be undertaken by Nigerian Companies. Insurance risks can be undertaken by non-Nigerian companies subject to the approval of NIC
JQS	Establishment of a Joint Qualification System (JQS) as an industry databank of available capabilities in the oil and gas industry- works with NIPEX for tendering
Waivers	Where inadequate Nigerian capacity exist in any sector/discipline, the Minister may authorize the continued importation of the relevant items up to 3 years from the commencement of the Act.

The NCDA 2010 –Government's NC Aspirations



Culled from Wabote, 2011. Both the capacity utilisation backed by law and that not backed by law require supplier development to be effective given the low capability level of the local supply chain

Nigerian Content: Target vs. Actual



	Engineering	Topside module fabrication (process modules & storage modules) (tonnage)	Accommodation modules fabrication (tonnage)	Subsea systems Fabrication/Co nstruction (tonnage)	Pipeline systems Fabrication/Co nstruction (tonnage)	Risers Fabrication/Co nstruction (tonnage)	Utilities module/packag es fabrication (tonnage)	Umbilicals fabrication and construction (tonnage)	Steel pipes procurement (tonnage)	Steel plates and sections procurement (tonnage)	All fabrication and welding to be in-country	Cranes/Crane Barges/Heavy Lift Vessels (manhour)	Accommodation Vessels (spend)
NC Target	80%	50%	70%	60%	100%	100%	50%	60%	55%	75%	100%	100%	90%
Actual NC	10%	20%	40%	20%	60%	60%	20%	30%	20%	0%	20%	30%	30%

Courtesy: S. Wabote 2011

Local Content- Policy and Legislation- the NCDA 2010

Some History: Nigeria not alone

United Kingdom 1973	▪ **Enacted three measures to improve local content in the petroleum sector** ✓ Offshore Supplies Office ✓ Auditing procedure for monitoring purchases made by oil companies ✓ The provision of financial assistance to the U.K. supplies industry
Norway 1972	▪ **Enacted local content law (article 54).** ✓ Law in effect till 1994 by which time Statoil and indigenous energy service sector had grown to a point where they could compete globally
Trinidad & Tobago 2003	▪ Local content on legislation focused on growing in-country fabrication capacity . First offshore platform completely built in-country by 2007
Brazil 2003	**90% of concessions held by Petrobras** ▪ Established specific local content rules in ordinance 180 ✓ *Fundamental principle - "Everything which can be done in Brazil should be done in Brazil"*

Courtesy – S. Wabote 2011

Add Canada (especially the North Atlantic), Angola etc. to the mix

Industry Reform: The PIB and Nigerian Content

PIB Nigerian Content Provisions

The objectives of the PIB as provided in Part 1 of the Bill include to

- 1(b) ‘enhance exploration and exploitation of petroleum resources in Nigeria for the benefit of the Nigerian people’;
- 1(i) ‘promote the development of **Nigerian content** in the petroleum industry’
- (s.178 (18)) - Work programme subject to approved **Nigerian content** plan in respect of:
  - Drilling of wells during initial exploration period
  - Drilling of wells during licence renewal
  - Appraisal work
  - Work on significant gas discovery

Industry Reform: The PIB and Nigerian Content contd.

- (s.179 (3)(d) – field development plan approval subject to an approved **Nigerian content** plan pursuant to the relevant law on Nigerian content development, which is the NCDA 2010
- S.285 non participation by government in petroleum operations of indigenous petroleum companies whose total production is not more than 25,000 bbl.
- S.286- indigenous petroleum companies producing not more than 25,000 bbl. to be allowed to produce up to technical allowable output (OPEC quota?)
- SS.287 and 288-Targets to be set for increased indigenous participation in the Petroleum Industry
- 80% cap on deductibility of foreign costs in respect of procurement of goods and services except where these are not available in Nigeria and subject to NCDMB approval

Local Content and Globalisation

Why Local Content?

- The oil and gas industry is the primary driver of all economic activities and thus anything that happens there impacts the rest of the economy. Local content development creates a (social) safety net for the government- stimulates economic development, increased employment, economic linkages, highly skilled workforce etc.

- For Nigeria, it is an opportunity to rediscover ‘the years of the locust’ in the industry and other sectors of the economy that had been neglected over time due to over-reliance on the oil industry

- Nigeria Content will lead to longer term reduction in cost as goods, services and skilled workforce requirements are generated in-country and sustained over time at lower cost thereby increasing margins/profits

- Other countries did the same- see previous slides

Local Content and Globalisation

The Case for Globalisation

- He who pays the piper dictates the tune
- NC leads to a short/medium term increase in costs
- Talents drive the industry and the cost of a poor talent pool in Nigeria includes high cost of expatriate staff, decline in both reserves find, replacement and production, leading to poor cash flow and poor return to shareholders
- Highly competitive and technically challenging/safety issues thus must hire the best and most qualified hands.
- Long lead time hence economically advantageous supply chain required to sustain it in terms of quality, schedule and cost
- NC against the spirit of BITs, ECT and certain National Treatment obligations under GATT (US vs. Canada FIRA Panel)
- Huge taxes, fees and CSR obligation which government should utilise to diversify the economy to create economic linkages

Local Content and Globalisation

Challenges of Local content

- Undeveloped local supply chain that can compete on an international basis
- Huge upfront cost to develop local supply chain
- Technological challenges
- Capacity and capability gaps across industries and sectors
- Lack of good supporting infrastructure (transport, water, electricity etc.)
- Poor academic curriculum/vocational training/investment in R&D
- Transparent bidding and contracting process
- Financial challenges for local companies
- Stringent Regulation/unrealistic NC Targets (?)

Helpful Thoughts 1

- Reconsideration of Industry concerns in respect of the following areas:

  - Provisions of the Act are stringent

  - Ambitious target in key categories despite (grossly) inadequate in-country capacity to meet targets

  - Ambiguous provisions in the NCDA Act require practical regulations to aid compliance

  - Huge Impact on Contracting & Procurement Processes and Cycle Time (due to steep learning and capacity curve)

- A review of the NCDA after 3-5 years to make it more practical given the lessons of implementation

Helpful Thoughts 2

- Moratorium of 5-7 years in key categories of Spend
- Setting up of a local content fund to be easily accessed by local companies
- Reviewing the objectives of the PTDF to make better use of graduates of its scholarship scheme
- Academic curriculum and training to be practical and aligned to industry requirements
- Capacity building across industry including NNPC, FIRS, and professional services

Conclusion

- Local content in the oil and gas industry is now an emerging issue that companies have to address especially in developing countries
- Governments should not unwittingly lose its competitive advantage by setting unrealistic targets
- Government to provide enabling environment- investment in education, R&D, infrastructure and fiscal incentives
- Collaboration between industry and government required given the long terms benefit that will accrue to both parties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Happy
Independence Day
celebrations

Thank You

Q AND A

THANK YOU FOR LISTENING

Send additional questions to

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