KENYA LOCAL CONTENT: APPROACHES AND MECHANISMS TO DRIVE LOCAL PARTICIPATION IN THE O&G SUPPLY CHAIN

Brief II

INTRODUCTION

On December 7th, 2017, the World Bank Group, within the framework of the Petroleum Business Opportunities (PBO) project, in partnership with Strathmore University Extractive Industry Center (SEIC), Extractives Baraza, and DAI Global, held the second session of a three-part series aimed at facilitating local content discussion amongst key public, private, and civil society stakeholders in Kenya's petroleum sector. The session, entitled "Kenya Local Content Exchange: Approaches and Mechanisms to Drive Local Participation in the oil and gas supply chain" sought to build on the outcomes of the first session held in July entitled, "Local Content: Vision to Implementation".

The Exchanges initiative is in response to a need, identified by PBO, for open and robust local content discourse following Tullow Oil's 2012 commercial oil discovery, with the aim of adequately preparing Kenya's private sector to participate in the oil and gas sector. Oil and gas operators are preparing to move into the development phase of the projects as regional governments work towards export pipeline development. This reinforces the need for a timely, structured and facts-based key stakeholder engagement process, to develop a shared vision for local content in Kenya's nascent petroleum sector for integration with the country's broader development strategies.

The "Approaches and Mechanisms to Drive Local Participation in the O&G Supply Chain "Exchange provided a platform for Kenyan stakeholders to move towards positioning local content (in oil and gas) as one vehicle, among others, for Kenya's sustainable development.

OPENING REMARKS AND KEY SPEAKERS

The event was kicked-off with an introduction that reminded participants of the key takeaways from the previous session and reinforced the integrated nature of the Exchanges with each session providing a building block for the next.

The keynote speeches were delivered by two African oil and gas professionals, who brought a wealth of real-world experience to the session.

The first keynote speaker, Eng. James Mbote, is a Kenyan entrepreneur with over 18 years of experience in the global upstream oil and gas industry and is a prime example of local content in action. Eng. Mbote enriched the session with his perspectives on the opportunities and challenges facing local entrepreneurs wishing to invest in Kenya's oil and gas industry.

The second keynote speaker, Toks Azeez, is Nigerian and has over 22 years of experience in oil and gas. He is currently Sales and Commercial Director for Baker Hughes (a GE company) in Sub Saharan Africa and greatly complemented the session by presenting the local content perspective of a major oilfield service company and demonstrating the mechanisms such companies employ to develop local content in their global operations.

The event was facilitated by Eng. James Mwangi, Governor for Energy at the Kenya Private Sector Alliance (KEPSA), Kenya's largest private sector association. Eng. Mwangi is CEO of Kurrent Technologies, one of Kenya's leading integrated Engineering and Health, Safety and Environment (HSE) consulting companies, and has over twenty years of experience in the oil and gas industry, both in Kenya and internationally. His experiences, and the fact that he is also an example of local content in Kenya, provides him with the credibility and knowledge to facilitate a dynamic and constructive discussion.

FIRST KEYNOTE SPEECH

Eng. James Mbote has vast experience in the global upstream oil and gas industry. His 18-year oilfield experience spans several countries including Tanzania, Libya, Oman, Yemen and Kuwait. Eng. Mbote is founder and managing director of Kenyan company Oilfield Movers Limited that provides logistics operations and services for the upstream oil and gas industry in the Eastern Africa Region. He also runs an oilfield support services company (ROLSS Ltd) which operates in Kenya, Uganda and the larger Eastern Africa.

Eng. James Mbote shared the experience of his company Oilfield Movers Limited, a company that provides logistical solutions and technical support services for the upstream and midstream oil and gas sector.

Eng. Mbote detailed four significant challenges his company initially faced in establishing itself as a credible oil and gas logistics company. The first challenge was financial; the oil & gas industry is capital intensive and the Kenyan financial institutions, which at that time did not understand the industry, were reluctant to support OML. This proved to be particularly difficult for a start-up company that did not possess a wide portfolio of assets as security. The second challenge was linked to the lack of adequate oil & gas skills in-country. Specialized oil and gas training is very expensive and bringing operatives up to required levels of performance takes significant time, partly due to the process of developing an "oil & gas culture" that Is essential to sustainable compliance with Standards. As an intermediate step, the company hired expats to execute the more technically advanced tasks and gradually transfer knowledge to local staff. The third challenge was the lack of an adequate policy and legislative framework. Eng. Mbote stated that while the private sector must take ownership of their own competitiveness; local companies can benefit from a legal and economic framework that provides support for their development. The fourth challenge was the lack of oil and gas knowledge throughout the supply chain. Most industries, from finance to hospitality to construction, do not understand the oil & gas industry's needs, requirements and Standards. Eng. Mbote feels it is crucial to develop this understanding throughout the Kenyan oil and gas supply chain and not only in specialized oil and gas companies.

Eng. Mbote shared three key factors behind OML's development from a small start-up to a major player in the Kenyan oil and gas sector. Factor one was gaining an understanding of and acquiring the necessary industry certifications, establishing systems and developing the underpinning culture to assure both legal and contractual compliance. Factor two was providing differentiated services and unique solutions while maintaining operational excellence and implementing continuous improvement project by project. Finally, Eng. Mbote emphasized factor three; a need for serious investment in personnel as key to sustainable success. OML recognized that its human resource sare its most crucial asset thus it invested heavily, from the start, in building the capacity of its staff to assure their motivation and retention through continuous career development.

Today, OML is a market leader in logistical solutions for the oil and gas industry with 112 employees, a diversified customer base that includes oil and gas, geothermal and wind power customers. Since 2013, the company has achieved impressive milestones including over 11 million kilometers driven, over 200 tons carried and close to 900,000 man-hours worked with a very strong safety record.

Building on this success, the company continues to look ahead and plan for future growth. The company plans to continue to invest in assets to serve its customers' needs, diversify its skills and customer base and expand regionally into the EAC region (e.g. Tanzania and Uganda). Part of their strategy involves the identification of future challenges with solutions, to mitigate their impact and transform them into opportunities. Some of the key challenges identified are the potential rapid increase in oil and gas demand in Kenya as projects move into the development phase. This increase in activity will put pressure on the limited pool of skilled labor available in the market. Access to finance will continue to be a challenge because to engage with the oil and gas development phase will require significant investments in assets.

Eng. Mbote stated that as Kenya develops its legal framework for oil and gas and local content, companies must carefully balance legal and contractual compliance because legal requirements, such as the use of local and community contractors, can frequently affect a contractor's ability to meet contractual obligations of project delivery timelines and compliance with Standards.

Eng. Mbote concluded his presentation by sharing a series of valuable insights and lessons that he has learned over the course of his journey as an entrepreneur. These include:

1. "Regulations are not apanacea, they are there to support". In other words, local business should not rely on protection from legislation but must invest to achieve and sustain international Standards in order to compete on price, operational excellence, project delivery and compliance. Laws and regulations should only be employed to enable the development of competitiveness.
2. "Businesses and investors should carefully select the market in which to play" because the oil and gas industry is one that requires long-term commitment and investment. It is therefore not suitable for short term investors or speculators. Investors seeking to participate in the oil and gas industry must be willing and able to take risks and appropriately schedule their investments.
3. "Financial discipline is key" because the oil and gas industry is cyclical with periods of high demand followed by long periods of limited activity. Hence cash flow management and complementary market share critical for a company's long-term survival.

4. "Companies should look at operating in the regional arena" and develop cross sectoral/ transferrable skills to expand their addressable market through lateral diversification. This strategy assures the skills developed do not wither on the vine after projects' completions and prevents a "skills drain" from the industry in periods of low activity.
5. Securing a "social license to operate with communities is key to business continuity". To achieve this the approach must be collective and includes all major stakeholders such as Government, civil society, host community, oil companies and their contractors.
6. "Transparency and integrity" are key to sustainable success. The oil and gas industry is a long-term undertaking for suppliers and hence companies need to establish solid foundations built on sound business practices.

SECOND KEYNOTE SPEECH

Toks Azeez has over 22 years of experience in oil and gas. He is currently Sales and Commercial Director for Baker Hughes (a GE company) in Sub Saharan Africa. Over the course of his career, Mr. Azeez has occupied several senior management roles including operations, business development, sales, applications engineering and legal compliance. Under his strategic direction, Baker Hughes successfully formed a local partnership with Nairobi-based Bentworth Investments Limited; Kenya's first indigenous oil and gas and geothermal service company.

Toks Azeez's presentation complemented Eng. Mbote's presentation by presenting the perspective of a major international oilfield service company, Baker Hughes GE (BHGE). BHGE is the world's first and only full-stream provider of integrated oilfield products, services and digital solutions with over 125 years of experience, operating in over 120 countries and with around 70,000 employees.A global player in the oil and gas industry, BHGE elected to develop innovative mechanisms to develop local content (localization)to enhance its activities in the countries in which it operates. One such mechanism is the BHGE Channel Partner Model. BHGE has developed a network of authorized BHGE representatives that are authorized to sell or assist in the sale of BHGE products or services and in some cases, conduct business on behalf of BHGE. This model is proving successful in developing credible and capable local entrepreneurs into robust and technically capable oil and gas product and service providers. The model follows a strict process that involves the careful selection and screening of partners; significant partner development and training with continuous support; and policies that assure motivation and the improvement/optimization of performance. BHGE has significantly grown its partner network over the last 5 years and reports success cases such as GCA Energy (Nigeria), a channel partner in the top 5% within Sub-Saharan Africa and which consistently contributes over 25% to overall channel orders in the region. However, the model is not without its challenges and BHGE have had to terminate channel partners on the grounds of breaches of code of conduct related to compliance issues.

When BHGE first entered the Kenyan market, it quickly identified a series of gaps and challenges, including limited availability of skilled local labour and a lack of technology, training and resources for local companies. Looking to close these gaps, BHGE formed a partnership with Bentworth Investments Limited, a young local company that was also looking for a partner to serve the nascent Kenyan hydrocarbon industry. In Oct 2014, Bentworth registered as Kenya's first indigenous oil and gas and geothermal service company. Naturally, the company faced several challenges, however, the focused investment approach of Bentworth's founders, allied with BHGE's channel partner support, facilitated the company's development. To provide Bentworth the opportunity to develop capacity on-the-job, BHGE awarded Bentworth subcontractor work on a major operator's exploration and production project in Turkana for the supply of cementing equipment, laboratory equipment, laboratory testing, and completion tools. To support capacity transfer and manage execution risks BHGE provided a senior technical desk engineer/operations coordinator and a senior field specialist to oversee the project and coach local staff. This was complemented by training, technical support and spare parts provision to maintain and operate Bentworth's equipment. BHGE also granted access to its *Achieve* learning system to assist with the development of Bentworth's staff.

From the outset BHGE and Bentworth have worked together to deliver quality services for operations in Kenya in challenging conditions in remote locations. The partnership has resulted in the creation of a strong indigenous oil and gas and geothermal service company in Kenya capable of delivering large scale projects and has promoted Kenyan ownership and operation of technical assets. In addition, the partnership has enabled the transfer of knowledge and technology through the development of Kenya's talent pool able to take on oil and gas projects in neighboring African countries.

Mr. Azeez closed his presentation by reinforcing that localization is not a "nice to have" but is an integral component of a sustainable business model. As newly established oil-producing countries seek to ensure sustainable development, they seek to drive local participation in the oil and gas industry through legislation and regulations that encourage local participation and the transfer of knowledge and technology. As a consequence, international companies actively seek to develop local capacity (technology, skills, Standards) to assure compliance and develop harmonious relationships with local governments and regulators. However, the case for localization is not purely based on compliance but also on sound business strategy because it has potential to reduce operational costs for operators in the medium to long term. Finally, Mr. Azeez closed by reiterating a key point, initially raised by Eng. Mbote; for local content aspirations to become reality, local entrepreneurs must take risks, comply with Standards and make long-term investments.

MULTI-STAKEHOLDER DISCUSSION

Following the keynote speeches, Eng. James Mwangi facilitated a shared discussion amongst participants centered on the following four questions:

1. Does the Kenyan private sector need help to participate in the oil and gas supply chain?
2. Does the Kenyan private sector need support to compete (capacity-building) or guaranteed access (regulatory protection)?
3. Levelling the playing field: How to bring Kenyan suppliers up to international Standards?
4. Attracting FDI and international suppliers: An opportunity or threat to the local private sector?

Q1: DOES THE KENYAN PRIVATE SECTOR NEED HELP TO PARTICIPATE IN THE OIL & GAS SUPPLY CHAIN?

Acknowledging the nascent nature of the oil and gas industry in Kenya, the participants unanimously agreed that the private sector indeed needs help to participate in the oil and gas supply chain. During the discussion, the participants identified two major constraints that prevent local companies from winning contracts in the industry.

Firstly, the stringent requirements of international HSSE Health, Safety, Security and Environment (HSSE) Standards. The industry, driven by major international oil companies, requires local companies to comply with Standards that are challenging to implement for local companies because of the resources they demand. In some cases, local companies don't even include HSSE as part of their business agenda, and are not able to appreciate the strategic importance of such investments beyond the short-term financial impact. Local companies must be trained in current HSSE Standards to maximize local participation and, fortunately for them, the industry is willing to provide this support to the companies that display readiness to comply with Standards.

The second constraint is related to access to finance. The oil and gas industry is a capital intensive and high-risk industry, thus getting funding is difficult and, at times costly, especially for SMEs. There is a "missing middle" in alternative financing for oil and gas in Kenya. On one extreme, you have large investors who are focused on large contracts of a sophisticated businesses nature and on the other extreme, there are the "impact investors", who are able to make smaller investments with less expensive terms, however, they tend to prefer industries perceived as being environmentally sustainable (e.g. renewable energy) and hence limit their investments in sectors such as oil and gas. Therefore, Government of Kenya support is needed to establish funding mechanisms that facilitate local SME participation in the oil and gas supply chain.

TAKEAWAY: The Kenyan private sector needs support to participate in the oil and gas supply chain, particularly in the areas of international HSSE Standards and access to finance. This will require a concerted effort from various stakeholders including the oil and gas industry, the financial services industry and the Government and will demand a significant commitment and investment from the Kenyan private sector itself.

Q2: DOES THE KENYAN PRIVATE SECTOR NEED SUPPORT TO COMPETE (CAPACITY-BUILDING) OR GUARANTEED ACCESS (REGULATORY PROTECTION)?

Participants were split in their opinions during the discussion of the second question. Some found guaranteed access (e.g. target percentages) to beat threat to investment and industry Standards. Industry participants reinforced that operators and contractors cannot neglect human safety, environmental protection and operational Standards to comply with regulated local content targets. Therefore, only way to achieve local content aspirations is to build local capacity to international Standards. Moreover, guaranteed access may indeed open doors to many local companies, however, it will not ensure in-country value-add (e.g. pure import agents) if it does not encourage the necessary skills and capacity development. If developed in collaboration with stakeholders, Kenyan laws and regulations may help local business understand their role, and protect local SMEs against unfair practices. Hence, it was widely accepted that there should be regulation but with realistic targets that support capable local companies, protect the sector's compliance with the necessary Standards and support IOCs in their efforts in developing local capacity and participation.

To reach an optimum middle that favors oil and gas operators, contractors and local companies, participants saw the value in taking the following approaches: staggered implementation of local content regulations in parallel with local capacity building strategies which allow for gradual roll-out over a realistic timeframe; creating incentives for companies to establish operations in-country (domiciliation);establishing an initial minimum level of protection that increases with time; and creating mechanisms for comprehensive stakeholder involvement that includes early negotiation with operators to manage expectations.

TAKEAWAY: Regulatory regimes need to be balanced to create an environment that promotes the development of local skills, capacity and Standards while also providing a competitive investment climate that promotes inward investment. Such balanced regimes are best developed through dialogue and coordination amongst all key stakeholders.

Q3: LEVELING THE PLAYING FIELD: HOW TO BRING KENYAN SUPPLIERS UP TO INTERNATIONAL STANDARDS?

International operators enter the country with very strict requirements for quality and HSSE Standards that cannot be compromised during operations. Hence, it is necessary to create an early awareness around the required international Standards for each supply chain category and socialize the importance of compliance with these Standards. However, this will require a legal framework and official local adoption of Standards, to ensure local companies are mandated to comply. Obviously, those local players who are ready to meet Standards today have a competitive advantage in the market.

Kenya could follow Trinidad and Tobago's successful capacity-building model, by bringing in international experts to share on-the-job experience. A complementary methodology is to bring Kenyan local companies up to international Standards through joint ventures with international companies who are already compliant and certified.

TAKEAWAY: The oil and gas industry cannot reduce or adapt its Standards to accommodate local suppliers. Rather, Kenyan suppliers must elevate their standards to meet those of the industry. To achieve this upgrading of performance, all players must play their part: The industry must provide expertise and development opportunities; the Government must create an enabling environment; and the private sector must invest resources and establish the necessary partnerships to elevate its Standards.

Q4: ATTRACTING FDI AND INTERNATIONAL SUPPLIERS: AN OPPORTUNITY OR THREAT TO THE LOCAL PRIVATE SECTOR?

The final discussion question gained positive momentum when everyone in the room rallied around the idea that FDI and international suppliers bring significant opportunities rather than represent a threat to local companies. International oil and gas service providers bring a wealth of industry-specific knowledge, networks and capital that can be absorbed by the Kenyan economy. It was noted, that in Kenya, FDI has already left a successful footprint in the financial sector; local banking professionals were developed to international Standards through hands-on experience within international banks. Now they represent the local banks that successfully compete with international financial institutions.

TAKEAWAY: F DI, when properly managed, is a vehicle for development because it can bring capital, technology, networks and skills to a country. While international companies have a role to play, it's up to the country to create the necessary environment to facilitate the absorption of these benefits into the economy.

CONCLUDING REMARKS

Dr. Melba Wasunna, Director of the Extractives Baraza, closed the event by highlighting a series of takeaways from the discussion including the importance of compliance to international Standards and the importance of financial discipline; the need for local risk-taking for companies to develop business in the oil and gas supply chain; the importance of partnerships and joint ventures between international and local entities for local content development; the need for an enabling legislative and policy framework that focuses on supporting local businesses to develop capacity and achieve international Standards; the importance of international companies in promoting local capacity development; the need for financing solutions for local SMEs; and a clear call for more stakeholder dialogue with the GoK and Senate.

KEY TAKEWAYS

Every country with a nascent oil and gas industry initially faces the challenge of a skills and Standards mismatch between the incoming global industry and the reality of the local private sector. To solve this mismatch and ensure the country reaps the economic benefits from the oil and gas industry through local private sector participation in its supply chain, all stakeholders must play their role collaboratively. The international companies must contribute to increasing local Standards by sharing expertise and resources; the Government must create an environment that attracts foreign investment and supports local companies to ensure they absorb international Standards; and the local private sector must take risks and make a long-term commitment to investing in elevating its Standards.