



Maximising the contributions of local enterprises to the supply chain of oil, gas & mining projects in low income countries

A briefing note for supply chain managers & technical end users

INTRODUCTION

This briefing note provides supply chain managers and technical end users on oil, gas and mining (OGM) projects in low income countries with practical guidance on maximising the involvement of local enterprises in the project supply chain.

Part One addresses four key questions:

- Why engage local enterprises in the project supply chain?
- How do you define local enterprises and what can they supply?
- What are the key challenges for supply chain managers and technical end users?
- How can these challenges be overcome?

Part Two provides guidance on three major opportunity areas to increase local enterprise participation in the project supply chain:

- Modifying procurement policies & processes
- Modifying contract documentation
- Supporting supplier development

PART ONE

Key questions about engaging local enterprises

Why engage local enterprises in the project supply chain?

Stringent local content requirements are increasingly a feature of the regulatory environment for developing-country oil, gas and mining (OGM) projects, as governments seek to maximize the social and economic benefits from the development of their country's natural resources.

However, many OGM companies are also beginning to recognise the business benefits that can flow from providing opportunities for local people and enterprises. Supporting local economic development by engaging local enterprises in the project supply chain can significantly reduce project social risk¹. Successful outcomes can also enhance the company's reputation with key local government and community stakeholders, which is critical

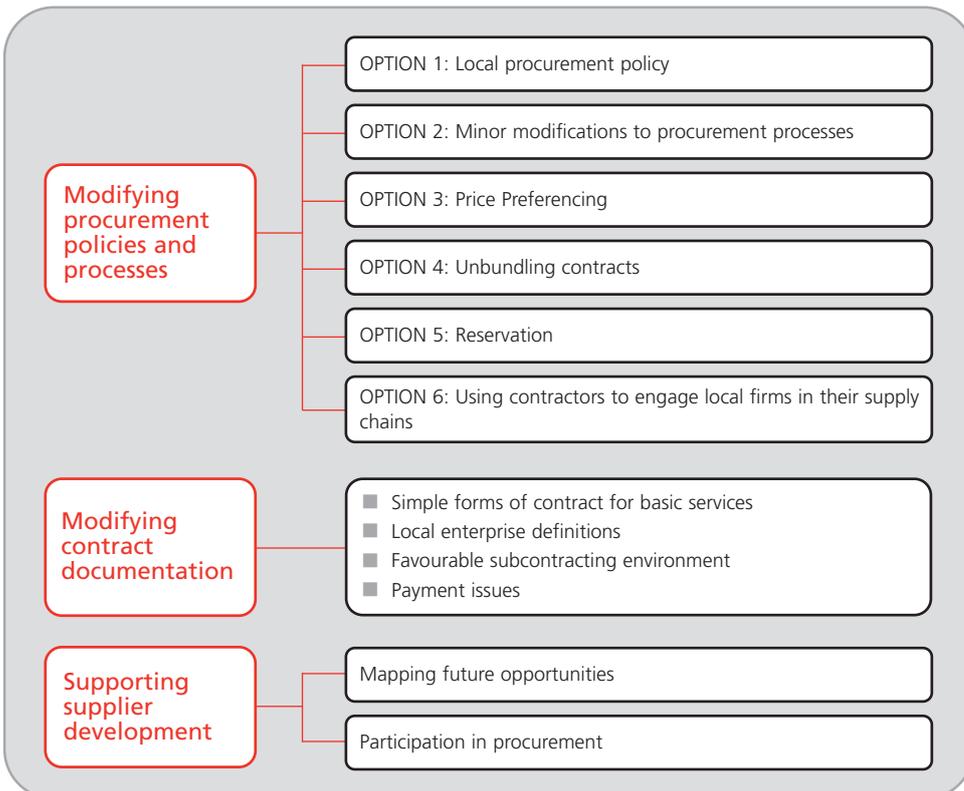
for gaining access to additional reserves and ore bodies.

How do you define the local enterprises and what can they supply?

DEFINING LOCAL ENTERPRISES

Before commencing an analysis of opportunities it is important to define precisely the enterprises that are being targeted for increased participation in the supply chain. These will vary between projects, so a universal definition would not be helpful. However, consideration of the following key factors will help define the target enterprises for any particular project:

- **Regulatory requirements** - Regulatory requirements defined by legislation or the terms of Production Sharing Agreements (or equivalent) may explicitly define local content requirements and the nature of any enterprises covered by these requirements. Regulatory requirements are typically framed in terms of "national" firms, where ownership may be defined by place of registration, composition of key staff or shareholdings.
- **Geographical region** - The project may be legally obligated or choose to target enterprises based within a sub-national region, such as the province within which the project is located or the area immediately adjacent to the project. This approach may be part of the OGM company's strategy to build 'licence to operate' with local project stakeholders.
- **Enterprise size** - The project may seek to target enterprises that are local small and medium enterprises (SMEs). Involving SMEs in the project supply chain is important because of the vital role they play "in promoting job creation and distributing the benefits of economic development more fully"². In some circumstances local firms may be exclusively SMEs anyway due to a lack of significant industrial development. Again, this type of specification may also form part of a licence to operate strategy.



Continued overleaf



WHAT CAN THEY SUPPLY?

For OGM projects in low income countries, the main opportunities for local enterprise engagement are likely to be mainly in the provision of goods and services with the following features:

- Local markets and businesses already exist.
- Technological and capital equipment requirements are low and/or are labour intensive.
- Operational and HSE risks associated with the supply of these goods and services are low.

Table 1 provides an overview of a range of potential basic goods and services in the areas of service provision, construction and trades, and wholesale and distribution. Many of these goods and services would meet the above criteria for many OGM projects.

It should be noted that the supply of these goods and services is often embedded within other larger contracts. For example, a facilities management contract may include basic cleaning, catering, basic foodstuff supply, landscaping etc. To support local supply of these goods and services where this is not already occurring may require modification to procurement and contracting (as explained in Part Two).

IDENTIFYING POTENTIAL ENTERPRISES

It is quite common and to be expected that local enterprises will approach OGM operations to look for contract opportunities. This can provide a simple mechanism for the OGM company to identify local enterprises and collect information about their capabilities. Other identification measures that supply chain managers and technical end users could utilise include:

- **Basic identification measures** - There are a range of simple measures to identify potential local businesses including: contacting local business associations and chambers of commerce; asking local staff; contacting small business support organisations; physically visiting local commercial and industrial areas; tapping into local informal networks; asking existing suppliers to recommend others in different industries³.
- **Collaborate with other OGM projects** - Mutual benefits from developing the local supply chain may be gained from working with other OGM operations in the project area and sharing knowledge of local firms.

Table 1 - Some potential goods & services for local supply in OGM projects

General Services	Construction & Trades	Goods (Wholesale, Distribution, Manufacture)
<ul style="list-style-type: none"> ■ Accommodation ■ Catering ■ Cleaning and laundry services ■ Security ■ Logistics and Warehousing ■ Mailing and courier services ■ Personnel agencies 	<ul style="list-style-type: none"> ■ Small vehicle maintenance ■ Low-voltage electrical maintenance ■ Simple mechanical maintenance ■ Civil works maintenance ■ Air-conditioning maintenance ■ Earthworks ■ Painting and corrosion protection 	<ul style="list-style-type: none"> ■ Pest control ■ Printing and photography ■ Forestry and environmental services ■ Translation services ■ Transportation services ■ Landscaping and gardening ■ Basic professional services (legal and accounting) ■ Telecommunications and data systems ■ Road marking & signage ■ Roofing and waterproofing ■ Sewage, stormwater and drainage ■ Carpeting and floor coverings ■ Fencing and paving ■ Waste recycling and management
	<ul style="list-style-type: none"> ■ Automotive parts ■ Small motor vehicles ■ Fuels, lubes and greases ■ Cleaning supplies ■ Food supplies ■ Uniforms 	<ul style="list-style-type: none"> ■ Furniture and fixtures ■ Laundry equipment ■ Machined tools and spare parts ■ Office equipment and stationery ■ Appliances and electrical goods ■ Construction supplies and hardware

- **Government databases** - Government (or government owned entities) supplier lists and databases may be available and may be used to build a picture of supply capability.

What are the key challenges for supply chain managers and technical end users?

Local SME contributions to the supply chain may be challenging where projects are located in under developed regions. Local businesses may not have necessary skills, experience and management systems

to readily integrate into the OGM project supply chain.

The responsibilities and opportunities for increasing local content of OGM projects rest substantially with the supply chain managers and technical end users responsible for procuring goods and services as part of their area of operations. This applies to both personnel in operating companies and within their major contractors, as these contractors can be responsible for significant proportions of project procurement.

Table 2 - Some inhibiting factors for supply chain managers and technical end users in engaging local enterprises

Inhibiting Factors	Description
Policies and incentives	<ul style="list-style-type: none"> ■ Existing procurement policies and procedures may be generally 'fit for purpose' for conventional project procurement but not be readily suitable for facilitating local enterprise contributions. ■ The benefits of maximizing the contribution of local enterprises may be realized at the corporate or strategic level e.g. through improved relations with the host government. However the immediate costs, effort and risks (see below) may be borne by those responsible for procuring goods and services at the project level.
Knowledge and skills	<ul style="list-style-type: none"> ■ Personnel procuring goods and services may not necessarily be fully familiar with the local business environment and/or have experience with engaging local enterprises in low income country environments.
Cost	<ul style="list-style-type: none"> ■ Initial transaction costs may be higher when engaging local enterprises. This may be perceived as a prohibitive barrier despite potential opportunities to realise cost savings in the longer term.
Time and management effort	<ul style="list-style-type: none"> ■ Engaging local enterprises may require additional management time and effort in the initial instance.
Quality	<ul style="list-style-type: none"> ■ Local enterprises may not readily meet the required quality standards or have the requisite quality management systems in place.
Risk management	<ul style="list-style-type: none"> ■ Engage local enterprises may result in an increase in the actual or perceived risk associated with contracts – on cost, time and quality issues – as well as occupational health and safety (OHS) and environmental performance.
Established supplier relationships	<ul style="list-style-type: none"> ■ Utilising established suppliers may be more attractive when faced with the additional initial effort and costs of identifying new local suppliers.



Table 2 identifies a range of factors which may act as barriers or disincentives. Strategies to increase local enterprise participation need to take these issues into account if they are to be successful.

How can these barriers be overcome?

The analysis in the above table suggests several enabling factors which could assist in overcoming these disincentives:

- **Senior management support** - Senior management commitment and support for local procurement initiatives is essential. This commitment needs to be reinforced where appropriate with policies, processes and modification to employment contract arrangements to establish the appropriate enabling environment for project-level staff.
- **Modifying procurement processes** - Utilising procurement processes present a significant opportunity to overcome some of the barriers to local enterprise engagement, particularly those associated with the key contract deliverables (i.e. cost, time, quality and risk management):
 - Minor modifications can generally be made to the structure of procurement processes to make them more accessible to local enterprises with little or no effect on cost or efficiency outcomes.
 - Procurement strategies can be used to transfer some of the risks and management effort for engaging local enterprises to major contractors. This is an appropriate mechanism where these contractors are in a position to more efficiently manage the process, achieve the required quality outcomes and mitigate the risks. Close coordination between the OGM company and the contractor should be maintained to support the effectiveness of this approach.
 - The use of competitive tendering approaches can use market mechanisms to minimize any cost premium for local supply, as well as any premium for risk and effort transfer to contractors.
- **Knowledge & skills development** - Any knowledge gaps of personnel procuring goods and services can initially be overcome through targeted training and awareness development. Practical experience can then consolidate what is learned.

The second part of this briefing note looks at how these enabling factors can be implemented in practice.

PART TWO

Guidance for supply chain managers and technical end users

This section provides guidance on three key opportunity areas for supply chain managers and technical end users to support local enterprise participation in the supply chain:

- **Modifying procurement policies & processes**
- **Modifying contract documentation**
- **Supporting supplier development**

Many procurement and contracting modifications can be implemented in the short term, focused initially on bringing any suitable or near suitable firms that exist in the local context into the project supply chain. In some instances the use of this approach may be able to generate "quick wins" in terms of increasing local enterprise involvement. Supplier development is generally a longer term process that involves multiple stakeholders. However, these strategies are inter-related and can be synergistic. Some of the key linkages include:

- Making procurement processes more accessible to local enterprises may serve as an efficient "self-selection" process for identifying potential local firms for future supplier development activities.
- Allowing local firms access to the supply chain even if only on basic contracts can be one of the most effective mechanisms for developing the skills and capacities of these businesses.

Modifying procurement policies and processes

The following section presents a range of modification options that can be considered for encouraging local participation in project procurement. These options can be considered individually or in combination.

Option 1: LOCAL PROCUREMENT POLICY

The alignment of corporate policy with local enterprise development objectives can greatly enhance the effectiveness of local procurement initiatives, providing the mandate and guidance to personnel involved in procurement at the operational level. This may involve modification of the organisation's procurement policy or the development of a specific or project-level policy relating to local procurement. Case study one provides an example from the

OGM industry of how a procurement policy can be modified to support local enterprise engagement without compromising core quality and integrity standards.

Option 2: MINOR MODIFICATIONS TO PROCUREMENT PROCESSES

Large client organisations (including governments, government authorities, and large OGM companies) often employ relatively complex procurement processes. While these systems are "fit for purpose" for larger, high value contracts, they may deter or discourage small local firms from bidding for work. The following minor modifications can be made to the structure of procurement processes to make them more accessible to local SMEs:

1. **Communicating future demand** - Use local communication channels to ensure local suppliers are aware of opportunities for involvement over the short and medium term. Communicating the forward demand map allows local suppliers to target pieces of work they have the existing capability for and to make investments to build the required capability to deliver pieces of work in the near future.
2. **Longer contract periods** - Longer contract periods may be desirable in some instances in order to enable emerging businesses to justify the acquisition of capital equipment.
3. **Simplifying tendering procedures** - Any simplification of tendering procedures may benefit all suppliers but can have a larger impact on SMEs. SMEs generally have fewer resources, so any action that renders the procurement process easier and less costly has a relatively larger beneficial effect on them⁵. Longer deadlines for responding to tenders are also of assistance⁶.
4. **Tender documentation** - Tender documentation should be provided in the local language, particularly for goods and services targeted for local supply. The system for announcing tenders and providing tender documents should also be appropriate for local enterprises.
5. **Tender workshops** - Dedicated tender preparation training or workshops open to all prospective bidders can assist bidders in understanding the process and the company's standards and requirements.



6. **Lowering the cost of information** - Lowering the costs of information can lessen or remove a significant impediment to SME participation in procurement processes. In Indian government procurement for example, bid invitations are supplied free of cost to SMEs, and a copy of the bid is also sent to the National Small Industries Association for circulation among SMEs. Copies of drawings and specifications, including those for which procuring entities normally charge a fee, are also supplied free⁷.
7. **Prequalification** - Prequalification is often so onerous and time consuming that local firms are discouraged from participating in procurement. The process could be simplified by using different levels of prequalification for different types of contract, or even post-qualification in some circumstances⁸. All prequalification requirements should be clearly communicated in a manner which is readily comprehended by local enterprises.

Option 3: PRICE PREFERENCING

Preferencing particular companies or groups, generally local firms, in the award of tenders is by far the most common means of implementing local content policies and can be consistently found in public procurement legislation. Preferences for local contractors and suppliers are generally set at 7.5 per cent, 10 per cent or even 15 per cent of the contract price but the selection of the preference level is essentially arbitrary⁹. Effectively, the local supplier will have the preference figure discounted from their tender price thus providing an advantage against external competitors. The advantage of this approach is that it provides direct assistance to local enterprises in securing contracts. However there can be disadvantages to price preferencing particularly in imperfect market conditions where local enterprises may be able to use the subsidy provided by the preference to charge higher than normal prices.

Option 4: UNBUNDLING CONTRACTS

There is an increasing trend within the OGM industry to combine supply requirements into larger (and therefore fewer) contracts. This "bundling" approach can reduce transaction costs and allow procuring entities to take advantage of quantity discounts. The problem with this approach is that it puts local small firms at a disadvantage or may even exclude them

Case Study One:

BHP Billiton's black economic empowerment procurement policy

An example of a "modified" procurement policy in the OGM industry to support local enterprise participation is the BHP Billiton Black Economic Empowerment (BEE) Policy for its South African operations. BEE legislation has been introduced in South Africa to address inequalities created by past history, particularly the exclusion of black South Africans from participating in the country's economy. A key component of this legislation is an obligation for many private companies to preferentially procure from previously disadvantaged black-owned enterprises. The BHP Billiton BEE Procurement Policy sets out clearly how the company will implement BEE procurement measure within its operations. The policy is publicly available⁴ and provides clarity regarding the required performance of suppliers (i.e. no different from the standards required of non-BEE suppliers) but also provides for enabling measures within the companies procurement processes.

The key elements of the policy include:

- BEE suppliers will not be treated differently than the norm with regard to quality, price, expected service level or delivery, safety standards, environmental impact or any other commercial or technical requirements. The current BHP Billiton general procurement policies and procedures will therefore apply.
- Support for small black suppliers may include setting aside for black suppliers only, certain tenders in part or whole. For these categories of spend other business entities will be unable to tender. For other spend categories, where set aside has not been applied, preference will be given to BEE suppliers commensurate with their BEE status.
- In order to supplement the listed approaches to promoting BEE procurement, the following additional mechanisms may be used: Indirect black supplier procurement where the principal contractor / supplier will be required to procure a stated percentage of the contract value from BHP Billiton preferred or approved BEE suppliers; or Joint venture arrangements as a condition of tender where the value awarded to a BEE joint venture partner will equate to the effort required.
- When applying for registration as BEE suppliers, suppliers must provide a statement of their ownership and control. BHP Billiton reserves the right to verify the BEE status of a supplier.

While BEE is a specific issue for South Africa, this policy could be adapted to cover any situation where an objective of policy is to increase purchases from a group who in normal circumstances would have difficulty in securing business.

from procurement processes altogether.

"Unbundling" contracts involves breaking packages of work or supply agreements into smaller parcels that are within the capabilities of targeted businesses to fulfil. The smaller packages may increase the likelihood of local enterprises being able to bid successfully for this work. Thus unbundling provides an opportunity for emerging enterprises to participate as prime contractors, service providers or suppliers, as an alternative to engagement only as subcontractors to large enterprises. This is welcomed as they can find it difficult to establish productive linkages with larger contractors¹⁰. Disaggregation of contracts into smaller pieces can also "encourage greater local competition"¹¹ where there are a number of suitable local suppliers, and may assist in offsetting administrative costs associated with smaller contracts.

Unbundling can be achieved by extracting elements or sub elements from larger contracts that involve goods and services that have been identified as suitable for local supply. These smaller packages could additionally be set aside or reserved for local enterprises (see OPTION 5). Alternatively, contracts may be unbundled along geographical lines when supply is required at several points that are geographically apart. SMEs located at or near the respective supply points may have comparative advantages over enterprises operating from a fixed location. In an OGM context, this approach could be applicable for multi-site operations where access between sites is poor or limited.

There are some potential disadvantages which need to be considered when pursuing an unbundling strategy. These include an additional administrative burden to administer an increased number of



contracts; potentially reduced effectiveness of project coordination and management; inappropriate division of responsibilities; increased contractual risk; duplication of establishment charges; and under utilisation of resources¹². Incentivising major contractors may be a viable and cost effective alternative to direct unbundling. This approach transfers many of the responsibilities to the main or prime contractor who may be in a better position to manage the process effectively (see OPTION 6).

Option 5: RESERVATION

Reservation is where a proportion of contract value or a whole contract is reserved (or "set aside") for execution by local enterprises. The attraction of the set aside option is that it can produce the quickest, most visible gains and can provide an entry point for SMEs into wider participation in project procurement¹³.

An alternative way in which clients may preference particular groups in procurement is by constraining the manner in which the project is delivered. For example, the classification system used in Indonesia and many other countries, constrains the ability of enterprises of certain sizes to bid for work of stated value. In effect, particular sized contracts are set aside for particular groups, and has the effect of reducing the ability of outside contractors to bid. Another example is specifying labour-based construction methods or community contracting which restricts bidding to 'labour based' contractors or to 'community' contractors.

Option 6: USING CONTRACTORS TO ENGAGE LOCAL FIRMS IN THEIR SUPPLY CHAIN

Many larger contractors operating in the OGM industry have experience in meeting local content requirements and expertise in deploying competency development systems and supplier support programmes, as these are part of their core business activities¹⁶. They will frequently be operating 'on-the-ground' with regular face-to-face contact with subcontractors and suppliers, which can facilitate informal and formal skills and knowledge transfer. They may already have established relationships or joint-ventures with local suppliers or subcontractors from previous contracts in the area.

Responsibility for promoting local content and engaging local enterprises can often be transferred to larger contractors and 'pushed down' the supply chain.

Case Study Two: Mozal aluminium smelter project

The BHP Billiton Mozal Aluminium Smelter Project in Mozambique has increased spending with Mozambican enterprises from around US\$6 million per month in 2002 to more than US\$15 million per month¹⁴. One of the key elements of the strategy to achieve this spending increase was the creation of 25 work packages for exclusive tender by Mozambican SMEs. The Smelter now utilises more than 200 Mozambican suppliers¹⁵.

Procurement strategies can be used to transfer some of the risks and management effort involved in engaging local enterprises to major contractors where these contractors are in a position to more efficiently manage the process and achieve the required outcomes. The use of competitive tendering approaches can minimize any cost premium for local supply, as well as any premium for risk and effort transfer to contractors.

Prequalification processes can be used to ensure contractors for major contracts have appropriate capabilities in engaging, subcontracting or partnering with local firms¹⁶. Suggestions for relevant prequalification criteria include:

- Track record of working with local firms (and evidence of the impact of this on these firms' overall marketability).
- Experience of developing the capacity of local suppliers and subcontractors (e.g. HSE systems, cost-efficiency, reliability).
- Experience in enhancing "community content" i.e. employment, skills development, and procurement opportunities for communities directly affected by OGM projects.¹⁷

At the tendering stage, clients also have the option of specifying that potential contractors do one or more of the following in delivering the contract:

- Enter into a joint-venture with a local enterprise; or
- Subcontract portion of the contract to local enterprises; or
- Obtain manufactured articles from local enterprises; or

Case Study Three: Targeted procurement in South Africa

Targeted procurement, as developed in South Africa, can be used to require joint venture formation between large contractors and SMEs, or to encourage subcontracting arrangements. Advocates of targeted procurement see it as an effective methodology for establishing new business linkages, particularly between large and small businesses¹⁸. Targeted procurement is a system of procurement that provides employment and business opportunities for marginalised or disadvantaged individuals and communities (referred to as "target groups"). It enables social objectives relating to these target groups to be linked to procurement in a fair, transparent, equitable, competitive, and cost effective manner¹⁹. Targeted procurement gives preferences at the bid evaluation stage to firms offering participation by the targeted groups over and above that required by the minimum goals. This provides incentives to contractors to innovate in local enterprise development. It effectively requires prime contractors to unbundle their contracts into smaller contracts and to procure the services of small scale enterprises to perform such contracts and to administer them²⁰.

In South Africa, the implementation of targeted procurement produced a quantum increase in procurement from disadvantaged groups very soon after its implementation at a very low cost premium. The market share of small businesses that were owned, managed and controlled by black people increased from approximately 2.5 per cent of the Department of Public Works budget immediately prior to implementation, to 22.3 per cent after the first nine months of implementation, and to 32.4 per cent in its third year of operation. This substantial increase in local participation only incurred a direct financial premium (i.e. the difference in price between the lowest responsive offer received and price of awarded tender) of less than 0.67%.

For more information see www.targetedprocurement.com.



- Obtain supplies and materials from firms which are local enterprises.

In some under-developed regions, direct specifications may not be fully feasible. In these instances it may be possible to set up the tendering process to preference large contractors that develop innovative approaches to maximising local enterprise involvement. Case study three presents an example of a procurement system designed to encourage innovation from contractors. Case study four presents an example of the type of innovative approach that contractors can develop given the right incentives.

Modifying contract documentation

GENERAL CONSIDERATIONS

Social objectives (such as increased local content) should preferably be included in the contract specification, rather than as conditions of contract. It is increasingly understood that it is very difficult to write unambiguous secondary objective conditions of contract that clearly state what contractors have to achieve. By including secondary objectives in the specification, the client is able to clearly define the objectives and the benchmarks the contractor has to meet. By linking the benchmarks to payment, it will provide an incentive to the contractor to deliver the objectives.

Where modifications to contract clauses are considered the following key points should be taken into account²²:

- Avoid making changes or alterations to general conditions of contract.
- If additional clauses are to be added they should be included under 'special conditions' or equivalent.
- If new clauses are inserted which have not been used before in similar circumstances, it is important to ensure there is no ambiguity with the general conditions or other special conditions.
- While contractual clauses often state an 'intention' to do something, there will typically be a need for the client and contractor to identify in detail in the specification what is to be done. This is important in ensuring the contractor understands the requirements and so that they can be accurately costed where necessary and monitored for compliance.

SIMPLE FORMS OF CONTRACT FOR BASIC SERVICES

Many of the opportunities for local enterprises are typically basic services that

Case Study Four: Contractor innovation in local content delivery in Timor Leste²¹

The Clough AMEC Joint Venture (CAJV) is one of a growing number of global oil and gas engineering services firms pursuing a long-term regional business development strategy based in part on delivering higher standards of local economic and social performance. The CAJV bid for the first Operations and Maintenance Services for the offshore assets of ConocoPhillips' Bayu-Undan Project, the first major oil and gas development in the Timor Sea. CAJV's business strategy is to position themselves as leading contractors in the region offering engineering services to ConocoPhillips and other operators of future developments in the Timor Sea, which is likely to see billions of dollars of investment in the next 10-20 years.

Timor Leste is one of the poorest countries in Asia. Its main oil and gas resources are located in the Joint Petroleum Development Area (JPDA) between Australia and Timor Leste. The Production Sharing Contracts administered for the JPDA specify that Timor Leste employees and businesses are to be used preferentially where possible to support developments in the JPDA. However, the lack of local capacity and the presence of established oil and gas support bases in Perth and Darwin in Australia represent strong inhibitors for the growth of a domestic support industry in Timor Leste.

In bidding for the Bayu-Undan contract, the CAJV identified the following drivers in the local commercial context:

- Timor Leste Government is seeking to maximise the local employment and commercial content through both the oil companies operating in the JPDA and the oil companies' major contractors.
- ConocoPhillips is seeking to satisfy the aspirations of the Timor Leste Government within the technical and safety requirements of the project, in order to maximize their opportunities to secure additional exploration and production acreage.

The CAJV bid document contained an innovative proposal for the staged development of a common user support base (CUSB) in Timor-Leste. The CUSB proposal entails a facility located on a single site, providing a range of commercial services: fabrication and machining services, office leasing services, warehouse storage, training facilities, utilities services (electricity, water supply, telecommunications, waste disposal) and lifting and freight services. The overarching aim of CUSB is to engage the local and permanent residents of Timor-Leste in a sustainable long-term business with potential for growth beyond the current needs of the Bayu-Undan Project. Part of the proposal was to utilise a multi-sector partnering approach to use the support base as a mechanism for developing the capacity of local enterprises to support oil & gas developments in the Timor Sea.

The CAJV developed this proposal through aligning the identified drivers with the delivery of the technical requirements of the contract scope of work. Despite highly competitive bidding for the contract (worth approximately US\$40M over three years), this innovative proposal was a material factor in the CAJV securing the contract.

are provided on a term basis. Many standard forms of contract are complex and may be unsuitable or onerous for managing this type of service. Complex contracts may also be problematic in under-developed areas where literacy may be an issue for some small business owners. Often organisations hiring basic services do not use a contract to avoid the effort required to generate one, instead paying on invoice from the service provider. This can expose the organisation to the consequences of having to rely on local legal systems should problems arise. Simplified contracts still need to include basic elements (i.e. form of offer and

acceptance; contract data; conditions of contract; pricing instructions; price list; pro forma task order; and client's scope of work template²³) but should have fewer options and be written in simple terms in the local language.

TARGET ENTERPRISE DEFINITIONS

Once the enterprises to be targeted are identified (as discussed in Part One), a clear and unambiguous definition must be provided for inclusion in tender and contract documentation. This will typically require specification of key characteristics of the enterprise (e.g. size, ownership) or a target area or both. This is an important



consideration due to the problem of token organisations or ‘fronting’ where enterprises make false or misleading claims about their true nature in order to win business. Case Study Five gives some examples of definitions from the Construction Industry Development Board (CIDB) in South Africa.

ESTABLISHING A FAVOURABLE SUBCONTRACTING ENVIRONMENT

Subcontracting is obviously one of the most effective means of involving local enterprises in procurement activities. However there are problems that arise due to the unequal negotiating power with prime contractors. A favourable subcontracting environment can be created by regulating the type of contract which a lead contractor is permitted to use in the engagement of targeted business, and by providing for secured payment. These subcontracts should not contain any of the following contractual provisions:

- Conditions that are more onerous than those in the prime contract;
- Rights given to the prime contractor without recourse to adjudication in the event of a dispute;
- Payment procedures based on a pay-when-paid, or pay-if-paid, system;
- A dispute resolution procedure that does not include inexpensive dispute resolution procedures;
- Unreasonable retention percentages and periods of retention; and
- A requirement for a surety for smaller subcontracts²⁵.

APPROPRIATE PAYMENT REGIME

Payment issues are particularly important for many enterprises in low income countries. It is common in many contracts in public and private procurement for payment to be required within 30 days (up to 90 days in some cases), a condition which may severely stretch many small enterprises. Delays in payment can further reduce the available working capital of SMEs and can severely affect their production capacity and profitability - in some instances late payment can be ‘life-threatening’²⁶. Options to address this issue include:

- **Structuring of Contract Milestones** - Contracts can be designed with milestones that allow for more frequent payment to ease liquidity problems of local companies²⁷.
- **Early Payment** - Clients may make provision for early payment. For

Case Study Five: Defining target enterprises in tender & contract documentation

The CIDB have produced a detail suite of specifications for defining a local and/or a small or medium enterprise²⁴. These definitions are designed to be used to support targeted procurement (see Case Study Four). Some of the elements are country specific; however the language and structure could be readily adapted for other applications.

Local Enterprise	An enterprise which has its sole office or head office located within the target area. It is incumbent on such enterprises to demonstrate their claims to such area-bound status on the basis of occupancy and the conducting of business operations from such offices. Indicators of compliance shall include payment of rentals for premises and payment of service charges, levies, rates and taxes to the local authority located within the targeted area.
Size of Business	Defined in terms of the following quantitative indicators: <ul style="list-style-type: none"> ■ total full-time equivalent of paid employees ■ total annual turnover ■ total gross asset value (excluding fixed property)
Management Control	The possession and exercise of legal authority and power to manage the assets, goodwill and daily operations of a business and the active and continuous exercise of appropriate managerial and financial authority and power in determining the policies and directing the operations of the business.
Separate and Distinct Business Entity	An enterprise which is free of any significant degree of direct or indirect Ownership, or Control, by any business which engages in similar business activities. Indicators of control shall, without limitation, include interlocking management or Ownership, common Principals, identity of interests among family members, shared facilities and equipment, or common use of employees. A business will not be considered to be a Separate and Distinct Business Entity should another business or a Principal of another business which engages in similar business activities owns more than 20% of the equity in that business.
Owner	A person who has all the customary incidents of ownership, including the right of disposition, and sharing in all the risks and profits commensurate with the degree of ownership interest as demonstrated by an examination of the substance, rather than the form of ownership arrangements.

example, the BHP Billiton BEE Policy allows for early payment (15 days after receipt of invoices) and also for financial assistance in acquiring materials²⁸.

Supporting supplier development

In many areas, substantial increases in local enterprise participation in the supply chain will not be possible without dedicated efforts to develop the skills and capacities of local enterprises. In the context of OGM projects, supplier development programmes will typically be managed by external parties or dedicated internal units. It is unlikely that contract managers would initiate a stand-alone programme or consider assisting businesses with clearly inadequate capacity. However, supply chain managers and technical end users will always be a key component of the

success of these programmes and will benefit directly from their outcome.

The following sections look at two key opportunities to support supplier development activities.

MAPPING FUTURE OPPORTUNITIES

Identifying suitable opportunities for supplier development requires the detailed input of the future end users of these goods and services within the OGM company and their major contractors. End user input is necessary to create an accurate and detailed map of the forward-demand of goods and services, and to establish the criteria for assessing which goods and services are prospective for the development of local supply capacity. Supplier development activities can then be focused in these appropriate sectors and sub sectors.



DEVELOPMENT THROUGH PARTICIPATION IN PROCUREMENT

Participation in procurement is essential for SMEs to acquire knowledge, information, skills, experience, technology and management capabilities²⁹. Exposure that results from completing a contract, even if the contract is small, will give local enterprises a much better understanding of what is required for successful completion of OGM contracts. This is one of the advantages of using procurement-based measures such as set asides which can initiate this participation, even if it is initially at a small scale.

Once local firms are involved in delivering contracts, there may be opportunities for supply chain managers and technical end users to assist local enterprises which are 'almost there' i.e. only requiring marginal development to become successful suppliers. These types of organisations may be best assisted by basic guidance provided by in-house resources, rather than through a formal supplier development program. An example of this type of supplier support is presented in the case study opposite.

Conclusion

This briefing note focused on the critical role of supply chain managers and technical end-users in engaging local enterprises. These personnel will typically face pressures in their roles that may act as a disincentive to engaging local enterprises. However the briefing note has demonstrated a range of enabling measures that can facilitate the achievement of local enterprise participation, particularly through the modification of procurement processes and documentation.

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Case Study Six: Amec oil & gas supplier development (the Philippines)³⁰

AMEC is the primary operations and maintenance contractor for the Shell Malampaya Gas to Power Project in the Philippines. One of their largest sub-contractor firms is a local catering company. The caterer is responsible for delivering high quality foodstuffs to the offshore platform as well as managing the on-shore rest and recreation facility for rig workers. The high monetary value of the contract (approximately USD \$1 million) combined with the high commercial risk associated with delivering quality foodstuffs to the offshore platform, means the contract is considered by AMEC as 'high value & high risk' and as such, monitored closely.

In 2002 - 2003 AMEC's monitoring systems and audit identified a gap between existing company performance and the international quality standards required. This gap was in part explained by the nature of the caterer's recent growth through the acquisition of other businesses. The pace of growth was not matched by implementation of policies, systems and procedures to safeguard quality through all parts of the expanding business. Working in partnership with the caterer's management team, AMEC developed a remedial action plan designed to systematically improve performance as well as develop systems for continuous improvement. The steps detailed in the action plan closely mirrored the minimum standards for Health, Safety, Environment & Quality (HSEQ), as determined by the client, Shell Petroleum Exploration (SPEX).

With support from an AMEC sub-contractor 'focal point', the caterer steadily worked through the HSEQ management checklists and in a one-year period moved from an 'on paper' commitment to HSEQ, to a more embedded understanding of HSEQ and thorough application across its activities. To compliment and reinforce progress in mainstreaming international standards for HSEQ, AMEC assisted the caterer to develop a HSEQ manual, drawing heavily on AMEC's knowledge and experience of best practice in this area.

According to the Caterer's senior management, the AMEC contract has not only been financially significant for the company (representing over 50% of its total business in the Philippines) but has also delivered important longer-term additional benefits. Through the capacity building support provided by AMEC, the caterer has been able to demonstrably enhance performance in all areas of operation and improve efficiency. The growth in its professionalism and maintenance of its long-term partnership with a leading engineering firm has enhanced its business credibility and contributed to its ability to successfully bid for foodservice contracts with other international and Philippine companies, including catering services to a leading mining company and to Philippine hospitals.

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