Local Value Creation

Maximising resilience in a time of uncertainty

Part 2: Integrating localisation into public sector procurement

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PwC Middle East's **Local Value Creation** series aims to provide a clear localisation framework to government decision makers and stakeholders throughout the Gulf Cooperation Council (GCC) countries for designing, implementing, and managing their countries' national localisation agendas. Through a series of papers that breakdown and explain each component of PwC's Localisation Framework, we will lay the groundwork for the design of localisation programmes from top to bottom, covering the complete value chain from conceptual design to implementation across the public sector.

In the first edition of the series, we focused on defining the localisation vision as a first step of designing a successful localisation programme. We discussed the localisation imperative for the GCC countries and explained how governments can identify the key strategic objectives of their localisation programmes and build a localisation formula that allows them to stimulate value creation and capabilities development in key areas of strategic importance.

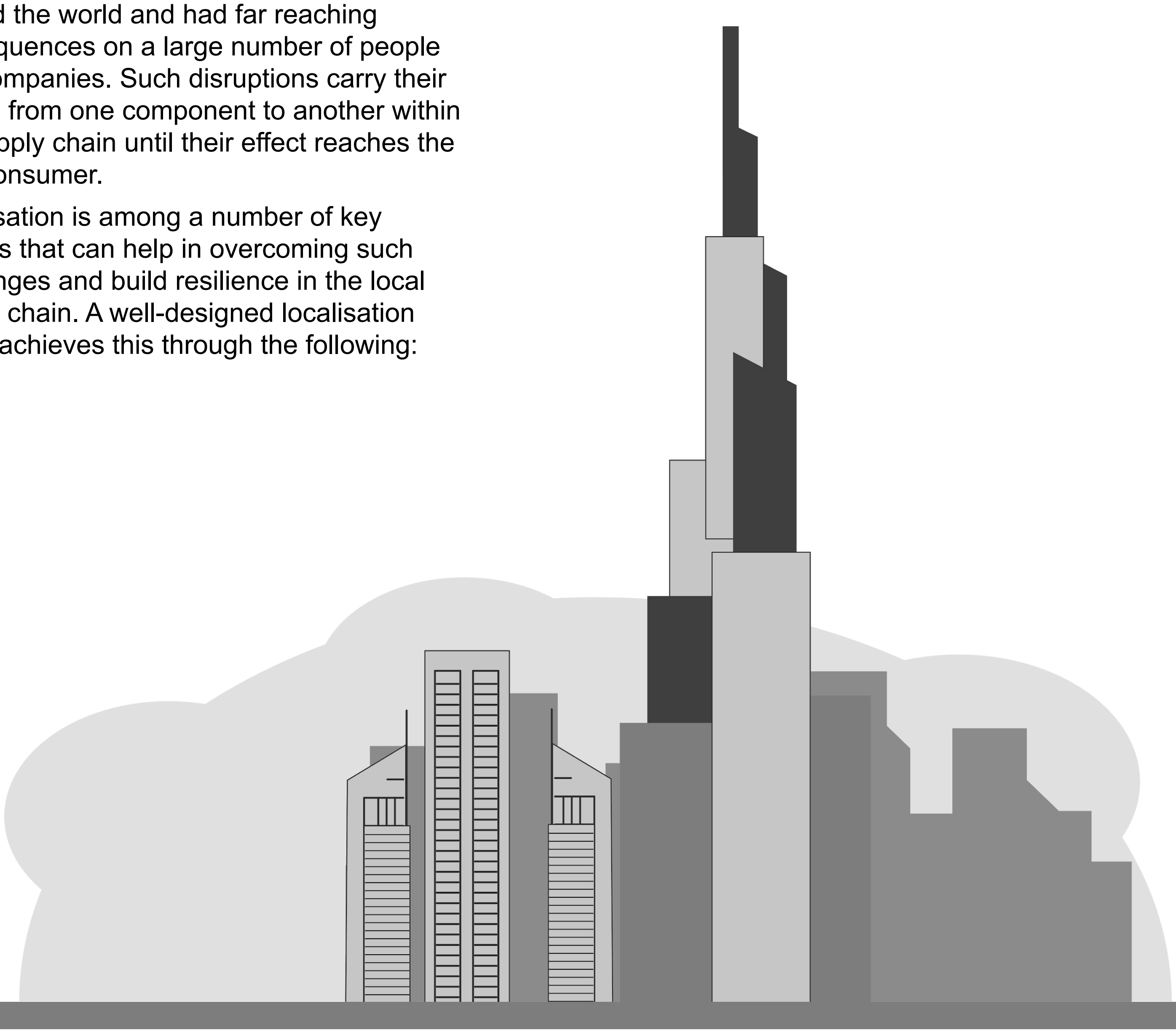
In this edition of the **Local Value Creation** series, we will shift our focus to the operational side of localisation; namely, Procurement Integration. We aim to provide the reader with a clear guide on what sectors stand to benefit the most from localisation, and how to achieve localisation objectives through the integration of the associated policies into public sector procurement.

Background

Supply chain resilience constitutes a key strategic objective and a national security concern for all countries. It is even more critical for resource-rich nations that are highly dependent on imports such as GCC countries. Supply chain risks can impact all stakeholders in the business cycle: the organisations, suppliers and customers. From the point of view of business continuity and risk management, it is important for governments to study the supply chain end-to-end to identify weaknesses and expected risks and be proactive when developing risk management strategies and crisis response plans.

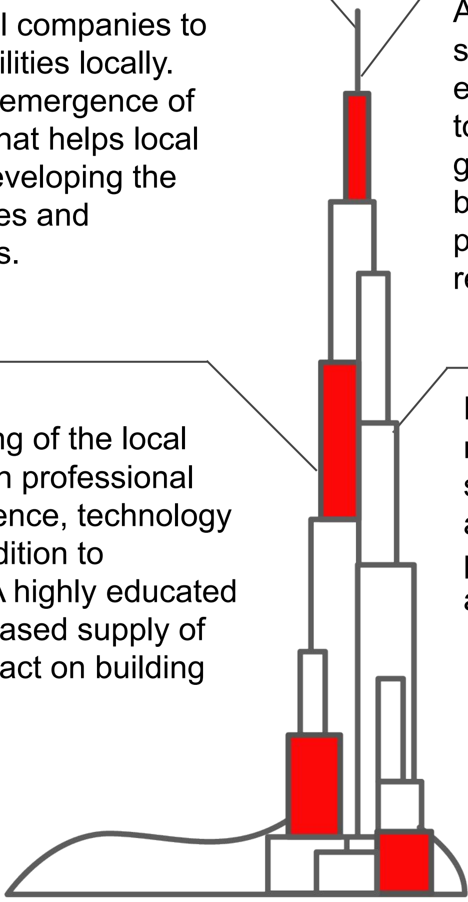
The increasing global interconnection and trade, disturbances caused by natural disasters, pandemics, man-made events, and economic turmoil and risks have further weakened supply chains. Events such as the SARS outbreak in 2003, Japan's Fukushima nuclear disaster in 2011, and more recently the COVID-19 pandemic in 2020 drew the attention to supply chain dependencies around the world and had far reaching consequences on a large number of people and companies. Such disruptions carry their effects from one component to another within the supply chain until their effect reaches the final consumer.

Localisation is among a number of key policies that can help in overcoming such challenges and build resilience in the local supply chain. A well-designed localisation policy achieves this through the following:



Enacting policies that facilitate and encourage local companies to reduce their import dependence and incentivize international companies to move some of their facilities locally. This contributes to the emergence of an effective economy that helps local companies focus on developing the necessary competencies and competitive advantages.

Assisting in the development of local suppliers. This in turn contributes to establishing a knowledge base and helps to stimulate innovation through access to goods and materials locally, as well as better coordination, dissemination of best practices and the ability to share resources between local suppliers.



Supporting the upskilling of the local workforce; especially, in professional disciplines such as science, technology and engineering, in addition to managerial positions. A highly educated workforce and an increased supply of skills have a major impact on building knowledge economy.

Promoting research and development to reduce costs, improve productivity and secure technological advancements. This accelerates the development of local products, as well as, enhances innovation and local capabilities.

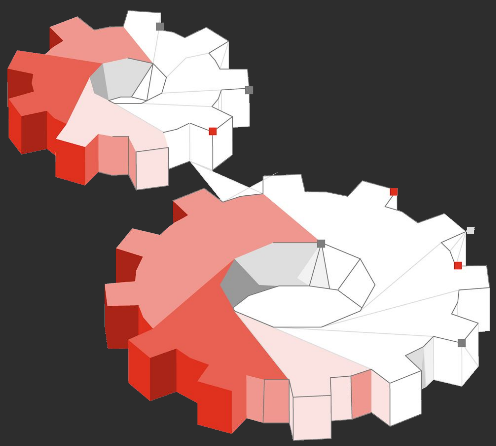
Countries with well-designed policies for managing supply chain risks proactively will be better positioned to identify the impact of destructive events on supply chains allowing them to assess how best to respond to such matters in a quick fashion. This ultimately leads to achieving their sustainability goals, reducing the likelihood of supply chain risks, as well as, building a more resilient economy.

In the short and medium terms, GCC governments and organisations need to rethink their business models and put supply chain risk management as a top priority. Localisation, digital transformation and diversification of the supply base are some of the key initiatives governments can undertake to improve their supply chain resilience. While some of these changes may require investment, they are often compensated for by the savings achieved through improving production and shifting the balance of demand towards the local market.

Responding to COVID-19

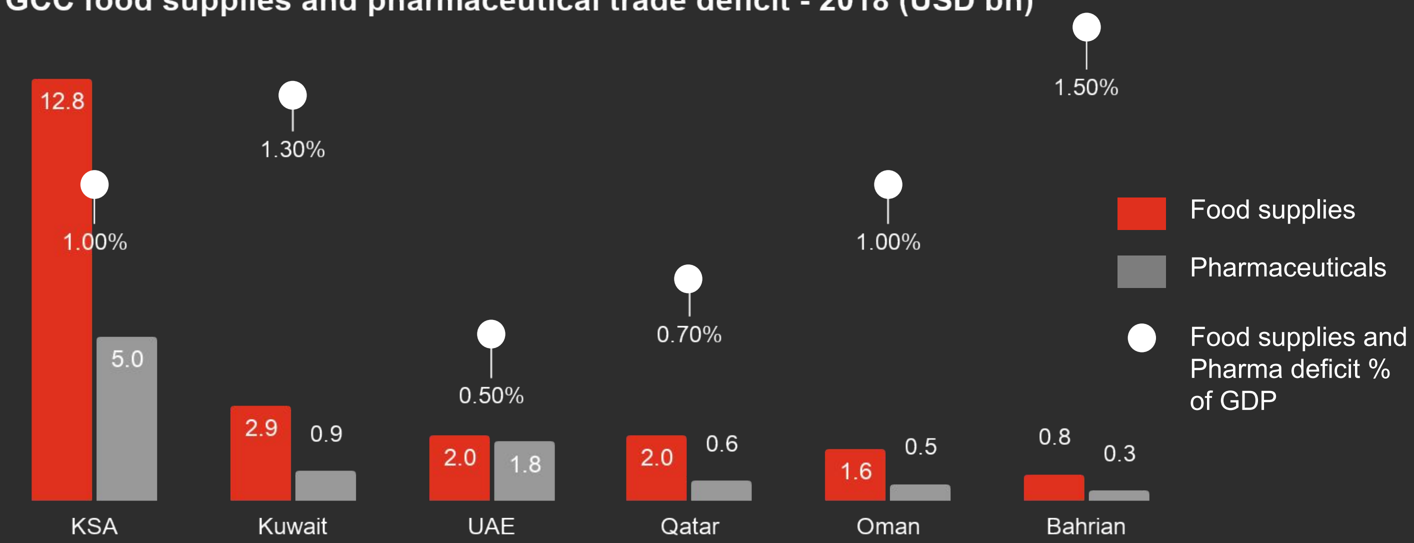
The emerging COVID-19 pandemic has forced factories around the world to slow down or halt production. This has disrupted global production and supply chains which provides countries with everything from construction materials to medicine and food.

Part of the problem is that today's supply chains are not diverse enough. Certain commodities and products are highly concentrated in a few countries, sometimes in few cities or even with one company. Since the 1980s, more and more of the global production has moved to Southeast Asia, and specifically China, which accounted for 28%[1] of the global manufacturing output in 2018. This has proved to be effective in reducing the cost of production, but has significantly increased the exposure of other countries to long transportation times, increased volatility, and supply chain risks stemming from crises such as COVID-19.



For countries in the region the dilemma is even worse. GCC countries are significantly dependent on imports to secure most of their essential needs, including pharmaceuticals and food supplies. In addition to the cost-effectiveness being a reason, the high dependency on imports can be attributed to the relatively recent focus on policies that encourage local manufacturing and production, shortage of workforce with relevant education and experience and the need for local suppliers development to compete with global ones.

GCC food supplies and pharmaceutical trade deficit - 2018 (USD bn)



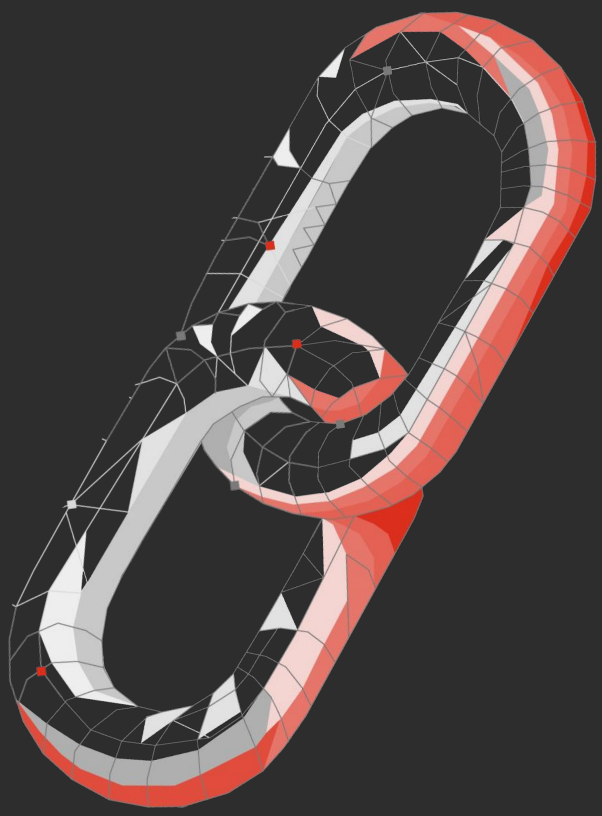
Source: Observatory of Economic Complexity (OEC), IMF, PwC Analysis

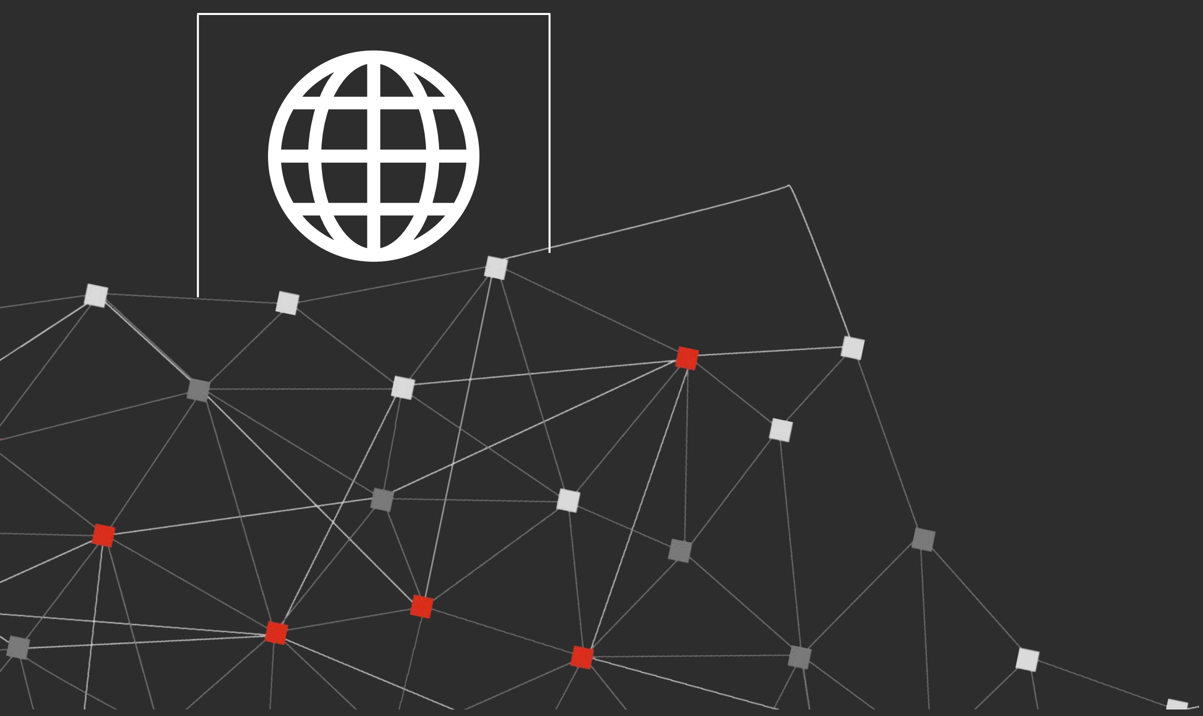
[1]Source: United Nations Statistics Division

The pandemic has hit some of the key sectors in the region including oil and gas, tourism, hospitality, construction, and retail. More importantly, COVID-19 has shown that food security and pharmaceutical industry's dependence on imports are still major issues for GCC countries as they remain exposed to price and supply shocks, as well as border closures.

COVID-19 underscores GCC countries' need for a sustainable recovery. The need is now more urgent than ever for investments in localising more of the supply chain in various vital sectors enabling them to face various geopolitical and economic challenges worldwide. Having the production inputs and finished goods available locally to face unexpected risks, instead of relying on imports, require local manufacturing capabilities and know-how which localisation programmes aim to build.

Although its long-term consequences have not yet emerged or been understood, COVID-19 offers GCC governments some valuable lessons on how to deal with such large-scale crises and how to be better prepared for similar challenges in the future through various strategies; localisation being one of them.





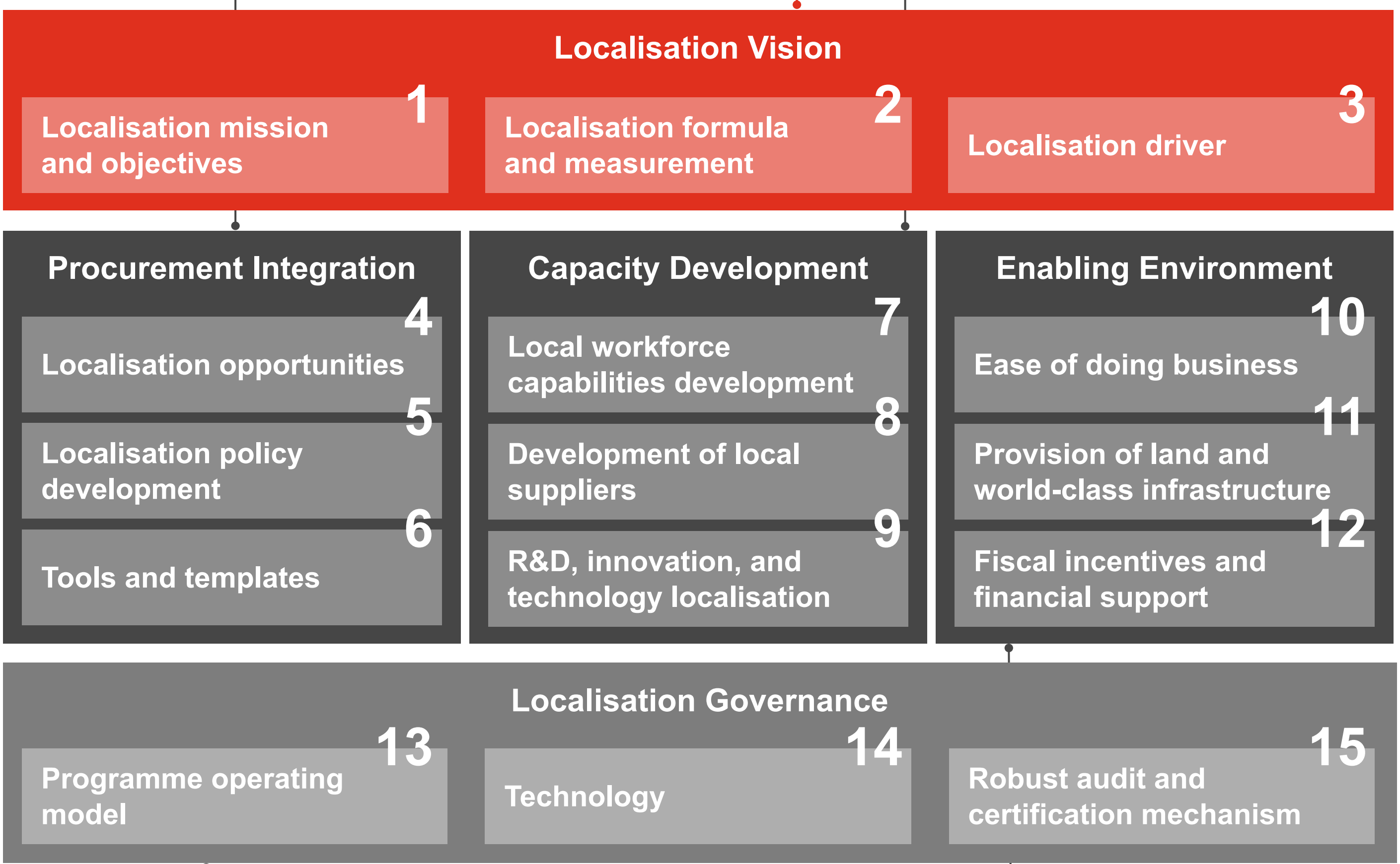
PwC's Localisation Framework

We have designed a localisation framework to help government officials and decision makers drive localisation across the public sector. The framework consists of the key elements required to execute a successful implementation strategy, including the following components:

Localisation Vision: A clear, unified localisation vision and strategy, identifying the strategic focus areas and targets, along with a formula tailored to each country's unique social and economic objectives.

Procurement Integration: An analysis of localisation potential across the public sector's procured goods and services categories, including design of a mechanism to incentivize procurement of local goods and services, and development of the tools and templates required.

Capacity Development: Initiatives to build the skills of the local workforce and develop the capabilities of local suppliers.



Localisation Governance: Development of the localisation governance model, enabling technologies, and monitoring and evaluation approach.

Enabling Environment: A host of policies and initiatives that seek to improve a country's business environment and enable localisation, including fiscal incentives, ease of doing business, and infrastructure.

Integrating Localisation Into Public Sector Procurement

The following sections of this edition of PwC's Local Value Creation series will focus on the second component of the Localisation Framework; namely, the Procurement Integration. The Procurement Integration answers the decision-makers' question on what to localise and provides the policy that outlines the operational changes required for a successful implementation of a localisation programme. It entails several elements including the identification of localisation opportunities, development of the localisation policy and designing the required tools and templates.

1. What should GCC governments localise?

As resource-rich countries began to discover and extract vast amounts of valuable commodities from beneath their soil, policy makers in these countries have looked for ways to best utilise these finite resources and create lasting economic value to their nations. The use of a localisation policy to retain value in-country is hardly a new concept, as most of the oil producing countries around the world have developed local content policies of some sort. In the case of GCC countries, however, the introduction of such policies is more recent and is primarily focused on the Energy sector due to its large share of the local economies and the employment potential it has.

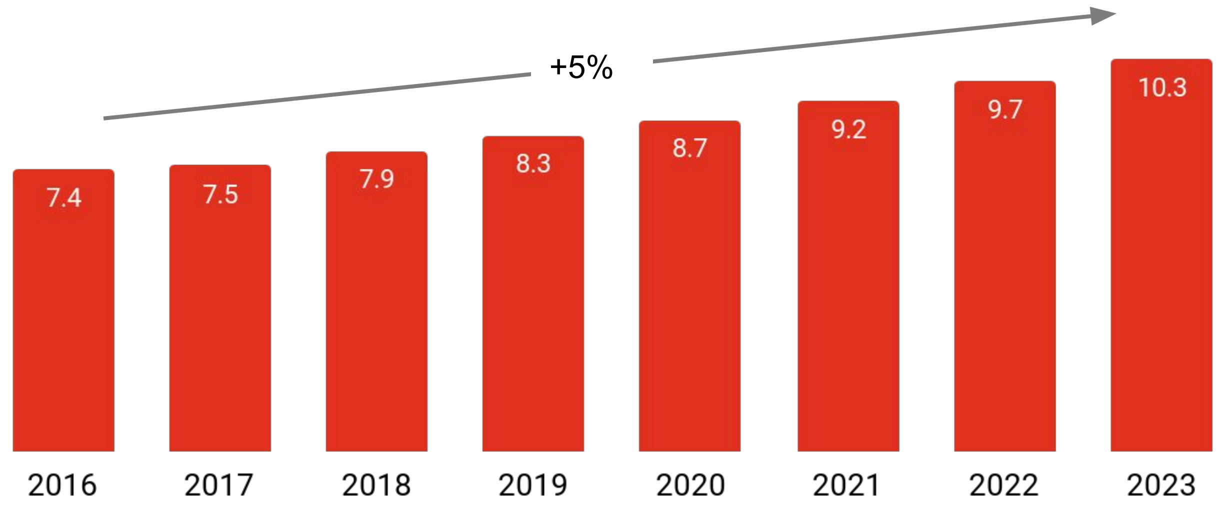
As governments now aim to extend their localisation agenda to include other sectors, a critical question arises: what should GCC governments localise? To answer this question, policy makers must determine the criteria for selecting the right sectors to focus their localisation efforts on, identify the potential opportunities within these sectors and define the key players that will support the implementation of the localisation policy.

Selecting the right sectors to localise

The process of identifying the right sectors to be localised will be unique to each country's national and strategic objectives, economical mix and persistent development needs. To be able to pinpoint the right sector to localise, a well-structured approach that takes into account the unique characteristics of each country against a set of criteria elements, should be used. In this section, we will list few of the key elements to be considered, and we will use Saudi Arabia and the pharmaceutical industry as an illustrative example.

1. **Sizable market:** Market size is a key element when evaluating which sectors the country will benefit the most from localising. Bigger market size provides higher potential spend to be retained in-country and better return on investment as a result of implementing a localisation policy. For example, Saudi Arabia's pharmaceutical sector is estimated at around USD 8.7bn and expected to exceed USD 10bn by 2023.The size of the sector, coupled with the expected growth fueled by population increase and high healthcare standards will bring in large gains when localised.

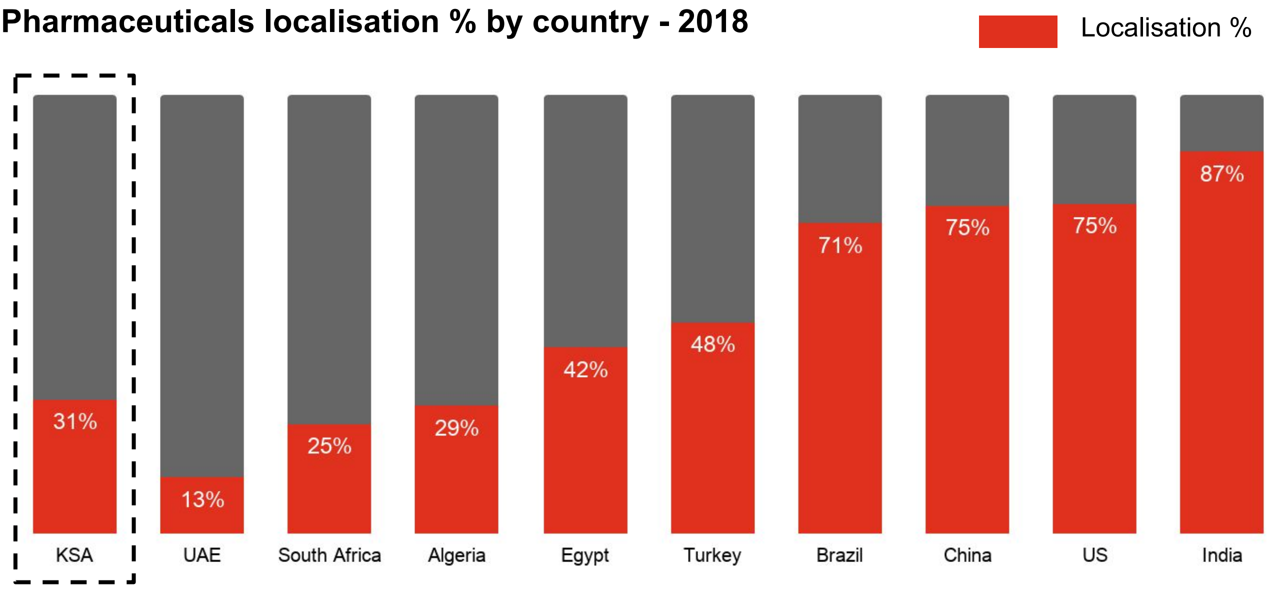
KSA pharmaceuticals market size (USD bn)



Source: BMI

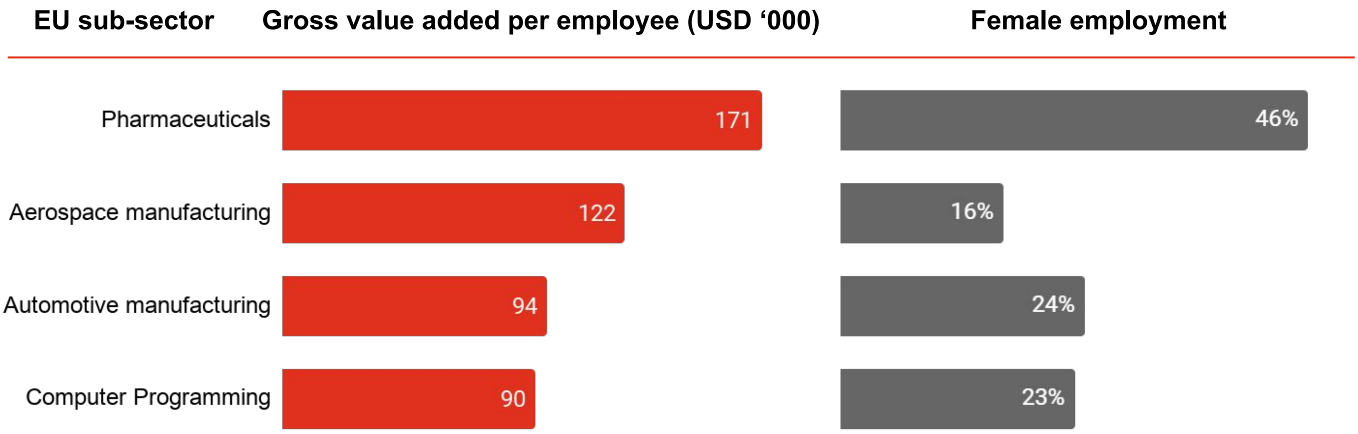
2. **Potential localisation levels:** Another critical factor in determining the right sector is its potential for localisation. Governments should benchmark the current localisation level of the targeted sector against regional and global countries with similar characteristics to identify potential localisation gains. For instance, Saudi Arabia imported close to 70% of its pharmaceuticals needs in 2018. This reveals a clear opportunity for Saudi Arabia to localise such a key sector and capitalise on other countries' experiences for lessons learned and to avoid their pitfalls.

Pharmaceuticals localisation % by country - 2018



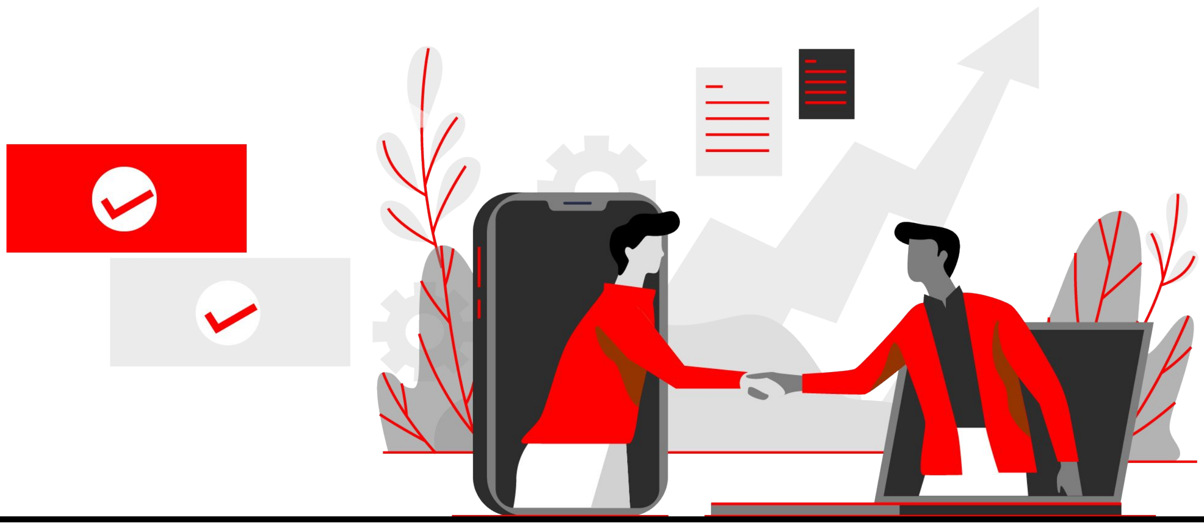
Source: IQVIA, OEC, PwC Analysis

3. **National vision and objectives:** As discussed in the first edition of the series, there are various strategic objectives present in many GCC countries such as enhancing economic resilience and self-sufficiency, diversifying the economy, building local workforce capabilities. These objectives should be considered when deciding and prioritizing sectors to localise. For example, some of Saudi Arabia's Vision 2030 key objectives are the creation of a diversified, self-sustaining economy that provides jobs for Saudis, as well as, increase the proportion of women in employment from the current level of 22% to 30% by 2030. Continuing on with the same example, pharmaceuticals could help Saudi Arabia meet these objectives due to its higher gross value-added per employee and higher gender balance compared to other key industries. The charts below show the pharmaceutical industry's contribution to the economy and female employment across the EU in 2016, compared to other industries.



Source: PwC Analysis

4. **National security:** National security plays an important factor when deciding on which sector to localise. Countries should look at protection against cross-border supply chain threats such as pandemics, geopolitical risks, bankruptcies, natural disasters, terrorism attacks, etc. The COVID-19 pandemic was a wake-up call for supply chain functions and exposed many organisations' reliance on imported products and services. As illustrated in the examples above, almost 70% of the pharmaceutical products in Saudi Arabia are produced overseas, which presents a national security threat in a time of crisis. Focusing on localising vital sectors, such as pharmaceuticals, plays a key role in achieving a country's national security goals and protecting it against these threats.



Identifying potential localisation opportunities

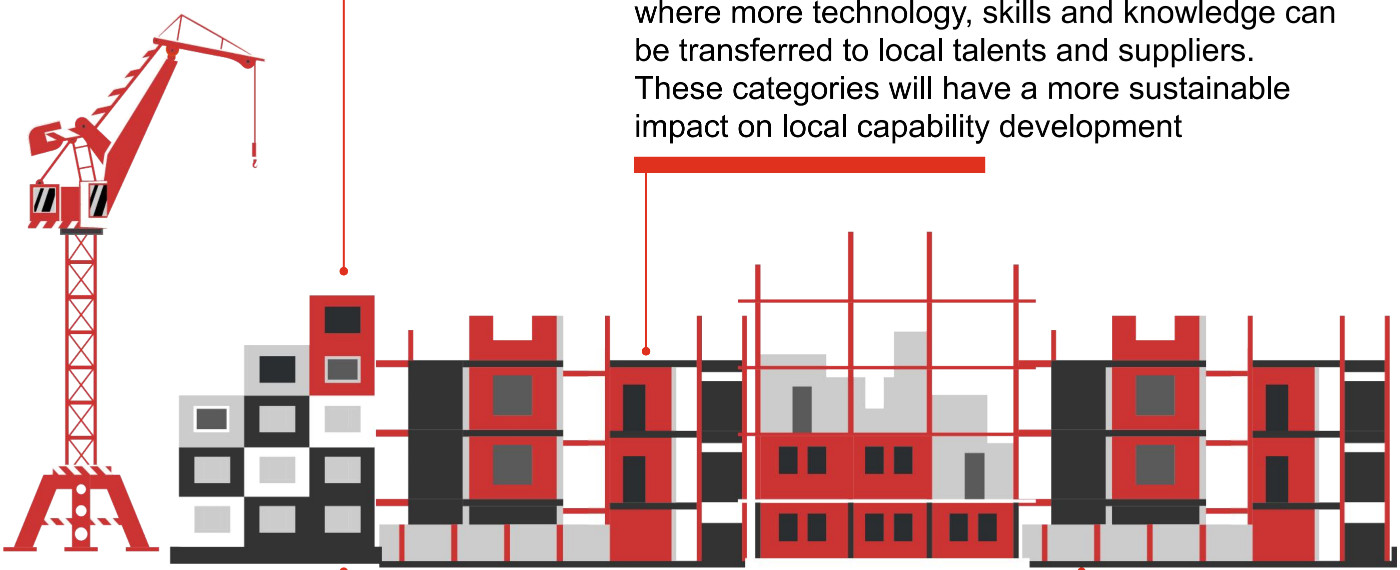
Once the right sectors are selected, the next task is to focus on identifying the potential opportunities for localisation within these sectors. Policy makers aim to identify sub-sectors and categories that will yield the highest gains when localised, either due to their criticality to national industries, availability of required resources in the country or the competitive advantage that the country has to facilitate successful related ventures.

The first step in identifying localisation opportunities is to conduct a spend analysis for the sector. Doing so will help the localisation driver gain insights on areas where the biggest spend happens and assist in breaking the spend down into defined categories. Accordingly, the categories that currently receive the most spending, and are likely to continue to do so in the future, are targeted because of their bigger potential impact on the economy and higher returns on investment.

These goods and services categories will then be prioritised against a carefully designed criteria in order to identify and select those with high localisation potential. Some of the criteria elements to consider are:

Impact on economy: prioritise categories that will have the broadest impact on the country's economy as a whole

Transferable know-how: prioritise categories where more technology, skills and knowledge can be transferred to local talents and suppliers. These categories will have a more sustainable impact on local capability development



Labor intensity: prioritise categories that provide high-skill jobs and thus can have an important impact on local employment

Capital requirements: prioritise categories that have the high capital requirements and ROI, as these bring larger foreign investments and retain local capital

Then, a competitive assessment for suppliers for the targeted categories will be conducted to identify the number of relevant local suppliers, their current and projected capabilities and their financial capacity. The assessment should detail the specific challenges faced by these suppliers when operating in the country to highlight the current gaps and design the right incentive schemes.

Finally, a supply and demand analysis for the identified goods and services categories is crucial to analyze the current and projected market dynamics. This will help in identifying the size of the market and the feasibility of the localisation initiatives related to the said categories.

Defining key players

To succeed in implementing the policy and maximising the localisation of the selected sectors, it is important to choose the right localisation driver[1], as well as the partners who will sponsor the planned initiatives and support the implementation of the policy into their internal systems and procurement processes. The localisation driver must be able to exercise some level of influence over the partners, either through shareholding ownership or through legislative powers. Partners usually include government and semi-government entities, as well as large private sector organisations that are aligned to the objectives of the localisation programme. A non-exhaustive sample of such entities across the GCC is illustrated below:

Infrastructure and public works

- Ministry of Transport Oman
- Ministry of Transport and Communications Qatar
- Ministry of Infrastructure Development UAE
- Ashghal Qatar

Utilities

- Ministry of Water and Electricity Oman
- Kahramaa Qatar
- Dubai Electricity and Water Authority (DEWA)

Transportation and logistics

- Hamad International Airport, Dubai International Airport, Muscat International Airport
- Al Duqm Port & Drydock, Salalah Port, Hamad Port, Port of Jebel Ali
- Qatar Rail, Dubai Metro, Riyadh Metro, Mowasalat Qatar

Mega projects

- Supreme Committee for Delivery & Legacy - Qatar World Cup 2022
- Expo 2020 Dubai
- NEOM Saudi Arabia

Education

- Ministry of Education and Higher Education Qatar
- Ministry of Education KSA
- Ministry of Education Kuwait
- Ministry of Education UAE

Health

- Ministry of Public Health Qatar
- Ministry of Health KSA
- United Arab Emirates Ministry of Health and Prevention
- State-owned hospitals

Telecommunications

- Ministry of Transport and Communications Qatar
- Ministry of Communications and Information Technology KSA
- Ministry of Communication Kuwait

[1] Refer to part 1 of this series for more information on the localisation driver

2. How to carry out an effective localisation policy?

Designing the policy

Carrying out an effective localisation programme is heavily dependent on comprehensive and carefully designed policies. Such policies need to address market deficiencies, improve the overall economy and be driven from the programme's strategic objectives as well as its focus areas. As such, each country views its localisation programme differently and thus adopts different types of policies.

From one aspect, countries can adopt different regulatory frameworks. For example, Malaysia encourages local content through providing incentives, and identifying aspirational targets that are not mandated. Other countries such as Brazil and Indonesia, mandate localisation policies forcing compliance. From another angle, the current localisation ecosystem within the country plays a crucial role in developing the policies. In some instances, countries with no existing policies have realized the importance of localisation and as a result have initiated new country-wide policies from scratch. In other instances, countries with established sectoral localisation programmes have opted to transfer policies from the sector to a country-level with required changes.

In the GCC, localisation programmes are almost exclusively focused on the energy sector given its large share of the local economies. Based on the lessons learned from the current programmes, GCC countries can adopt the same concepts on a larger scale, across a diverse body of organisations, and transfer the localisation agenda into a nationwide programme. Some of the potential changes include:

Align different objectives: As different sectors may have varying objectives depending on the industry characteristics and needs, alignment between sectors' objectives becomes key to the success of the programme. It is important that different stakeholders agree on a set of unified objectives that serve all sectors. These objectives will then guide and influence the design of all other policy elements.

Agree on a governance model: To enable efficient control and avoid overlap between different stakeholders, a robust governance model should be designed and agreed on. The governance model will define the roles and responsibilities of different stakeholders, facilitate communication and reporting channels, and enable solving escalations and disputes. Additionally, one local content certification scheme should be enacted to avoid burdening and confusing suppliers.

Design a cohesive formula and calculation methodology: The designed localisation formula and its components must be in line with the national strategic objectives, as well as the target sector needs. For example, giving more emphasis on research and development may benefit suppliers in some sectors and disadvantage others working in other sectors. Stakeholders should agree on the overall programme targets and KPIs, as they are ultimately responsible to deliver on them.

Unify the procurement requirements: Pre-tender cut-offs used to filter suppliers based on their localisation scores, thresholds related to the size of the contracts, as well as evaluation calculations and award mechanism used during the tendering process are all important elements to agree on between the programme stakeholders. Some of these requirements, however, may stay unique according to the sectors' particular needs.

Whether these localisation policies are transferred between sectors or built from scratch, an important element of an effective localisation programme is the buy-in of the surrounding ecosystem. Policies are most effective if stakeholders are consulted and are supportive. Therefore, it is critical for the localisation driver to first identify the key internal and external stakeholders and engage them while drafting localisation policies. These key stakeholders bring in new perspectives to policy conversations, as well as, result in policy alternatives. In addition, discussions with these stakeholders ensure potential implications of these policies are taken into consideration and alternative options are put forth. For example, the success of Oman's In-Country Value programme can be attributed to several factors including the close collaboration with the government and Energy sector stakeholders.

Generally, there is no predefined list of stakeholders to reach out to as relevant stakeholders vary from one country to another according to the government structure and the programme driver. For example, the development of the energy sector localisation programme in most GCC countries involved a steering committee, internal operations team, a panel of external certifiers, Energy companies, and the sector suppliers.

In general, developing a successful localisation policy requires involving the following key stakeholders:

Steering committee

Led by the localisation driver and key stakeholders. Their main responsibility is to set the strategic objectives, oversee the overall programme and take key strategic decisions.

Relevant entities and partners

These include ministries, government authorities and large private companies participating in the programme. They will drive the localisation agenda and support the implementation of the localisation policies.

Auditors and certifiers

These usually include third-party financial audit firms, appointed by the localisation driver, to ensure the integrity, consistency and standardization of the programme.

Suppliers

They are all the companies with local presence involved in providing goods and services, and impacted by the localisation policies.

As the stakeholders and the programme objectives differ between countries, localisation policies will also be different. The following section highlights some of the key localisation policies from around the world.

Kazakhstan

- Minimum commitment levels of local content in goods, works and services is required for bids for new subsurface mineral rights
- In addition, 95% of the employees should be Kazakhstani citizens as a minimum requirement

Mozambique

- Preferential treatment is given to the purchase of local goods and services “when such goods and services are internationally comparable in terms of quality, availability, and quantity required and are offered at prices inclusive of taxes not higher than 10% of the available imported goods”

Angola

- Certain categories of the petroleum sector’s procurement expenditure, including logistics, catering, pressure tests for storage tanks and pipelines are reserved to Angolan companies
- Establishes a “competitive regime,” which places certain categories of expenditure into international competitive tender, yet provides for “Angolan state companies and/or private companies the right of first refusal, provided that the value of the relevant bid is no more than 10% higher than those of other companies”

Indonesia

- Prioritization is given to domestic companies; there are minimum local content requirements for sourcing of goods
- Monitoring and compliance are carried out through a mixture of self-regulation and government agencies
- Companies are required to establish and deliver training programs designed to achieve the local target levels

Norway

- Licensees must use Norwegian suppliers to procure goods and services for their petroleum activities
- At least 50% of R&D activities required to exploit the resources of a license must be performed in Norway
- IOCs are obligated to provide theoretical and field training, including overseas, and engage a certain number of Norwegian personnel in their petroleum activities

Ghana

- Ghanaians must compromise at least 50% of the management and technical staff from the start of petroleum activities and that percentage should increase to at least 80% within 5 years after the start of petroleum activities

India

- Domestic companies bear a tax rate of 30%, while foreign companies are subject to 40%

Nigeria

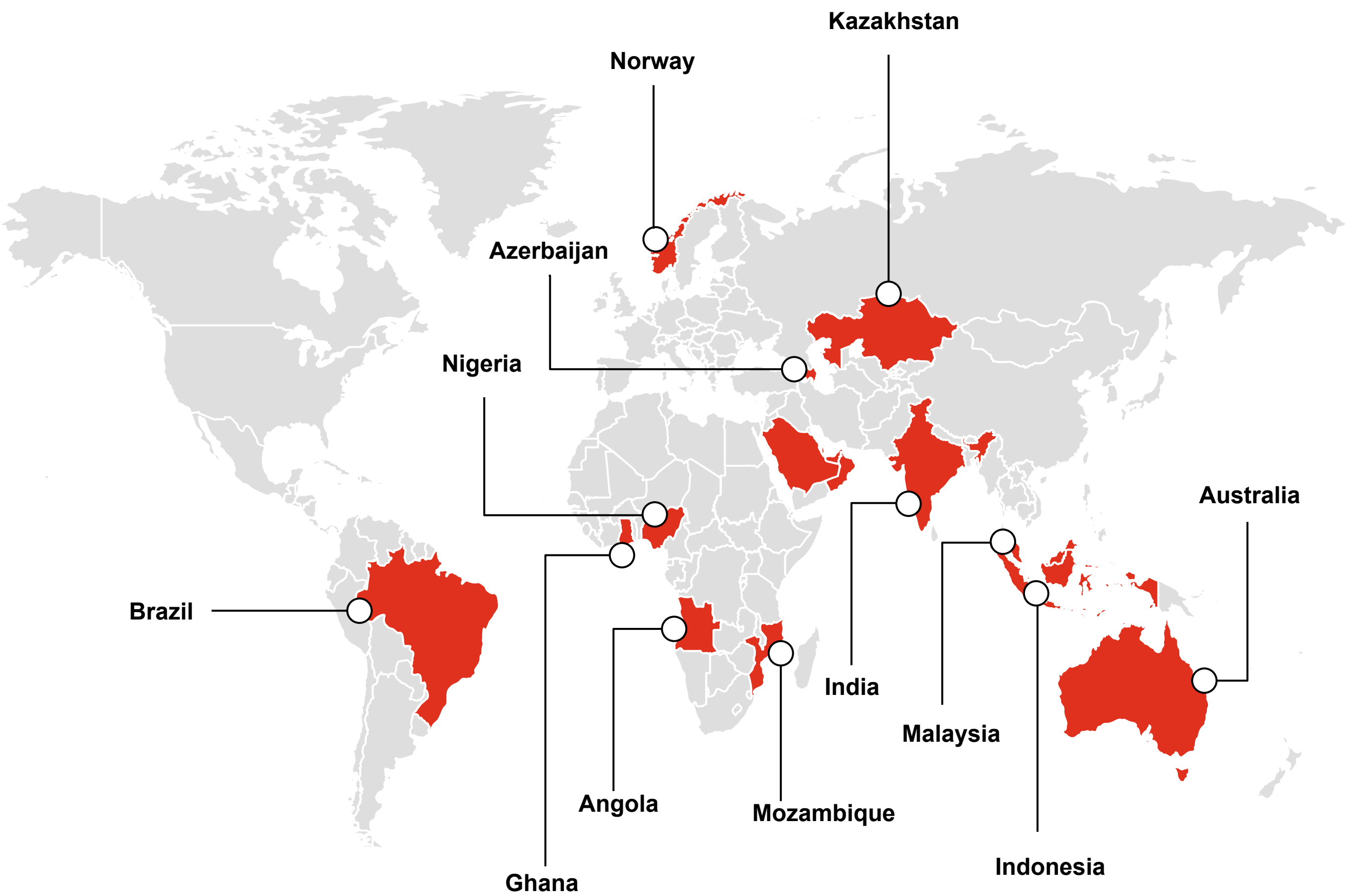
- Locally incorporated companies with Nigerian shareholder majority are required to be involved in all new licenses as full-paying partners with a minimum 10% participating interest

Azerbaijan

- Export-oriented oil and gas operations expected to last for more than six months require the employment of at least 80% Azerbaijani citizens at all staff levels

Australia

- Tariff reduction on certain equipment is offered in return for demonstrating the provision of fair and reasonable opportunity to Australian suppliers, with a focus on small and medium sized enterprises (SMEs)



Integration of the policy into the procurement process

It is critical to integrate the defined localisation policies throughout the procurement lifecycle in order to build local supplier capabilities, increase supply chain resilience, and reduce long term costs. Once the policies are defined by the localisation driver, partnering entities should conduct an analysis to identify the key observations in the current procurement operations, opportunities for improvement and touchpoints to integrate localisation policies.

Looking at the end-to-end procurement process, there are multiple touchpoints that can be identified for integration into the procurement process.

Pre-tender

Integrating the localisation policy into the procurement process starts at the pre-tender stage. Design decisions ranging from determining localisation score cut-offs for different categories for goods and services to thresholds used to select applicable policy types should be carefully considered by the policy maker. Tools and templates used to capture suppliers' localisation-related information and metrics are key at this stage.

During tender

Localisation policies impact is mostly seen during the tendering process. As having a localisation score becomes part of the requirements, various changes will be made to technical and/or commercial evaluation and potentially to contract negotiations. For example, during commercial evaluation, an evaluation formula will be designed taking into consideration a balance between localisation score and bid price. Changes may be required to associated procedure documents and existing ERP systems to accommodate suppliers' localisation scores and bid evaluation electronically.

Post-tender

Finally, a process will be designed to monitor suppliers' performance against their localisation commitment during contract execution. Post contract completion, a performance evaluation mechanism, along with an incentive and penalty scheme, will be designed to determine the supplier's eligibility for premium rewards or possible deductions as per the policy.

Identified integration areas are then prioritised along with the key actions necessary for a successful implementation. These actions include updating relevant processes, documentation and associated internal systems. It is important to set reasonable timelines and assign ownerships to oversee the implementation and ensure successful integration of the policy.

To test the logistics, reveal weaknesses and ensure a smooth and efficient implementation of the localisation policy, pilots should be conducted on select tenders. In addition, it is extremely important to educate all parties involved; especially, suppliers and partnering entities on the changes through awareness campaigns, training sessions, social media ads, etc.

Lessons learned

Integration elements play a huge role in determining the success or failure of the programme. From that perspective, there are multiple lessons learned from the implementation of localisation programmes around the region and globally. Here are a few examples:

Policy element	Oman	Brazil	Malaysia
Sourcing of goods and services	• Require contract bidders to present an Omanisation plan considers it in the contract evaluation and ring-fences contracts for local contractors • Segment project scope for small companies where possible • Provide direct and ring-fenced contracts for local contractors to support them, under the LCC (Local Community Contractor) and SLCC (Super Local Community Contractor) programs • Simplify the registration process for local SMEs	• Provide opportunities for local suppliers to participate in procurement through tailoring procurement volumes and specs • Facilitate pre-qualifying process for local suppliers and introduce LC as a tender selection criteria (20% weight)	• Preference to domestic-only tender lists when local capability is available • Companies with a priority status from the government are eligible for a 5-year partial tax and regulatory exemption

Policy element	Oman	Brazil	Malaysia
Upskilling local workforce	• Help contractors locate skilled talent through job matching, screening and training • Develop contractors' talent pipeline by providing unskilled workers with upskilling training • Provide support to local contractors to raise performance standards through conferences and workshops	• Proactively develop local suppliers by identifying highest demand areas and providing incentives through off-take agreements	• Offer internship and on-the-job opportunities for citizens to develop local capability as well as capacity in the oil and gas industry • Sponsored 30,000+ students to pursue secondary and tertiary education nationally and internationally
Developm-ent of domestic supply chain	• Collaborate with government and industry stakeholders to promote localisation	• Provide incentives and financial support to local suppliers and promotes JVs with foreign players	• Fiscal incentives are linked to performance requirements in the form of export targets, local content requirements and technology transfers, which are specific to every manufacturing license
Key results	• 14,300[1] new training and job opportunities created for Omanis between 2011 and 2014, including hires in Super Local Community Contractors (SLCCs) and high school and graduate student training • Omanisation in SLCCs has significantly increased thanks to PDO-sponsored training for locals residing in SLCC's concession area	• 76% LC achieved in O&G from 57% since reporting started in 2003 (19% increase) • +$14.2B worth of contracts diverted to local industry • +600,000 new jobs created since 2003 • 74,000 people trained in 175 professional categories related to focus areas • Suppliers reported inefficiencies and bottlenecks due to ambitious targets	• Launch of the Economic Transformation Program (ETP) aimed at transforming the country into a high income economy • No focus on export-parity competitiveness – investments led to massive over-borrowing and fiscal-debt crises

[1]Source: PDO Annual Report, 2014

Key considerations when implementing localisation policies

Localisation policies are part of large national programmes. They are led by governments with the participation of public sector organisations with varying goals and maturity levels, and involve a large number of suppliers from the private sector. Moreover, localisation policies aim to bring about major changes in government procurement processes, employment policies, training initiatives and investment within the country. Due to the complexities associated with such programmes, they will inevitably carry risks and challenges to implement. A few of the key considerations are listed below:

Ease of doing business

Localisation policies will inevitably produce another administrative burden in the procurement process and decrease competition in the local market. Additionally, policies such as exclusive employment of locals and hiring of local suppliers may discourage foreign companies from engaging in the local market and reduce the attractiveness of doing business in the country. To overcome that, governments should not implement localisation programmes in isolation, but rather they must introduce incentives to make setting up business in the local market attractive to foreign investors.

Absolute target-setting

Governments may consider higher percentage localisation more desirable without a clear understanding of economic value associated with it. Imposing local content requirements will create value for an economy up to a certain point, beyond which it may actually destroy value. The percentage of economically beneficial local content can increase with time as the capabilities of the domestic industrial base and supply chain progress, but it will never reach a 100%. Some inputs will always prove cheaper to import than to build locally.

Inflationary effect

Implementing localisation policies may lead to increase in the prices of manufacturing inputs and final consumer products. It is important to note that these increases are not usually a result of technological advancement or improvement in quality, but rather they are solely due to import restriction stemming from such policies. A case study released in 2018 by the European Centre for International Political Economy (ECIPE) showed that as a result of the localisation policies implemented in Russia and Brazil, heavy vehicles' prices rose by an estimated 9.7% and 13.7%, respectively. While these price effects carry on and impact other areas in the supply chain leading to inflationary effects across the board, logistics and inventory carrying costs usually go down, along with working capital improvements as a result of inventory reduction.

Coherence with broader economic development

For a localisation programme to be successful in achieving its objective, it must be comprehensive and take into consideration other capabilities of the country. For example, upskilling local workforce, may require improvements in indirect areas such as the education sector and technological infrastructure in the country. Moreover, as companies will be encouraged to source goods and services locally, there may initially be a concern with local suppliers' quality.

Impact on trade

Some studies have shown that even though localisation reduces the import reliance in a particular sector, it can also decrease the exports in some countries and regions as they become less competitive after implementing localisation policies. ECIPE studies have also shown that after implementing localisation policies in the heavy vehicle manufacturing industry, Russia and Brazil exports have in fact decreased by 3% and 5%, respectively. This was due to increased manufacturing input prices leading to manufacturers' inability to compete effectively. However, with the appropriate government incentives and by carefully choosing the right sectors to focus on, localisation builds expertise and provides low-cost feedstocks for other industries. These contribute to improving efficiency, boosting competitiveness and raising export levels.

It is essential to anticipate the potential implications of localisation policies and adopt mitigation actions and supplemental policies to decrease the severity of the consequences. In Malaysia's key industry localisation programme, the government initially facilitated the creation of local champions, providing them with preferential pricing and treatment, which resulted in the cancellation of contracts due to "poor management and non-competitive pricing". This, among other factors, ultimately led Malaysia to refine its approach to localisation and launch the Economic Transformation Programme (ETP).

3. What tools are needed?

Designing the right tools

Establishing a comprehensive toolkit is a key enabler for successful implementation of the localisation programme. These tools support the integration of localisation policies into the procurement lifecycle and include templates for capturing suppliers' scores and data collection, forms, various contract clauses, and general instructions and guidelines.

All tools and templates should be accessible to all users, easy to understand for all concerned parties and structured in a clear and organized way to facilitate quick completion and easier certification and audit process. They should also be supported by a set of guidelines that provide clarity on filling and completing the templates.

Performance management

For a successful implementation of a localisation programme, or any programme for that matter, a set of Key Performance Indicators (KPIs) must be defined. By defining and monitoring these KPIs, the localisation driver can form an understanding of the barriers to reaching programme targets and gain deeper knowledge about the future improvements. The use of KPIs helps to create a clear picture of the variables that affect the success of the programme and contributes to the decision-making and planning process. KPIs are usually identified by the localisation driver along with the primary stakeholders, and when applied effectively, they act as a compass to guide the strategy to meet the goals.

Some of the key metrics widely reported in localisation policies around the world include:

Workforce

- National headcount and salaries
- Time and spend on training

Supply of goods and services

- Spend on local suppliers (based on definition of local in the policy)
- Contribution to the overall economy (e.g. GDP)
- Reduction of prices

Supplier investment

- Spend on supplier development through targeted programmes
- Number of sectors or opportunities localised
- Local supplier improvement

Participation

- Number of certified suppliers

Data collection process

Once the tools are developed and KPIs are defined, there should be a clear governance and a defined process to collect and analyze data, evaluate KPIs to derive insights, and report results and progress periodically.

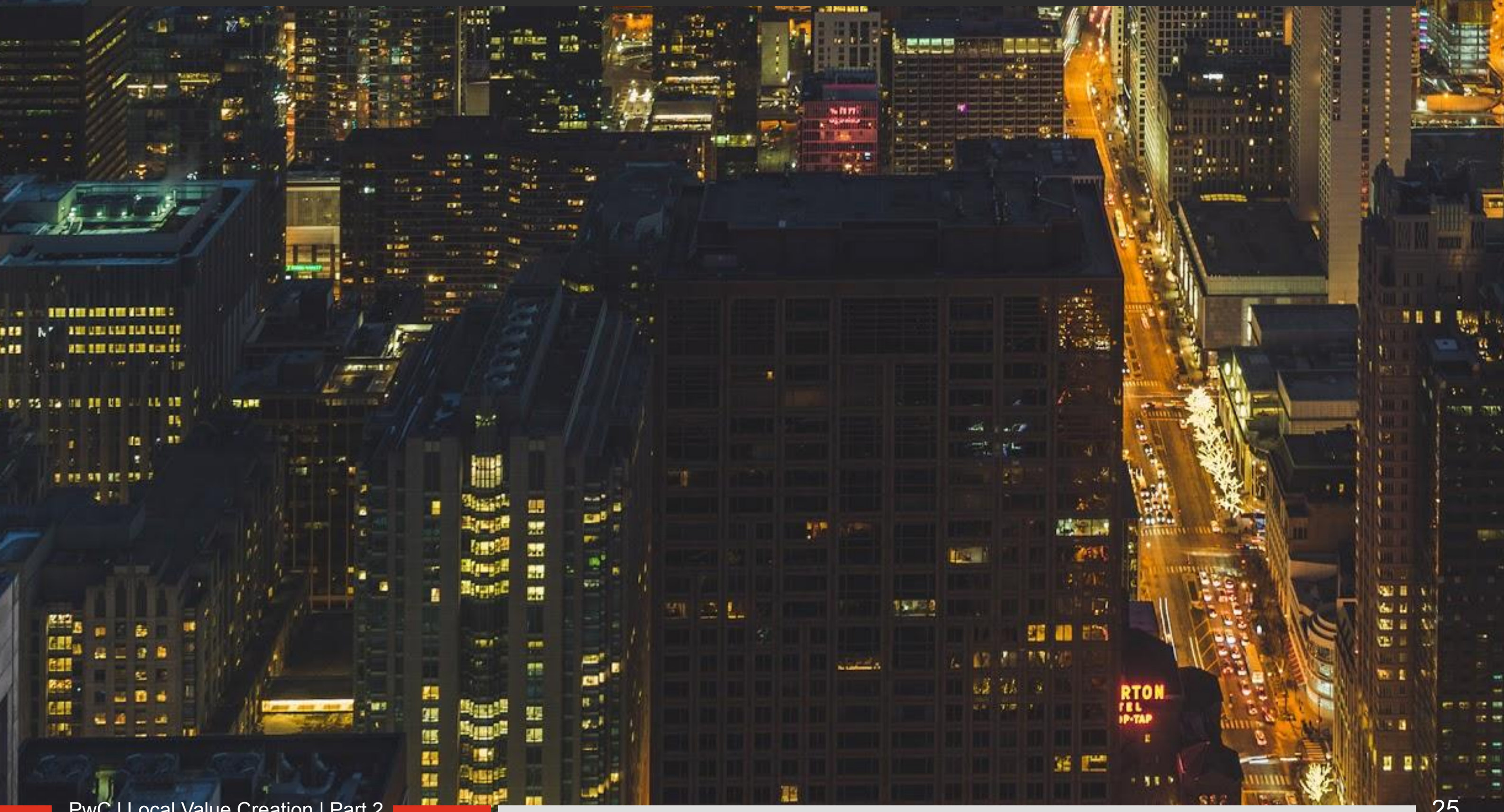
In most instances, a standard data request template, automatic system extraction, and web-based data collection forms are used. Furthermore, utilising visualisation applications to design dashboards for KPIs reporting provides the users with better insights and enhanced reporting and analysis.

Conclusion

Despite government investments and diversification efforts, GCC countries continue to face many challenges pertaining to their supply chain resilience. These challenges will continue in the future if the appropriate actions are not taken and the adequate mitigations are not devised. Localisation can play a big role to ease the impact of supply chain future shocks, whether they are a result of economic downturns or natural disasters.

Localisation programmes with effective and comprehensive policies are the cornerstones to achieving national visions and objectives from building resilience in the local supply chains to the diversification of the economy and the creation of jobs. Developing and implementing a localisation policy, however, is a large undertaking and requires a careful design process, exhaustive impact studies and alignment between stakeholders.

In this edition of our Local Value Creation series, we have shed the light on how to design policies that meet the different needs of each country and explained the steps that the localisation driver must take to reach an effective policy in line with the strategic objectives of the programme. We further explained how to integrate these policies effectively into the procurement process of the various sectors identified and how to utilise the right tools to do so. In the coming editions, we will continue with the remaining elements of PwC’s Localisation Framework, starting with the capacity building side as an important pillar to a successful implementation of the programme.



PwC Localisation Service Offerings

- Localisation vision and strategy
- Category localisation roadmap
- Local content programme and framework development
- Supplier development
- Government incentive schemes
- Local content certification
- Supplier localisation strategy development
- Local workforce capabilities development
- Localisation digital portal
- Localisation feasibility studies

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