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# **Toward a strategic management perspective on local content in African extractives**

**By Michael Wendelboe Hansen**

**Paper presented to 2017 EIBA conference in Milan**

# Toward a strategic management perspective on local content in African extractives

By Michael Wendelboe Hansen<sup>1</sup>

*Abstract: Local content requirements - i.e. government backed requirements that extractive MNCs must procure inputs locally - are fast becoming a major issue in MNC-host country bargaining in Africa. Across Africa, governments are seeking to mobilize MNCs for sustainable development through increasingly stringent local content requirements. As a result, extractive MNCs are facing a rapidly evolving strategic field, the management of which may have immense implications for their investment decisions, profitability and efficiency. While a vibrant and dynamic literature on local content in Africa is emerging, this literature is predominantly informed by economic and political perspectives, and strategic management perspectives are virtually absent. This is problematic as one of the main reasons why local content interventions in Africa fail to produce the expected results is that they often are based on an inadequate understanding of MNC strategy and interests. Hence, the aim of this paper is to characterize and conceptually develop the strategic management perspective on local content. The paper outlines generic strategies that MNCs may adopt to balance the often conflicting pressures for local content and global efficiency. It is concluded that by better aligning local content intervention with MNC strategy and interests, the likelihood of positive development outcomes will be greatly enhanced.*

## Introduction

In recent years, African developing countries have introduced a host of local content (LC) requirements and rules throughout their extractive industries (Morris et al., 2012; Hansen et al, 2015). These LC requirements reflect a significant change in policy toward more restrictive (or at least, more assertive) approaches to foreign extractive investors across Africa (UNCTAD, 2013). LC is not only seen as a vehicle for local job and income generation, but also increasingly as a vehicle of industrial development and structural transformation (Morris et al., 2012; Buur et al., 2013). Where international development banks and donors previously were opposing mandatory LC requirements, they are now accepting that LC intervention, designed the right way, may contribute to African economic and industrial development (Buur et al., 2013; World Bank, 2016).

The intensifying LC pressures and expectations across Africa present extractive MNCs with a new strategic field (Warner, 2010a): LC requirements may undermine the financial viability of MNC operations, disrupt the effective functioning of value chains, compromise quality and safety standards, and threaten global reputation and brand. But LC requirements may also offer an opportunity for extractive MNCs to

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differentiate themselves against competitors, and to foster new long-term partnerships with local producers and governments. To deal with this evolving strategic challenge, more and more extractive MNCs are developing policies and programmes for LC and LC is in the process of becoming an institutionalized practice in many MNCs (IFC, 2007; Warner, 2010; Tordo et al., 2013; World Bank, 2016).

The growing LC pressures on extractive MNCs in Africa and other developing regions have not gone unnoticed in the academic literature. In recent years, a burgeoning literature on LC has evolved. This literature has examined LC from an economic efficiency perspective (i.e. how does LC influence trade and investment or local competition (Tordo et al., 2013; Warner, 2011); from a value chain perspective (i.e. how does LC disrupt or re-shape global extractive value chains (Morris et al., 2012); from a governance perspective (i.e. how does LC requirements align with other policy areas (Kragelund, 2016; Ramdoo, 2015); from an industrial development perspective (i.e. how can LC be used to spur industrial development (Wilson and Kuszewski, 2011; Kazzizi and Nouri, 2012); or from a political-economy perspective (i.e. how can coalitions for LC policy be established and how does LC feed into local political settlements (Buur et al., 2013; Whitfield et al, 2015)). However, what is notably absent from the evolving LC literature is a strategic management perspective, i.e. a perspective that seeks to understand LC from the perspective of decision makers in MNCs (Kwon and Chun, 2009). Such a perspective is important, not only because it may provide MNC decision makers with a better understanding of the strategic and operational trade-offs related to LC in Africa, but also because it may inform policy makers about the strategies and interests of MNCs, thus allowing them to design LC interventions that are better aligned with the workings of MNCs.

The contribution of the paper is as follows: It reviews the LC literature and position the strategic management perspective within that literature. It maps the LC practices adopted by MNCs and develops a model for strategic decision making in MNCs that may inform future research on firm perspectives on LC. In conclusion, the paper outlines implications for the design of LC intervention in African resource rich countries. The conceptualization and delineation of the strategic management perspective on LC will be based on, and draw from, the literature on LC in Africa and generalizations beyond the African context must thus be made with due consideration of African economic, political and institutional specificities.

## **The literature on local content in Africa**

LC has a long history in both developed and developing countries (Chang, 2008) and has been a key element in industrial development strategies (Tordo et al., 2013). LC in manufacturing was the essence of import substitution development strategies of the 1960s and 1970s adopted across the developing world and the numerous EPZs established as countries moved toward export oriented development strategies

also were explicitly aimed at facilitating local content in exports (Altenburg, 2001). While LC has been actively promoted in manufacturing, it is however in extractives that LC measures have been most common, evidently motivated with ambitions of escaping the inherent enclave nature of extractives.

Given the long history of LC, there is also a long tradition for analyzing and discussing LC in the academic literature: The early LC literature examined LC from a trade economic perspective. This literature typically viewed LC requirements as trade related investment measures (TRIMS) and as such potentially trade distorting (Hufbauer et al., 2013). Hence, it was generally argued that LC measures would distort trade and prevent efficient allocation of resources (Grossman, 1981; Richardson, 1991; Munson & Rosenblatt, 1997). LC requirement might in fact have the opposite effect of their intention (Grossman, 1981) as they could depress investment and reduce government revenues. Were governments to open up for more LC intervention, some trade economists argued, the spigot would be opened for unproductive rent seeking activities, especially in African developing countries where institutional safeguards were weak (Krueger, 1974; Bhagwati, 1982). Current generations of trade economists have maintained a critical stance toward mandatory LC requirements (Tordo et al., 2013; Warner, 2011).

Economists of a more heterodox persuasion have offered more favorable accounts of LC intervention, arguing that LC may produce positive development outcomes under certain conditions (see e.g. Morrissey, 2012; Kazzazi & Nouri, 2012; Ado, 2013; Amendola et al., 2013; Hansen, 2014; UNCTAD, 2010). There are several potential advantages of LC requirements it is argued: 1.They may protect infant industries at early stages of industrialization; 2.They may constrain the market power of MNCs vis-a-vis local industry; 3.They may provide compensation for those local communities adversely affected by extractive operations; and 4. They may support and facilitate structural transformation and industrialization through market access and productivity spillovers. Contemporary political economists have even questioned whether the rent seeking activity accompanying LC intervention necessarily is 'unproductive' as the rents deriving from LC in extractives may help stabilize political settlements in societies with high levels of 'systemic vulnerability' (Khan, 2000; Whitfield et al., 2015; North et al., 2009).

Apart from the debates on the economic and political efficiency of LC intervention, it is also debated whether and how LC contributes to economic development and integration of developing countries in the world economy. The spillover literature - an economic literature that analyses indirect and unintentional impacts of FDI on host countries, so called spillovers (Blomstrøm & Kokko, 2000) - argues that LC policy effectiveness depends on the 'technology gap' between the foreign investor and local industry, and the 'absorptive capacity' of local industry (Morrissey, 2012; Rugraff & Hansen, 2010). It is argued that the larger the technology gap, the less likely LC will be (Nunnenkamp, 2002). Moreover, a key precondition for LC to

benefit host economies is that local firms are able to absorb the opportunities provided by growing LC and transform these opportunities into sustainable competitive advantage (Narula & Pireli, 2016).

The global value chain theory (Gereffi et al., 2005) has inspired a large number of empirical studies that examines whether and how global lead extractive firms - so called chain leaders – organize global value chains to also include developing country producers. One example is Morris, Kaplinsky and Kaplan's (2012) cross country project "Making most of Commodities". This project examined the 'depth' and 'breadth' of value chain collaboration between extractive MNC chain leaders and local firms across eight African countries, including Tanzania, South Africa, Zambia, Angola and Nigeria.

Generally, various studies of LC tend to be rather pessimistic in regard to the development impacts of LC: UNCTAD (2007) concludes that *"a common feature of the extractive industries, especially when TNCs are involved, is the relatively limited incidence of linkages with domestic suppliers"* (UNCTAD, 2007: 140). Morrissey (2012) concludes a survey of spillovers in African extractives that spillovers on local industries are few and that those that are there have little industrial development potential. Several studies argue that lack of spillovers in Africa mainly are due to low absorptive capacity in local industries (Morrissey, 2012; Girma, 2005; Osabutey and Debrah, 2014; UNCTAD, 2013). Hansen (2014; 22) concludes a review of the literature on linkages in African extractives that *"there are plenty of studies pointing to the limitations of linkage formation: that they in many sectors and countries are few and short term, that they are mainly related to low value added activities, and that they offer few opportunities for learning and upgrading"*. Morris et al (2012) conclude that it is indeed possible to mobilize African extractives for broader industrial development, especially due to the fact that the progressing outsourcing of extractive MNCs' global value chain activities offers rich opportunities for local African producers. However, most experiences with LC in Africa hitherto are disappointing: LC in African extractives remains limited and where it exists, its depth is 'thinner' than its 'breadth' (Morris et al., 2012).

Some see the main culprits behind LC failure in Africa in high technical, safety and social entry barriers in global value chains in combination with weak absorptive capabilities of local supply industries (Morris et al., 2012; Hansen, 2014). Others argue that failure of LC intervention is related to the fact the LC regulations become 'captured' by ruling elites' rent seeking efforts (Besada et al. 2015). Finally, it is argued that African LC fails due to weak institutions to enforce LC regulation, and a poisonous contractual environment which discourages MNCs to enter long term and intensive collaborations with local firms (Ramdoo, 2015).

While numerous studies examine the rise and demise of LC in Africa from political, economic and value chain perspectives, very few studies examine LC from the perspective of the MNC, even if much of the explanation for the weak state of LC interventions may be related to lack of alignment with MNC strategies

(Kwon and Chun, 2009). In the following we will explain in more detail what a strategic management perspective on LC is and review the sparse literature that analyse LC in Africa from a MNC perspective. The aim is to develop a conceptual framework that can guide future strategic management research on LC in African extractives.

## **A strategic management perspective on local content in Africa**

### **What is a strategic management perspective on local content?**

A strategic management perspective essentially analyzes how bounded rational managers navigate uncertainty, in the case of MNCs, in their international operations. The main issues of interest for strategic management are whether and why MNC managers should invest in foreign locations; whether and how they should standardize or adapt their global operations; and whether and how they should exploit their existing capabilities in foreign locations or use foreign locations to augment their capabilities (Tallman, 2001). A key point of a strategic management perspective is that MNCs' responses to given contingencies will be heterogeneous so that MNCs positioned in similar regulatory, institutional and industry environments may respond differently due to their idiosyncratic bundles of resources, e.g. assets, managerial routines and paths (Teece, 2000).

The academic literature on LC from a strategic management perspective is sparse. However, in recent years a practitioner driven literature has evolved that directly or indirectly examines MNC strategy in relation to LC, including in Africa (see e.g. Warner, 2010a, 2010b, 2011; BSR, 2011; IPIECA, 2011; Tordo et al., 2013; IFC, 2007; Wise & Shtylla, 2007). A handful of studies analyze LC activities adopted by MNCs operating in specific African countries, e.g. in Tanzania (see e.g. Mjimba, 2011; Sutton, 2014 or Hansen, 2013), in Mozambique (Buur, 2013); in Zambia (Kragelund, 2016), in Ghana (Osabutey, 2012) or in Nigeria (Ovadia, 2013). This literature is still nascent and it is only to a limited degree informed explicitly by strategic management theory.

We will in the following make an initial attempt to draw up the contours of the strategic management perspective on LC and move toward a more theory-driven understanding of how MNCs will position themselves in relation to LC pressures and opportunities. We will start out by explaining what the regulatory space for MNC LC activities is. We will then move on to understand which LC practices MNCs typically are adopting. Finally, we will build a conceptual framework for analyzing which generic LC strategies can adopt based on external and internal contingencies.

## The regulatory space for local content in African extractives

The legal requirements in African extractives have become more restrictive and assertive in recent years (UNCTAD, 2013; UNECA, 2013; Wilson and Kuszewski, 2011), placing a growing pressure on MNCs to come up with LC solutions. Where LC requirements in the wake of structural adjustment in the 1980s and 1990s were relatively vague, African governments have since moved toward more assertive and restrictive approaches (UNCTAD; 2013; Tordo et al, 2013; Hansen et al, 2015). Across the Africa, mining codes and oil and gas concessions contain varying elaborate measures aimed at mitigating extractives' inherent enclave nature; measures such as local ownership requirements, local employment rules, production sharing agreements, or local procurement requirements. Among the measures directly aimed at creating LC are rules stipulating percentages for local procurement; local firm reservations for certain inputs and services; reporting requirements; requirements for service provision, etc. More indirect measures include local supplier development programmes and/or

### Types of local content requirements

#### Minimum targets

1. Blanket min LC targets
2. Disaggregated minimum LC targets
3. Disaggregated minimum LC targets for expenditure
5. Domestic-only tender lists
6. Full, fair and reasonable access to procurement opportunities for domestic suppliers
7. Reduced pre-qualification criteria for domestic suppliers
8. Mandated foreign/domestic consortia or sub-contractor alliances
9. Minimum participation of domestic sub-contractors/suppliers in contracts awarded to foreign suppliers (by \$ value)
10. Minimum national ownership of suppliers awarded contracts

#### Basis of Contract Award

11. Preference to domestic suppliers so long as performance, quality and time of delivery are competitive with international performance and prices"
12. Nominal price advantage to domestic suppliers on award, eg 10% blanket
13. Bid evaluation on basis of 'where all else equal, preference local suppliers or highest levels of LC'
14. Economically Advantageous basis for contract award, e.g. application of 'K' Factor
15. Contract award veto for Government authorities on Tender Board on basis of insufficient LC or inadequate LC

#### Plan Contract Execution

16. Advance payments to domestic suppliers eg 30%
17. Minimum training obligations for nationals, eg first consideration to nationals, targets by cost or training hours
18. Minimum obligations for growing competitiveness of domestic suppliers, e.g. minimum investment requirements, minimum training obligations beyond that needed for contract execution
19. Obligations to report on LC performance

Source: Warner, 2011

selective tariffs. Some measures will be binding (e.g. that certain inputs are reserved for local producers) while other will be non-binding (e.g. reporting requirements). The level of precision of measures will also vary; some measures sets specific targets for LC (e.g. that at least 30% of value of inputs must be procured locally), while other measures will be more intentional and vague. In some cases, LC requirements only apply within certain thresholds, e.g. that inputs must be procured locally, provided that prices are no more than xx% above world market prices.

The emerging LC field is characterized by exceptionally high legal and conceptual ambiguity, which leaves MNCs with huge uncertainty as to what is required from them. In particular two aspects of LC intervention create uncertainty: Ambiguity regarding definition of 'local' and the overambitious nature of much LC intervention (Hansen et al., 2014; 2015).



### *Ambiguous definitions of 'local'*

LC is generally understood as the total value created in the host country through the procurement of local goods and services (Wilson & Kuszewski, 2011; BSR, 2011; IPIECA, 2011; Sigam & Garcia, 2012; Ado, 2013). However, this definition raises a number of definitorial and measurement related issues and problems, especially when it comes to defining 'local' (IFC, 2007):

Essentially, definitions of 'local' either focuses on value added or ownership (Morris et al., 2012). If focus is on value added, it will imply that LC is more than mere symbolically processed imports (e.g. relabeling and repackaging). Hence, it is expected that substantial value is added locally. However, one difficulty in this regard is that any supplier will to higher or lesser degrees import inputs and further process them making the measurement of local value added inherently difficult (Warner, 2010b). Moreover, LC can be created by a MNC internalizing activities in a subsidiary located in the host country in which case there is local value added but no local ownership. A MNC may also outsource inputs to a foreign supplier that is established in the host country through a 100% controlled subsidiary. Again, value added is local, but ownership is foreign.

While some African countries apply both value added criteria in their LC policies, most African countries operate with ownership based definitions LC as such criteria are easier to monitor. However, also here there are definitorial problems: For instance, local ownership may be by foreign nationals resident in the country (Kragelund, 2016). Or, foreign firms may set up local 'brief-case' companies with a local strawman through which they 'produce' LC. Moreover, ownership is often mixed between local firms and foreign firms, which create further confusion as to what constitutes local ownership.

Different criteria for defining local content			
		Ownership based definition	
		Foreign nationals	Local nationals
		Enclave	Brief case companies
Value added based definition	Import high	Enclave	Brief case companies
	Local value adding high	Captive LC/ LC through foreign suppliers	LC produced by local firms

### *Over-ambitious LC regulation*

LC regulation is often designed without due consideration of local capacities, institutions and infrastructures. This either forces MNCs to renounce on their global quality, safety and social standards or to assume the often huge costs of developing a local supply base and institutions (Morris et al., 2012). A main problem with much LC intervention in Africa is that the supply conditions are not in place to realize the ambitions (Morris et al., 2012; Morris et al., 2012). Hence, MNCs will not be able to find qualified local suppliers and service providers. As LC measures often lacks realistic and long term programmes to develop

local supply capacity (UNECA, 2013; Hufbauer et al., 2013; Hansen et al., 2014), host countries either will have to back down on LC ambitions. Alternatively, they may allow uncompetitive local firms to enter LC contracts, hoping that they in time will build the necessary capabilities and scale (Warner, 2011; Altenburg, 2011; Tordo et al., 2013). As LC measures often lack grandfather clauses (Tordo, 2013) the result is that once obtained, protected LC positions will be difficult to remove. Another related problem is that African host countries often lack of institutional capacity to oversee the implementation of LC (UNCTAD, 2006; Wyse and Shtylla, 2007; BSR, 2011). For instance, Ramdoo (2015) argues that despite the existence of LC policy measures, penalties for non-compliance are almost non-existent in most of African countries. Related to this, LC interventions will often not be coordinated with other policy areas and may be undermined by policies and priorities in other areas (Kragelund, 2016).

In sum, extractive MNCs in Africa are subject to a legion of binding and non-binding requirements related to LC. Often LC requirements are inconsistent with other policy areas, they are inadequately taking local capabilities into account, and it is uncertain the degree to which they are binding and being implemented at all. All this opens a wide strategic space for MNCs.

## **MNC local content practices in Africa**

### *The content of MNC local content activities*

At the most generic level, MNCs may formulate an overall local content policy, the purpose of which is to state the company's LC commitment to stakeholders and employees. The local content policy is the framework within which specific strategies, systems, plans and programs are implemented (IFC, 2007).

Before adopting specific LC measures, MNCs will conduct an assessment of the LC environment in the country in question, focusing on capacity of local supply industries, quality of institutions, and stringency of regulatory requirements (IFC, 2007). Possibly, educational and awareness raising activities will be undertaken to align expectations of local communities, policy makers and the MNC. In addition to a traditional NPV calculation of investment projects, MNCs may undertake economic impact optimization (EIO) modelling to inform policy makers about the trade-offs of various forms of LC intervention (Warner, 2010a).

At the operational level, MNCs may survey local industry to identify potential local suppliers and to create short lists of relevant suppliers. In most African host countries, there will only be few qualified local suppliers available and for some value chain activities, none. Hence, it may be necessary to invest in developing and upgrading local suppliers. Initially, MNCs may develop forecast models for how fast local procurement can be expanded and what it would take. Subsequently, specific supplier standards will be formulated and potential suppliers will be screened.

#### **Types of MNC LC activities**

- Local procurement objectives and standards
- Specific LC standards for global suppliers
- Supplier screening programmes
- Development of short lists of capable suppliers
- Supplier development and training programmes
- Support for development of local institutions to enhance skills level and absorptive capacity.
- Development of local infrastructures
- Supplier monitoring and auditing
- Reporting and communication of local content activities and achievements
- Lobbying governments to influence LC standards and regulations
- Observance of global CSR standards
- CSR and local community policies and programmes

Activities to train and upgrade suppliers may be initiated so that they can meet MNCs' technical, safety and social standards. Often, upgrading of suppliers will require that the MNC invests in developing public and private training programmes, e.g. at engineering universities or vocational schools. In terms of actual selection, MNCs may adopt open and transparent tenders for key inputs, with uniform procedures for prequalification, standards to be observed, and selection. Once suppliers of LC are identified and selected, extensive monitoring, auditing and control will be required to ensure that quality, safety and social standards are met. Auditing can be conducted by internal staff or by external consultants. Eventually, MNCs will report on progress on LC internally and to the public/ authorities.

While the responsibility for LC deliveries formally will be with the lead extractive MNC holding the concession, the actual implementation of LC objectives and activities may in practice be carried out by foreign suppliers that act as subcontractors to the lead MNC. Hence, the LC policies, programmes and practices of lead MNCs may in many instances mainly be directed toward globally preferred suppliers, and LC requirements will be included as part of supplier KPIs (Hansen, 2013).

#### *The scope and depth of local content activities*

LC can be achieved at all stages of the value chain. While most LC initiatives described by the literature focus on upstream activities, LC may also be achieved in downstream activities such as refining, sales and service. The complexity, technological sophistication and entry barriers at different points of the value chain are varying and so are the opportunities for local firms to become suppliers (Morris et al., 2012). In general, LC may be easier to achieve in relation to operational expenditures and more difficult to achieve in relation to capital expenditures (Mjimba, 2011). The reasons are that the technology gap is highest in relation to capital expenditures (typically investment in equipment or facilities); that capital expenditures

are concentrated at early stages of project development where there has been little time to develop LC; and that capital expenditures often are one off transactions that are too costly to source locally. In contrast, operational expenditures are typically continuous throughout the operation; many of these activities have low technological sophistication (e.g. catering, security, transport, accommodation, or logistics), and asset specificity is generally low. Over the life cycle of the project, the combined value of LC in such less advanced operational activities may be higher than the value of LC in hard to achieve LC in capital expenditures (Sutton, 2014).

The more types of activities made subject to LC, the broader the scope, what Morris et al (2012) calls 'breadth of linkages'. The more intense the LC collaboration, the deeper it is, what Morris et al (2012) calls 'depth of linkages'. If local supply industries are qualified and if the MNCs actively promote LC, deep and reciprocal LC collaboration can evolve where the involved companies in conjunction develop new competencies (Scott-Kennel and Endervick, 2005). Shallower LC with limited upgrading will occur where local capacity is low and/or MNC willingness to outsource is limited. The literature finds that LC linkages in Africa generally are few and shallow, and typically related to low risk, low technology activities such as earthmoving, catering, security, logistics, utilities and simple maintenance (Kaplinsky et al., 2011; Mjimba, 2011; Morris et al., 2012; UNIDO, 2012).

#### *The organization of local content*

The implementation of LC policies and programmes involves numerous MNC departments. In the initial negotiation over contracts, strong involvement of legal, technical and financial departments will be required to ensure that LC is economically, legally and technically feasible: Technical departments will be consulted to assess whether and how a possible technology gap between local suppliers and MNCs' standards can be bridged. Legal departments will examine local content requirements for dispensation clauses, joint procedures for tendering, and arbitration procedures (Warner, 2010a). Financial departments will calculate how compliance with LC requirements will affect the IRR and NPV of the investment.

The balance between HQ and subsidiaries in relation to LC will vary over the investment cycle. At early stages of the investment cycle, LC will typically be negotiated by HQ. As the project matures, LC becomes an operational issue and local procurement takes over. A dedicated local procurement team may be established to identify, advice and manage local suppliers (IFC, 2007) within the limitations set by global procurement contracts as well as corporate quality, safety and social standards.

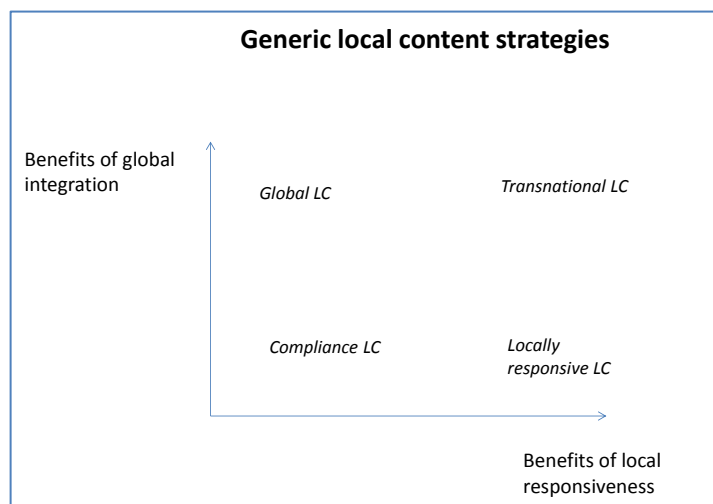
In some instances, LC will be initiated and organized by HQ CSR unit. Hence, most large extractive MNCs have adopted – at least formally – corporate CSR programmes and activities, and such programmes often are extended to include LC components (Hufbauer et al., 2013). LC as part of CSR can take the form of local

community development programmes, CSR training at local service providers and suppliers, or programmes to involve locals in building infrastructures, etc. (ICMM, 2011; BSR, 2011). A potential tension arises between the corporate CSR function and local procurement units as corporate CSR standards may counter local procurement mandates. A clear allocation and responsibilities and tasks is thus necessarily in order to avoid conflicts between the different MNC units.

### Generic local content strategies

As argued, LC provides a strategic field in which MNCs need to navigate. MNCs need to make strategic choices regarding a host of issues, including how much and how deeply they should engage in LC, how to engage with local governments and communities, to what extent should positions be filled by locals, how much should be invested in upgrading local suppliers, or how should results of LC activities be communicated, etc. At the present, the majority of MNCs in Africa do not have a clear LC strategy, but experts in the field expect that most extractive MNCs will have to adopt such a strategy within a few years (Warner, 2011). In the following, we will identify generic LC strategies that MNCs may adopt to address challenges and opportunities of local content:

As argued by classical strategic management thinking, MNC strategies are poised between mandates of global integration and mandates of local responsiveness (Prahalad & Doz, 1999. See also Hennart, 2009; Hufbauer and Schott, 2013; Qui and Tao, 2001; Birkinshaw et al, 1995; Buckley, 2009 for similar arguments). Some MNCs seek benefits from aligning operations around the world; from creating scale through concentration; and from producing synergy through division-of-labor. Other MNCs focus on building advantages through adapting to and exploiting advantages



in the various locations that they operate. Based on this logic, we can envision four generic MNC LC strategies: The responsive LC strategy will focus on aligning the MNCs' LC activities with the needs and capabilities of the host country. MNCs pursuing this strategy will seek local ownership and employ local managers as it is believed that this best allows the MNC to tap into local resources. By having local ownership, the MNC may be better positioned to engage in LC activities. This is because locally owned companies have better access to regulators, better understand institutional environments, and are better

embedded in local business networks. Global standards and procedures will be adjusted to fit local requirements and capabilities. Specific tailor-made training, monitoring and auditing schemes will be established to ensure that local rules and requirements are observed. Locally responsive LC strategies require that the MNC has strong dynamic capabilities that allow it to modify its organizational structures and managerial routines to fit the particular conditions of the host country (IPIECA, 2011). The advantage of a locally responsive strategy is that local community risks will be reduced and that chances of benefitting from local capabilities will be enhanced. The danger is that this strategy may embroil MNC in local politics and business networks which could eventually create global reputational problems. Moreover, the strategy may be costly as global routines, contracts and procedures must be modified in order to adapt to the local context.

The global LC strategy is focused on aligning subsidiary LC with the global mandates of the MNC. There will be little willingness to invest specifically in locally adapted LC solutions as this will reduce global efficiency and increase risk. MNCs subscribing to this strategy may have global objectives for LC - for instance as part of their CSR policy - but will be unwilling to adapt their global standards and organizations to local conditions. LC practices will be oriented toward securing compliance with global standards and mandates rather than with local regulations and capabilities. MNCs adopting this strategy may even seek deflection of LC requirements that conflict with their global mandates, either by seeking requirements to be changed/rolled back, or by paying lip service to local content requirements. Moreover, MNCs adopting such strategies will prefer to create LC through their global-sourcing-follower partnerships. MNCs pursuing this strategy will see the relationship to local authorities as inherently conflictual and will try to keep as low a low profile as possible in the countries they operate in.

The compliance oriented LC strategy is aimed at securing compliance with the standards and regulations of the various locations in which the MNC operates. MNCs adopting this strategy have no major strategic interest in local responsiveness or global integration of their LC. Typically, responsibility for LC will reside with subsidiary managers, but HQ will institute procedures for monitoring, auditing and reporting to ensure that all units comply with local regulations. The compliance oriented LC strategy is reactive and passive and the MNC has no ambition of establishing strategic partnership to develop the local LC sector. As LC is not part of the core strategy of the MNC, procurement managers will tend to stick to already known networks, i.e. global suppliers. While the compliance oriented strategy is a minimum strategy, the fact that LC regulations in Africa recently have become more stringent means that more MNCs are forced to embark on a compliance oriented strategy (Tordo et al., 2013).

The transnational LC strategy will simultaneously seek benefits of global integration and local responsiveness. MNCs subscribing to this strategy will for instance seek global advantages from working with LC development. Through long term partnerships with local suppliers, they will develop new competencies and strategic alliances that can strengthen their global competitive position. This strategy is consistent with an increasingly defragmented global value chain in extractives, where MNCs increasingly co-ordinate webs of externalized value adding activities. Investing in LC is furthermore seen as a vehicle for global reputational gains and for risk mitigation. The transnational LC strategy will not take the business environment for granted, but will invest in developing it through training activities and by changing perceptions and expectations among communities and regulators. A proactive approach to local supplier capacity will be adopted, e.g. by instituting supplier development programmes, supporting governmental training schemes, or seeking to improve institutions that affect the contractual environment. As LC activities are considered to have huge strategic implications for the parent, this strategy requires strong involvement from HQ. Hence, a LC policy will be formulated at the strategic level and will be implemented throughout the MNC by cross departmental teams from HQ and subsidiaries.

### **The drivers of local content strategy**

Having classified the various strategies that MNCs may adopt in relation to LC, this last section will provide a methodology for assessing where MNCs would and should place themselves based on the costs and benefits of global integrational and local responsiveness respectively. How MNCs position themselves in relation to LC requirements and expectations will eventually be determined by managers' perception of LC facilitating and LC inhibiting factors. In the following, we will seek to map these facilitating and inhibiting factors more systematically. We will argue that MNC LC strategies essentially will be formulated based on managers' consideration and perception of costs and benefits of LC. On the one hand, they will face increased costs due to LC because they have to spend more resources on setting standards for and training and monitoring of local suppliers. Moreover, they may assume risks and increased input costs. On the other hand, they may reduce costs of imports, develop new strategic partnerships and gain a better reputation in the host country and beyond. We will argue that MNCs face four generic types of costs and benefits when they consider to invest in LC: 1. Input costs and benefits, i.e. the costs and benefits of procuring inputs locally; 2. Transaction costs and benefits, i.e. the costs and benefits of engaging in contracts with local suppliers; 3. Coordination costs and benefits, i.e. the costs and benefits of aligning LC activities in one country with global mandates and policies; 4. Competitive costs and benefits, i.e. the costs benefits in terms of competitive positions vis-à-vis competitors. Eventually, the decision as to whether a MNC will

invest in LC activities, how much and in what way, will be shaped by these generic categories of costs and benefits.

### *1. Input costs*

MNCs will be interested in engaging with local suppliers, partly to reduce costs, partly to access unique local capabilities. In relation to costs, local sourcing can lead to lower transportation and logistics costs, as well as lower production costs. Moreover, as African host countries often impose steep tariffs on imports, it will be cost efficient to replace imports with LC. Outsourcing activities to local suppliers furthermore implies that the supplier - rather than the MNC - assumes many of the organizational and financial costs caused by fluctuations in the market. In relation to accessing unique capabilities, MNCs may engage in LC to access local knowledge and capabilities that it may difficult to access for an outsider. This could be access to labor resources, to local authorities or to specialized and context specific skills. LC furthermore allows MNCs to tap into local industrial clusters and share risks of investments in supply chain and human capital development with other firms. An added benefit of being part of industrial clusters is that it may ease access to stakeholders in the African host country (Wise & Shtylla, 2007).

However, frequently LC may increase input costs rather than reduce them and significantly affect FDI projects' net present value adversely (Warner, 2011; Lahiri and Ono, 2003). This is because African suppliers may be expensive, protected as they often are by import tariffs and LC reservations. What is more, while MNCs may invest in upgrading local suppliers, the technology gap to local suppliers is often too wide to bridge due to the highly specialized technological and organizational inputs required for extractive operations (Robbins et al., 2009; Morrissey, 2012). The gap is not only related to low technological capacity of local suppliers but also to lack of scale and low productivity (Robbins et al., 2009) as well as their ability to meet international CSR standards (Wilson and Kuszewski, 2011). A related problem explaining why MNCs often will resist LC is that African suppliers often have low 'absorptive capacity', i.e. weak capabilities to learn from LC collaborations (Osabutey & Debrah, 2012; UNCTAD, 2013). The pursuit of LC in such contexts may render projects too expensive, may lead to delays, and may compromise safety and quality standards (Warner, 2011).

### *2. Transaction costs*

It is not only input costs that affect the LC strategies of MNCs but also the costs of contracting in those inputs, so called 'transaction costs'. Hence, LC carries search costs, information costs, monitoring costs and enforcement costs (Hennart, 1991). These costs are determined by the nature of transactions as well as the institutional environment in which transactions take place. MNCs propensity to engage in LC will to a large



extent depend on the transaction costs of contractual relations to local producers versus the transaction costs of contractual relations with foreign suppliers and/or the coordination costs of hierarchy. Compared to hierarchy (i.e. internalized modes), LC will lower coordination costs and reduce diseconomies of hierarchy. When transaction costs are relatively low e.g. due to the existence of transaction cost reducing institutions (i.e. judicial procedures for contract enforcement and arbitration or effective certification systems), MNCs will be more willing to engage in LC (Hansen, 2014).

However, a number of factors specific to African developing countries may render the transaction costs of LC prohibitively high: First, weak institutional environments and institutional uncertainty seriously impair LC as these institutional voids raise transaction costs of contracts (Hansen, 2013, 2014). So while it may be correct that Doing Business indicators for institutional environment does not significantly influence FDI levels (Altenburg and Drachenfels, 2006), they influence the propensity of foreign investors to link up to the local economy (Hansen, 2014). Second, MNCs may frequently have invested large resources in developing global-sourcing-follower relationships. As the asset specificity of such relationships is very high, MNCs will be unwilling to switch, even if local suppliers are efficient and contracts can be enforced. Third, LC depends partly on the degree to which MNCs fear leakage of core competencies. MNCs may have no problem sharing non-core technology and skills with local firms; however they will be unwilling to risk contributing to the development of future competitors (Mjimba, 2011). Fourth, transactions that are frequent are more likely to be subject to LC than transactions that are ad hoc and few (Warner, 2010a). This is one of the reasons why LC is more likely to take place in connection with operations rather than in the initial investment phase.

### *3. Coordination costs*

A key objective for MNCs is to reap benefits of global integration and ensure that the various activities around the world are aligned and coordinated. Hence, the LC activities of MNCs in given host countries will be partly dependent on the extent to which they are aligned with the global organization of the MNC. Extractive MNCs operating in Africa are increasingly adopting highly outsourced business models, where the lead MNC becomes the coordinator and financial mediator of huge interfirm networks (Morris et al., 2012). Such de-fragmented value chains potentially reduce costs and risks, increase efficiency, facilitate access to other firms' complementary resources, and make suppliers carry the costs of fluctuations in the market (BSR 2011; Singh & Bourgoignie, 2013). In such value chains, MNCs need not maintain specialist services, and only competencies that are most effective in building competitive advantage are kept in-house (Wilson & Kuszewski, 2011). This value chain de-fragmentation opens rich opportunities for creating

LC, and is the main reason why many authors see large potential in LC policies for Africa (Morris et al., 2011a).

There is - however - a number of reasons why MNCs cannot cease this opportunity: First, while the growing specialization of the industry evidently offers new opportunities for local suppliers in Africa, it also raises entry barriers (Sigam & Garcia, 2012; Jourdan, 2008; UNCTAD, 2013). Very few African suppliers will be able to meet the increasingly stringent standards required to operate in highly specialized global value chains and the path to becoming a preferred supplier is becoming ever more demanding (IPIECA, 2008). The proliferation of social and environmental standards advocated by global consumer groups and NGOs only add to these entry barriers (Wilson & Kuszewski, 2011; UNCTAD, 2013). As a consequence, in most cases, the outsourcing of value chain activities in African extractives will lead to global not local sourcing. Second, MNCs are developing long term agreements with global suppliers. This is the so-called global-sourcing-follower model which is a model where MNCs negotiate global supplier contracts for critical inputs with a small group of preferred suppliers (Kaplinsky et al., 2011; Morris et al., 2012). The value of global lead firms within extractives is increasingly determined by the effectiveness of their global value chain (IPIECA, 2011). This model effectively locks-in many activities that potentially could have involved local suppliers (Tordo et al., 2013; Warner, 2010c). For instance, new equipment often comes with a warranty and maintenance scheme that locks MNCs into long term contracts with the equipment supplier (Kragelund, 2016). Third, MNCs have global coordination and integration mandates that will often conflict with LC in a specific country. Hence, local procurement is constrained by MNCs' quest for strategic, technical and operational alignment and scale within their global organizations and value chains (BSR, 2011).

#### *4. Competitive costs*

LC might have serious positive and negative implications for MNCs' competitiveness. On the one hand, engaging in LC may create new advantages for MNCs and differentiate them from their competitors. As LC moves to the top of political agendas in resource rich African countries and as African host countries increasingly adopt assertive approaches to LC, those MNCs having a proven LC track record will get an edge in negotiations over concessions (Hansen et al., 2015). Another competitive advantage from engaging in LC is related to community risks. Extractive operations typically have huge impacts on the local communities where they operate (Kraemer & Tulder, 2009). Lack of embeddedness in the local economy through LC significantly increases risks of community backlash. In fact, the most important source of stop-of-operation in mining is social risks, scoring higher than commercial and technical risks (BSR, 2011; Wise & Shtylla, 2007). In this situation, strong local content performance may be the MNC's 'social license to operate'. A final competitive advantage of proactive investments in LC could be that MNCs may get first mover

advantages, e.g. by obtaining exclusive control over the best local resources or by getting an opportunity to influence and shape LC policy and institutions at early stages of LC development (Buur et al., 2013).

But while strong performance on LC may create new competitive advantages for MNCs, these advantages must be balanced against the competitive disadvantages deriving from the above mentioned higher input and transaction costs. Moreover, engagement in LC may imply reputational costs for MNCs. Hence, it has been argued that awards of LC contracts in Africa often are part of local political settlements and rent seeking activities. As such, LC engagement may embroil MNCs in local power games and expose them to rent seeking efforts (Buur et al., 2013), with potential negative reputational ramifications.

## **Implications and conclusion**

To sum up, we have argued that local content is an evolving strategic field for MNCs, historically mostly related to extractives, but spreading to other sectors, in particular utilities and later also large scale manufacturing. The LC requirements offers a grey zone with high levels of legal, competitive and operational uncertainty and ambiguity which opens up for strategy. For growing numbers of extractive MNCs investing in Africa, it is essential to consider how they could and should position themselves in this emerging field. The paper presented the tools, procedures and organizations that MNCs may adopt to engage this field. Overall, MNCs must decide the extent to which they will engage in the field and whether they want to be highly responsive to host country calls for LC, or they want to maintain the integrity of their global value chains and strategies. The paper argued where MNCs position themselves in this strategic field depends on the costs and benefits of global integration and local responsiveness respectively. On the one hand, MNCs may view LC as an opportunity for differentiating themselves against competitors, for reducing risks and costs, for improving reputation, or for developing new capabilities through strategic partnerships. On the other hand, MNCs may view LC as a cost that undermines the profitability of its investment, as a risk for its reputation and as an impediment to the smooth operation of its global value chain. A framework for analyzing and prescribing the strategic positioning of MNCs was provided that may inspire and inform future deliberations over MNC local content strategy.

By providing a strategic management perspective on LC, the paper filled a void in a LC literature that is more or less exclusively informed by economic, value chain and political-economy perspectives. By offering typologies of MNC LC practices and strategies as well as an analysis of drivers of MNC engagement in LC, the paper has illustrated the breadth but also heterogeneity of an evolving

The drivers of MNC local content activities in Africa			
		Direction of pressures and incentives	
		<i>Pressures favoring responsiveness to LC requirements</i>	<i>Pressures countering responsiveness to LC requirements</i>
<b>Dimensions</b>	<i>Input costs and benefits</i>	Reduce costs of inputs Gain access to local networks and resources	Expensive local suppliers Lack of competencies among local suppliers Low quality of inputs
	<i>Transaction costs and benefits</i>	Diseconomies of hierachi makes LC relatively more attractive	Weak contractual environment, weak IPR protection and regulatory uncertainty increases transaction costs of LC
	<i>Coordination costs and benefits</i>	Growing outsourcing in extractive value chains Global CSR and community responsiveness pressures	Global quality, safety and social standards Switching costs of global contracts Global scale and synergy
	<i>Competitive costs and benefits</i>	Proven LC capability a differentiator Proven LC capability a social license to operate LC gives first mover advantages in factor markets	Cost disadvantage in financial markets Non-exclusivity of LC contracts Reputational risks of LC

management field. This conceptual work can be seen as a first step toward developing more specific hypotheses regarding MNCs' responses to LC challenges and opportunities in Africa and beyond.

For African policy makers, a better understanding of MNC LC strategies and practices is essential. In fact, it is probable that a main reason why African LC interventions have been ineffective in the past is that these interventions were based on an inadequate understanding of the interests and strategies of MNCs. Policy makers need to understand the conditions under which MNCs will react favorably to LC requirements and when they will not. Introducing LC requirements that are misaligned with MNC strategies may lead to divestment, window dressing local content, rent seeking, and preservation of unproductive local industries. More MNC aligned LC policies would, *inter alia* imply that African governments engage in supplier development programmes that ensure that MNCs can find qualified local partners to team up with; that governments focus on improving the contractual environment so that MNCs and local suppliers can engage in long term contractual collaborations; that governments have realistic expectations to which kinds of value chain activities MNCs will be able and willing to localize; and that governments ensure consistency between LC polices and other policy domains. Only if governments start producing LC policies that are based on a sound understanding of the mandates and strategies of modern extractive MNCs, will they be able to harness extractive MNCs for sustainable development!

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