NIGERIA: NATIONAL CAPACITY
BUILDING CAPACITY IN THE OIL SECTOR THROUGH “INDIGENIZATION” POLICIES

OVERVIEW

LEVEL OF OPERATION:
National

GOVERNMENT ROLE:
Regulatory and as JV partner

FOR MORE INFORMATION:
See Nigerian Content Development and Monitoring Board; for historical accounts of Nigeria’s indigenization policies and its state-owned oil company, see references in the case study, particularly Ovadia (2013), Nwokeji (2007) and Frynas (2000).

KEY COMMODITIES:
Oil and gas, coal, tin

TOTAL NATURAL RESOURCE RENTS (AS % OF GDP) [2015]:
4.7 per cent

NATIONAL EXTRACTIVES COMPANY:
Nigerian National Petroleum Corporation

UNDP HUMAN DEVELOPMENT INDEX VALUE [2016]:
0.527 (Global Rank 152)

Nigeria is Africa’s largest oil producer, and the 10th largest in the world. The country is significantly dependent on the oil sector, which provides the majority of economic activity (35 per cent of GDP), foreign exchange earnings (over 90 per cent) and government revenue (up to 80 per cent). Despite its size, the sector has operated as an enclave industry for many years, and successive initiatives to build indigenous capacity have failed to meaningfully reduce Nigeria’s oil sector dependence on foreign capital and expertise. Things have somewhat improved in recent years, following an overhaul of local content policies as well as a maturing of the industry. However, to this day, using resource wealth as a means for national development and poverty reduction remains a challenge, after more than five decades of oil and gas exploration and production.
INITIAL INDIGENIZATION DRIVE IN NIGERIA’S OIL SECTOR: THE NNOC / NNPC

The first successful well was drilled in Nigeria in 1956. Throughout the 1960s, Nigeria’s petroleum policy was largely limited to fiscal changes and did not attempt to intervene directly in the running of oil exploration and production. Oil companies hired locally as it reduced their costs, but a key constraint was the shortage of skilled Nigerian nationals. Nigeria’s Petroleum Act of 1969 included a requirement that owners of oil drilling leases ensured that within 10 years at least 75 per cent of the workers employed as professionals, managers and supervisors in their operations would be Nigerians. This did not happen, as enforcement of these policies was weak.

Following the Civil War, Nigeria joined OPEC in 1971, with an immediate effect on the country’s oil policy as OPEC encouraged nationalization. Thus, the Nigerian National Oil Corporation (NNOC) was established as a vehicle for the promotion of Nigeria’s indigenization policy in the petroleum sector. Indeed, an indigenous petroleum industry appeared promising in the early 1970s: successful government participation was deemed necessary to “play a large role in determining the extent of future economic gains from petroleum.”

However, conflict existed between the NNOC and Petroleum Ministry officials, who did not let NNOC develop oil-related activities. It has been reported that a key powerful official, who had no background in oil or energy, but was nominated as NNOC chairman, routinely overruled the professionals in the company and Ministry. As a result, Nigeria failed to take advantage of the crude oil price spikes of 1973–74 and was losing customers. A panel set up to review the situation in 1976 described Nigeria’s oil resources as a “wasting asset.”

The NNOC became the Nigerian National Petroleum Corporation (NNPC) in 1977 through a merger with the Petroleum Ministry. Until 1986, when the Ministry of Petroleum Resources was reestablished, the NNPC peculiarly combined the functions of an oil company with the regulatory powers of a ministry. The NNPC’s ambitious goal was to eventually control the entire oil industry in Nigeria. While it became an increasingly important player in the oil market, its impact on capacity development has been disappointing. NNPC being one of the better-paying employers in the country—senior managers and others with influence on the corporation were under pressure to secure employment for relatives, friends and allies, a practice that ensured overstaffing and the employment of many unqualified people. Despite its relative autonomy in its early years, NNPC was described as “hopelessly inept” and became entangled in allegations of massive fraud.

---


7 Nwokeji (2007). Id. note 4, pp 15–16.


By 1979, the government had acquired 60 per cent ownership in all the major foreign oil companies except for one production-sharing agreement. This indigenization of the oil industry changed little, since the foreign companies retained managerial control of the joint ventures despite minority shareholding. Government participation had little more than financial implications. In one telling case, Nigeria nationalized BP’s share of a joint venture in 1979, thereby owning 80 per cent, but let Shell continue to operate it on behalf of government. The NNPC never carried out its threats to fully nationalize the oil industry; on the contrary, the decline in exploration in the 1970s led the government to introduce increasingly generous fiscal incentives in the early 1980s to stimulate investment by foreign companies. Government officials simply recognized that Nigeria could not dispense with foreign companies. The lack of domestic capacity was dramatically compounded by the immediate problem of falling oil prices (and thus major losses of government revenues) and political crises. The Nigerian state’s ever-greater reliance on revenues from foreign oil companies left it with few alternatives.

Despite increased oversight and a vigorous (and partly successful) anti-corruption drive by a military junta in power from 1983 to 1985, the NNPC remained “unwieldy, amorphous, and over-centralized.”\(^\text{10}\) In the decade following the mid-1980s, unprecedented changes and structural reforms of NNPC occurred, including separation of the corporation into five “semi-autonomous” sectors, separation of the regulator, a hiring freeze and restructuring of the corporation into a commercial entity. However, a complacent attitude toward corruption undermined the reforms and organizational improvements. NNPC and the highest echelon of government were cited in messy petroleum deals, and the organization continued to struggle and be marked by excessive red tape and bureaucratic delays.

Indeed, NNPC’s long struggle for focus and autonomy has been one of several problems hindering the development of the corporation and the Nigerian oil and gas industry as a whole. From the beginning, there has been a tendency to tie it directly to the presidency, as a patronage resource and source of corruption that has marked public administration in the country. In 2006, NNPC’s wholly operated production was a mere 10,000 barrels per day, plus a 50,000 to 60,000 barrels per day operation where Italian Agip functioned as service contractor. The engagement of a service contractor itself underscored the company’s unsatisfactory progress, the consequence of neglect, political interference and inability to independently source financing, among other problems.

The Nigerian state’s ever-greater reliance on revenues from foreign oil companies left it with few alternatives.

**POLICIES IN FAVOUR OF INDIGENOUS PRIVATE COMPANIES**\(^\text{11}\)

Although indigenous participation in the form of private enterprise has been allowed in all spheres of the oil industry since the 1960s, it remained limited to small-scale distribution of refined products. The only two indigenous private oil companies in the 1970s and 1980s did not survive, and until the late 1980s there were virtually no private indigenous companies.

\(\text{10 Nwokeji (2007). Id. note 4.}\)

\(\text{11 Based on Ovadia J. S. (2013). Indigenisation vs. domiciliation: A historical approach to national content in Nigeria’s oil and gas industry. In T. Falola, & J. Achberger (Eds.), The political economy of development and underdevelopment in Africa, London: Routledge; and Frynas (2000), Id. note 4.}\)
The upstream sector was effectively opened up to private indigenous companies with the first public bidding for oil blocks in late 1990. As a result of the government’s indigenization measures and readiness to grant licences to newcomers, private indigenous oil companies came to own a significant number of oil licences: almost 40 indigenous private companies owned licences by the end of 1993, and 46 by 1999. From the early 1990s, indigenous oil companies expanded their exploration and production operations.

However, the rise of these indigenous oil companies did not threaten the dominance of large oil companies: by 1997, the two largest indigenous companies represented less than 1 per cent of Nigeria’s production, compared to 97 per cent for the six large established companies (Shell, Mobil, Chevron, Elf, Agip and Texaco). Moreover, indigenous companies lacked intrinsic technical and financial capabilities to conduct operations. Thus, technical partnerships with Nigerian companies became an effective strategy for small foreign oil companies to enter the market, leading to increased penetration of Nigeria’s oil sector by foreign companies.

More problematically, the awarding of oilfield concessions, often on a discretionary basis, was always an important vehicle for graft in the Nigeria oil industry. Allocation of oil blocks to indigenous companies, without opening them up to public competitive tender, was seen as a way for leaders to help cronies, political and business associates, and sometimes misappropriate resources themselves by proxy.

The Nigerian government renewed its local content efforts in the early 2000s. The Marginal Fields Program was introduced in 2001 and was designed to give local companies greater access to oil fields. A marginal field was defined as any field that had oil and gas reserves booked and reported annually to the Department of Petroleum Resources, but which had been unproductive for a period of over 10 years. Locally owned firms could bid on these oil fields. In 2003, 24 fields were awarded to 31 companies, but only nine were eventually developed and accounted for just 4 per cent of output. Difficulty in accessing finance was cited as the major factor in the inability of many of the licence holders to develop the fields. Other constraints included the highly technical nature of the petroleum industry, security issues and a difficult operating environment. Some local operators also acted as fronts or proxies for foreign investors who eventually bought the assets. Despite these constraints, 31 more marginal fields were listed for bidding in 2013.

In 2005, the Local Content Vehicles Program (LCV) was introduced on the bidding for oil licences. Each bid had to include a minimum 10 per cent share for local content vehicles that would be full-paying partners. The program intended to strengthen the capacity of Nigerian oil companies through direct ownership in international oil companies’ operations. However, the program created numerous shell companies, and only 10 per cent of the more than 100 approved local content vehicles had prior experience in the sector, indicating again some patronage and fronting. Furthermore, most of the local content vehicles were unable to pay for their 10 per cent shares, while others sold their share

From the early 1990s, indigenous oil companies expanded their exploration and production operations.

---

just after it was awarded to them, a loophole in the program. The LCV program was only used in 2005 and was ultimately viewed as unsuccessful, as it did not result in building local capacity as intended.14

Following investments in human capital by the NNPC and some of its joint venture partners over the years (including training programs and scholarships as required by local content policies15), a crop of competent and experienced Nigerian engineers, geologists and geophysicists emerged. Some established private oil prospecting and oil services firms.16 However, their ability to gain a foothold in the upstream sector was severely impeded by a lack of capital. The Nigerian banking sector had little capability to carry out energy financing. Managerial capacity was also missing, as most indigenous contractors had no formal business structure. On the other hand, greater local ownership and operation of oil companies raised concerns about the handling of environmental and security issues.

TECHNOLOGY TRANSFER REQUIREMENTS

The slow progress of indigenization and lack of benefits from the oil industry led to the passing of the Nigerian Oil and Gas Industry Content Development Act of 2010 (the “Act”), a comprehensive overhaul of the local content policy framework. The Act is extensive and is designed to promote value added by Nigerian firms, covering various requirements and interventions in terms of local content and preferential access.

It also established a Content Development and Monitoring Board to oversee implementation.

Among other things, the Act requires oil operators to submit an annual plan “setting out a program of planned initiatives aimed at promoting the effective transfer of technologies from the operator and alliance partners to Nigerian individuals and companies.” It further offers some details on what is required: “The operator shall give full and effective support to technology transfer by encouraging and facilitating the formation of joint ventures, partnering and the development of licensing agreements between Nigerian and foreign contractors and service or supplier companies...” and “The operator or project promoter shall submit a report to the Board annually describing its technology transfer initiatives and their results...”17 This makes Nigeria one of only a few countries to have legislated actual technology transfer requirements.

Despite some resistance from international oil companies and excessive ambitiousness (or unrealistic expectations) of targets set by the Act, there has been a marked improvement in local content overall.18 However, little is publicly known about the success of technology transfers, as the annual plans are confidential. International oil and service companies are traditionally perceived to be resistant to the transfer of technology, and progress is likely to be neither easy nor quick.

---

14 Ibid.
16 Columbia Center on Sustainable Investment (CCSI). (2016). Linkages to the resource sector: The role of companies, government and international development cooperation. Eschborn: Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH.
KEY LESSONS

- To be successful, policies to build national capacity must address in combination existing shortages in technical expertise, managerial, institutional and financial capabilities. These are not easy to implement in a low-capacity environment.

- Well-crafted regulation can support the creation of national capacity, but requires a long-term approach. Policies set without consideration of existing capacity, poorly designed or lacking enforcement, lead to firms seeking loopholes or ways to circumvent the policies.

- Training locals for skills and in mid- and upper-management roles is critical to building capacity, as these employees may later run a state-owned enterprise or go on to start their own business in the sector.

- Public administration of the extractives sector is generally most effective when policy, regulatory and commercial functions are performed by separate bodies, with the state-owned enterprise (SOE) restrained to the commercial space. Lack of autonomy and focus results in a poorly-managed SOE that can fail its mandate and inflict significant damage on the sector.

- Programs designed to develop national capacities can also be used as vehicles for rent-seeking, clientelism and elite accumulation. In Nigeria, a significant portion of resource wealth has been used for private gains. There is no easy solution to fixing broader institutional and governance weakness in the context of resource abundance, but it should be taken into account in local content policies.