Establishing a Local Content Unit for Rwanda

In brief

- The Government of Rwanda has recently drafted a “Made in Rwanda” (MiR) policy that seeks to improve the overall trade balance by improving perceptions of Rwandan products within the country. Part of this proposal includes the establishment of a Local Content Unit (LCU) that connects new investors with potential local suppliers.

- Based on lessons learned from Ethiopia, Tanzania, and Rwanda, this policy note provides initial guidance on the appropriate design of a Rwandan LCU. It offers lessons on who should lead the LCU, what should be its responsibilities in the first 24 months, the appropriate target setting, and the linkages between the LCU and other departments (government and donors).

- Establishing a LCU could help realise the objectives set out in the Made in Rwanda policy by fostering linkages between foreign and local firms. It may also push domestic suppliers to improve their product quality in order to meet the input standards of demanding multinational firms.
Introduction

The Government of Rwanda has recently drafted a “Made in Rwanda” (MiR) policy. This seeks to improve the overall trade balance by improving perceptions of Rwandan products within Rwanda, promoting nascent industries, and boosting the productivity of exporting sectors (MINEACOM, 2017). A key proposal within the MiR policy to help realise these objectives is the establishment of a “Local Content Unit” (LCU):

“[Rwanda Development Board] RDB will consider setting up a Local Content Unit within its investment promotion department that will connect new investors with potential local suppliers…The LCU would essentially be a matchmaking service offered to investors. The LCU would also set up ‘supply meetings’ where the investor can share their requirements and receive quotes from local suppliers.”

The aim of this brief is to support this initiative, and provide a more detailed proposal on how Rwanda could structure such an LCU. In part I, we set out the reasons why it is the appropriate decision to establish an LCU. Here we will argue that improved linkages between large firms and local suppliers are key to meeting the overall MiR objectives, and that LCUs are the most appropriate solution to accomplish this. Part II then looks at how to establish an LCU. This will cover the IGC’s proposal on how the LCU should be led, the LCU’s initial responsibilities, target setting, and linkages between the LCU and others (government/donors).

Part I: Why establish a Local Content Unit?

In recent years, several large multinational firms have started operations in Rwanda (including several big manufacturing plants, agro-processors, airlines, and international hotel chains). The economic benefit of such anchor firms can be extended significantly if they would increase their share of inputs and supplies purchased locally.

The importance of linkages between anchor firms and local suppliers

When firms choose to increase their share of local content, it tends to provide important direct benefits for domestic producers. Domestic suppliers that have stronger links to large, exporting firms tend to experience larger increases in their overall output and productivity (Spray, 2017). If local content would substitute for imported goods, it would also lower the import bill and thus improve the trade balance, as Rwanda’s “Domestic Market Recapturing Strategy” aims for (MINICOM, 2015).

Improving linkages between domestic suppliers and large exporting firms also brings with it important medium-term learning benefits for domestic suppliers. To meet the high demands of foreign buyers, exporters
also require high-quality inputs. To receive these, they tend to be more demanding of domestic suppliers, who in turn are required to learn to produce higher-quality goods (Kugler and Verhoogen, 2012, Bastos, Silva and Verhoogen, 2016). For that reason, Sutton (2014) argues that “the most powerful engine of capability building lies in firm-to-firm interactions in supply chains”. Importantly, empirical assessments suggest that vertical supplier relationships, where domestic firms supply goods and services to large exporting firms, are more conducive for generating positive externalities through backward linkages than horizontal intra-industry interaction between domestic firms and exporters (Javorcik, 2004). These medium-term productivity benefits can be considered even more important than the direct effects on increased output, as they tend to drive economic growth, and by signalling the competence of Rwandan industry could even attract additional multinationals to settle in Rwanda (Sen and Logan, 2016).

**The main challenges to improving local content**

While large multinationals often express strong interest in increasing their share of local content, two main challenges prevent them from doing so (Sutton, 2014):

- **Information asymmetries:** Newly established international firms often do not have extensive local networks, and so are unfamiliar with all the inputs that domestic suppliers may be able to provide. As a result, firms instead rely on their previous set of trusted international suppliers.
- **Quality-constrained local suppliers:** Many firms rely on imports because the specific types of high-quality technical inputs cannot be found domestically. Improved local sourcing would thus only be possible if domestic supplies are of comparable quality to imported goods and can therefore function as substitutes.

**Approaches to improving local content**

One approach commonly adopted in countries to stimulate local content use is to rely on local content regulation (Sutton, 2014). An example of this can be found in Latin America’s car industries, which often had strict local purchase rules for all producers (e.g., x% of certain goods must be purchased from domestic firms). Such rules were generally unsuccessful and had negligible effects on local content use for two reasons. Firstly, it is easy to circumvent such policies through creative accounting practices and deceptive statistics (Sutton, 2014). They are difficult for governments to enforce and raise administrative costs considerably. Secondly, this policy did not explicitly address either of the two constraints to improving local content use mentioned above, namely information asymmetries and quality-constrained local suppliers. Instead, it would force producers to use higher-cost and lower-quality domestic inputs, creating market inefficiencies that would thus reduce the overall productivity and competitiveness of the export sector (Spray, 2017). This both discourages
foreign investment in the host country and also raises costs to local consumers (Johnson, 2016).

The other approach is to use long-term dialogue and training by a designated government agency in order to persuade and facilitate improved local content use for multinationals: the Local Content Unit. As argued by Sutton, “What is needed is a small, highly professional team that can liaise with Multinational Firms in a co-operative manner, and with a deep understanding of both (a) local capabilities, and (b) the feasible modes of engagement of local firms in supply-chains” (Sutton, 2014). Such a facilitation approach is considered superior to regulation because its voluntary nature requires the government to understand and engage with the multinational’s current constraints to local content use and provide a solution that aligns with their business interests. To do so, it would tackle both constraints identified above:

- Address information asymmetries by suggesting potential local suppliers (firm linkages): The LCU would use its extensive knowledge and relationships with local suppliers to ‘suggest’ possible new linkages.
- Quality-upgrade local suppliers (firm-specific trainings): Based on initially explored potential linkages, the LCU would further work together with the anchor firm to ensure the potential Rwandan supplier receives the appropriate training and capability building to produce the required input specifications and meet the input quality standards.

In contrast to local content regulation, the government’s active involvement in matching domestic firms to large exporters ensures improved implementation and monitoring of use of local suppliers.

An example of the possible benefits an LCU may bring can be found in Box 1 for Ghana. This shows that there are extensive benefits from ensuring multinationals increase their local content use. Yet, Tullow Oil was only able to identify reliable domestic supplier relationships after it actively reached out to new suppliers and provided targeted training. This suggests that none of these benefits would have likely arisen from a crude ‘local purchase’ rule. In addition, Tullow Oil was only able to invest in training local suppliers because of the size of its oil investments. An LCU would be able to extend such services and training schemes to a much larger range of businesses.
Box 1: Increasing local content use for Tullow oil, Ghana

Tullow Oil is an independent oil and gas exploration and production company working in Africa with operations in Ghana and Uganda. As part of Tullow Oil’s business model, it seeks to maximise participation of local businesses within their supply chain.

To bridge the information gap between the company and local suppliers, Tullow held a series of contract awareness events. It also ensured that local suppliers met its high quality standards by establishing its own training development mentoring and coaching, and vocational training schemes.

While this constituted a considerable investment, it resulted in a range of reliable and durable relationships with domestic suppliers. In 2015 they spent $309 million on local suppliers in areas such as medical equipment, civil and mechanical engineering services, transport services, security and freight forwarding. This ensured that the benefits of Tullow Oil’s operations extend far beyond the oil industry.

(Sutton, 2014)

Part II: What is the appropriate design of a Local Content Unit?

Many countries across sub-Saharan Africa are currently aware of the need for a facilitative approach to extending the share of local content use for multinationals, and have experimented with different types of organisational design. In this section, we will provide some recommendations for a Rwandan LCU based on initial lessons learned from similar units in Ethiopia and Tanzania.

Who should operate the LCU?

The role of the LCU is difficult because it tends to combine responsibility over a series of government tasks with high-priority objectives (e.g., stimulating job creation, reducing the trade imbalance), yet also requires an extensive understanding, engagement, and interaction with private sector actors.

The location of the LCU tends to reflect the balance between these two elements. For instance, the Government of Tanzania has allocated responsibility for local content management to the Planning Unit under the Office of the Prime Minister. This has the benefit of empowering the LCU through political authority and can also help improve coordination between different ministries which all may need to play a role in facilitating ties or providing trainings to local suppliers (Hymowitz, 2016). For Ethiopia, the LCU is part of the Investment Promotion Agency, which
has excellent working relations with multinationals and may thus be able to better facilitate firm-to-firm cooperation.

For both Tanzania and Ethiopia, it was considered necessary for the head of the LCU to be a senior appointment who can report directly to political officers, but also someone who is considered as politically ‘neutral’, well-connected, and widely trusted and respected by the business community. The rest of the team tends to be a small group of highly able and motivated members. For instance, after several years of operation, Ethiopia’s unit has grown to around ten members: six drawn from relevant ministries, two local professionals with relevant private sector experience or relevant technical expertise, and two international members with experience of contract negotiations with multinationals (Sutton, 2014).

Based on international evidence, we thus recommend the following for the operation of Rwanda’s LCU:

- The LCU could be established as a separate unit within RDB, reporting directly to the Chief Operating Officer (COO). This would build on the excellent work conducted in recent years to attract foreign direct investment and supporting investment aftercare.
- It may be advisable for the LCU’s head to be a senior appointment, and considered to be politically ‘neutral’, well-connected, and trusted and respected by the business community.
- To allow for the selection of a highly skilled group of staff members, the government may choose to keep the rest of the team small: three ‘expert’ officers with relevant technical expertise.

**Initial responsibilities of the Local Content Unit (first 24 months)**

As described above, all LCUs have two main responsibilities: improving firm linkages (suggesting potential local suppliers) and providing firm-specific training (to meet higher quality standards).

Established LCUs tend to split these two operations into separate ‘sub-units’. For the Ethiopian Investment Commission, for instance (see box 2 below), these are embodied in a “Relationship Building Programme” (RBP) and an “Enterprise Development Centre” (EDC). Tanzania (see box 3) also has an EDC, but its role differs slightly and is less tailored to the needs of individual supplier companies. Instead, a broad set of key ‘capabilities’ are identified for training and capacity-building (including both administrative and technical skills). Completion of this programme for local supplier firms then allows them to become “approved vendors” to the target multinationals (Sutton, 2014).

For the purposes of a new LCU, it is sensible to sequence these two elements. The first main task is to identify all the leading multinationals across all sectors, with the aim of getting to know these companies and
beginning to understand their main current sourcing operations (imports and local content). Only after that could opportunities be mapped out and explored in detail. It can work with both the buyer and supplier firms to help identify the needs for a set of detailed training programmes. It can also ensure that the training is provided (through direct financing, or liaising with development partners). Yet, after this training period, it is key that the LCU steps back and relies on the firms to further develop their mutually-beneficial relationship. Interference on the side of government at this stage may either scare off interested parties or raise expectations for additional ‘incentives’ for future collaborations (which would undermine the integrity and sustainability of the LCU).

Box 2: The Ethiopian Investment Committee

In Ethiopia, the role of the LCU is taken up by several units of the Ethiopian Investment Commission. One key initiative for this lies with the “Relationship Building Programme” (RBP), which is responsible for overall ‘intervention aftercare’ and seeks to engage with large investors on a continuous basis. To ensure investor challenges are promptly resolved, a number of set routines are adopted through a two-tier meeting structure: fortnightly meetings to discuss live issues, and quarterly meetings for a comprehensive review of firms’ big issues. Challenges and opportunities for greater supply chain linkages with domestic suppliers are integrated into this system.

The EIC further stimulates supply chain linkages through a series of forums. Here, prospective international lead firms are invited to discuss their local content constraints (e.g., in terms of health and safety standards, technical and business requirements) to help prospective suppliers better understand the MNCs’ constraints. Similarly, prospective suppliers are able to make themselves noticeable and discuss possible future collaborations. In order to stimulate firm capacity, the EIC also has an “Enterprise Development Centre” (EDC). This aims to provide targeted trainings to a supplier firm once a set of input item specifications has been drafted by the buyer, compared to the supplier’s current capability, and a detailed training programme has been agreed between the two parties.

While the EIC’s activities have only been operational for a few years, the initial results are promising. This includes the integration of local firms into the supply chains of retailers (including H&M and Unilever) and selected major food processors (including Nestle and PepsiCo). For some of these local firms, trainings are still ongoing to help raise their business practices and quality standards to the required level, but after completion their certification is expected to exhibit large benefits for the local firms’ supplies and increase access to international markets.

(Sen and Logan, 2016).
Box 3: Tanzania’s Local Content Unit

In Tanzania, the main impetus to establish a LCU came from the discovery of offshore gas. To ensure the benefits from this industry were extended to the wider economy and improved domestic job creation and business development, the Government of Tanzania aimed to build up a pyramid of contracting relationships between a prospective international lead firm, a local lead sub-contractor, and smaller local firms (that are contracted by the local lead sub-contractor). The Unit is working to develop its knowledge of local companies and has convened meetings with domestic construction firms to assess which firms have the ability and interest to engage with the supply chain.

So far, the overall impact of Tanzania’s LCU is unclear. Meetings with multinational gas firms and their lead foreign construction firms are ongoing. A key outcome of the engagement process will be to agree on training arrangements for a set of local SMEs in construction to qualify as ‘approved vendors’. The government is also currently looking to partner with a number of development partners in order to finance the training programmes.

(Sen and Logan, 2016).

Following the lessons learned from Ethiopia and Tanzania, the following may be a helpful guide for initial responsibilities of Rwanda’s LCU:

For the initial three months of the LCU:

- The LCU may choose to identify and become well-acquainted with 20 large leading companies that could improve their local sourcing. It may also be helpful to complete a detailed report that describes current sourcing operations (imports and local content) for all these companies.
- Based on the list of the 20 large companies’ imported goods, the LCU may wish to identify 30 high-potential (large and SME) domestic supplier companies that could potentially serve as suppliers for the 20 leading companies.

For months 4-6 of the LCU:

- It is helpful to directly share and discuss the list of potential suppliers with the 20 leading companies. Allowing for immediate rejection of any supplier that they do not regard as feasible (e.g., due to poor previous working relationship) may help avoid future disappointment.
- Next, the individual leading companies and potential domestic suppliers could be brought together in a series of meetings to explore potential future collaborations.
- Afterwards, a joint report could then be drafted with the leading companies that reflects back on the process and determines which potential domestic suppliers are worth progressing with and what type of
training, inputs, or assistance is required in a one-year window.

For months 7-24 of the LCU:

- For each of the possible buyer-supplier linkages, the LCU may then wish to work with the leading companies to develop a detailed, costed programme (between 6 and 18 months in length) to offer training and support to enable the domestic supplier to produce goods and services that meet the leading company’s quality standards and goods and services specifications.
- The LCU could then have the mandate to finance such training programmes directly or may wish to approach development partners and ensure they can offer the training support.

Target setting of the LCU

As with any new government initiative, it will likely come under considerable pressure to show prompt results for its initiatives once operational. However, promoting firm-to-firm linkages is a difficult and time-consuming process. Based on the findings from the Rwanda Supplier Development Programme (Box 4), a short timeframe can seriously undermine the effectiveness of the intervention.

For target setting of Rwanda’s LCU, the government may wish to consider the following:

- Start small, and seek to grow over time. While initial results are important to establish credibility, trying to do too much at the outset could set the LCU up for failure.
- Implement the training programmes on a ‘rolling’ basis (so that firms that are more advanced in establishing their training programmes do not have to wait for others).
- Aim for a few ‘headline’ results after 12 months (e.g., initial supply contracts signed for three firms) but expect that the first big results will only become apparent after 24 months.
- Integrate an effective monitoring and evaluation framework in order to assess progress, learn lessons, and shift LCU policy in the medium-term.

Linkages between the LCU and other government activities

In order to adequately address the underlying constraints to improving local content, LCUs cannot operate on their own. For that reason, they are closely integrated with other government activities in both Ethiopia and Tanzania. The case of the Rwanda Supplier Development Programme (Box 4) provides additional support for this. Two other government activities can helpfully support the LCU’s activities: a complementary firm database that lists the activities (and credibility) of domestic suppliers, and pre-existing private sector development programmes that would assist and lower the risks to suppliers’ quality upgrading (such as the Export Growth
Facility). While these are complementary, it is critical that the LCU does not hold off its activities, and develops its own, independent expertise.

For linkages between Rwanda’s LCU and other government policy, the following may be helpful:

- Building links with other government programmes can strongly improve the effectiveness of the LCU. The RDB firm database in particular could provide a wealth of data in order to identify potential new domestic suppliers to link to multinational firms. Similarly, collaborations with the Export Growth Facility may help suppliers reach export markets and thus reach the minimum necessary scale for which it is worthwhile to invest in new production capabilities.
- However, it may be wise for the LCU not to rely too much on other government activities (e.g., wait for such databases to be completed, or rely too extensively on one source of data). The main source of expertise to develop firm linkages should come from visits, interviews, and dialogue meetings with domestic suppliers.

**Linkages between the LCU and donor support**

A final consideration around the LCU is to assess the appropriate role of support from developing partners. This can be particularly important to finance firm-specific upgrading. However, careful attention should be paid to ensure that the LCU staff continues to lead all the work, and that donor support does not undermine the initial critical stage of relationship building with target firms.

For linkages between Rwanda’s LCU and donor support, international evidence suggests the following:

- To build up the capacity of the LCU and foster long-term relationships between the LCU and target firms, the government may wish to ensure that the LCU team conducts the initial work themselves (including conducting firm meetings, writing up summary reports). This means it can be helpful not to rely on the labour or expertise of external consultants, especially in the initial phase of the work.
- Development partners will be important in financing firm-level trainings and support. It is important, however, that such support is drafted only after initial firm-to-firm links are made and a draft programme has been developed based on a tailored list of desired input item specifications from buyers, and a target list of domestic suppliers drafted by the LCU.
Box 4: Rwanda supplier development programme

An early attempt to improving domestic linkages in Rwanda is the “Supplier Development – Backward Linkages Programme”, piloted by Trademark East Africa. The programme aimed to identify five opportunities where a single buyer was spending more than $250,000 per annum on a product that could be supplied by a local company already producing the product or service.

The Supplier Development Programme was set up in a comparable way to the proposed LCU:

• In Phase I, the team contacted more than 30 Rwandan companies to understand their current import practices. They also identified 50 potential product and service opportunities for consideration, with 20 pursued in detail. A final list of eight items were approved for Phase II and MoUs were signed with each of the buyers (signifying their interest in the programme, their willingness to partner with a supplier if quality, cost, and volume requirements were met).
• During Phase II, the consultants then surveyed the local market and through interviews enrolled specific suppliers into the programme through the signing of a MoU.
• During Phase III, the consultants developed action plans together with the suppliers to help win the buyer’s contracts. However, the programme had no explicit funding for implementation of the action plans, so that discussions revolved around whether suppliers were willing to make the necessary investments to achieve quality and cost improvements.

After 24 months, the programme resulted in two concrete deals (at values of $150,000 and $450,000 per annum). While these are considerable results, they do fall short of the initial target of five high-stake deals. The authors note six lessons to improve effectiveness of the programme:

• Lesson 1: (External) investments are needed for suppliers to meet quality standards
  Many proposed linkages did not come to fruition because neither buyer nor supplier wanted to bear the risk of investment or purchase commitment without the other’s guaranteed assurance. If an LCU would assess viability of the investment and share the risk (possibly through training or loan schemes), it would reduce suppliers' risk and provide confidence to the buyer of the supplier’s ability and commitment to upgrading its production capacity.
• Lesson 2: Leverage public procurement regulation for local suppliers
  Government purchasing can further reduce the investment risk of suppliers’ production upgrading by offering a predictable long-term buyer. This is also reflected in the Made in Rwanda policy.
• Lesson 3: Integrate export promotion into supplier upgrading plans
  The feasibility of suppliers’ investments were often closely aligned with production scale. Just supplying to the targeted large domestic buyer was insufficient to justify a major improvement in production capacity. It is thus key to integrate export growth opportunities into firms’ upgrading plans, and aligning this with other programmes (e.g. Rwanda’s Export Growth Facility).
• Lesson 4: Lower the programme’s overall targets
  The Supplier Development Programme should lower targeted supply opportunities from $250,000 to $50,000 per annum. This will open up more opportunities, and will make technical assistance more financially feasible.
• Lesson 5: Allow more time for gaining agreements and vetting participants
  Programme delays came because buyers and sellers needed more time to agree on potential deals, and local companies also required more time to meet minimum requirements. It is thus key to keep short-term expectations low. In addition, it is advisable to move to a ‘rolling’ implementation approach where different firm-to-firm linkages can be at different stages (i.e., some are still in early discovery stages, while others have moved into the training stage).
• Lesson 6: Information provision -- Establish a reliable company database and organise forums
  Buyers have limited understanding of local markets and the availability of suppliers. Having a trusted company database would strongly increase the probability of buyers sourcing products or services locally. This is closely linked to the RDB Company Database proposed in the Made in Rwanda Policy. In addition, establishing forums where buyers and suppliers could meet and introduce themselves would further support linkages.

(Karisimbi Business Partners, 2017)
Conclusion

LCUs provide an important means to improving linkages between foreign and local firms by tackling two underlying constraints: addressing information asymmetries by suggesting potential local suppliers (firm linkages) and quality-upgrading local suppliers (through firm-specific trainings).

Based on lessons learned from Ethiopia, Tanzania, and Rwanda, this policy note provides initial guidance on the appropriate design of a Rwandan LCU. It offers lessons on who should lead the LCU, what should be its responsibilities in the first 24 months, the appropriate target setting, and the linkages between the LCU and other departments (government and donors). These suggest that through careful design, government can greatly assist the functionality of such a LCU.

Based on these recommendations, we can also identify four “pitfalls” that are worth avoiding:

• Pitfall 1: Relying on legislation alone.
  While other improvements in the business environment are important (e.g. Rwanda’s improvement in the Cost of Doing Business), this alone may not be sufficient to stimulate supply chains. Linkages will not be made by themselves, even if the information is available. For that reason, establishing a unit with the purpose of stimulating active relationship building can be important for improving job creation and reducing the trade imbalance.

• Pitfall 2: Forcing multinationals to cooperate.
  There are significant benefits through greater supply chain linkages, but these cannot be ‘forced’ through local content regulation. Instead, it is key for government to understand and engage with the multinational’s current constraints to local content use and provide a solution that aligns with their business interests.

• Pitfalls 3: Missing the big opportunities.
  While linkages produce short-term benefits to suppliers (e.g., increasing output and employment), the main benefits accrue over the medium-term through the required quality improvements that suppliers need to meet in order to supply multinationals. Such productivity improvements ultimately drive economic growth and export promotion. For this reason, rather than trying to focus only on brokering short-term supply contracts, the LCU should seek to stimulate long-term relationships that result in wider supply chain upgrading and exports.

• Pitfall 4: Doing everything at once.
  While the LCU can be promising, it will take time for it to develop its capacity and to show initial results. For that reason, it is important to start small and expand over time. Because it takes time for businesses to form long-term relationships, its targets should initially be procedural
(focused around identifying firms), and only after 24 months should the LCU be expected to broker new contracts between multinationals and domestic suppliers.

Following the lessons from the ongoing work of the Ethiopian Investment Commission and Tanzanian Local Content Unit, we believe that Rwanda’s establishment of a Local Content Unit can also bring about considerable economic benefits. Through the Rwandan government’s proactive role in fostering linkages between foreign and local firms and deepening domestic firm capabilities, it can become a leader in stimulating local content management and offer important lessons for other countries in the region.

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