Constraints and Opportunities for Small and Medium-Sized Enterprises in Uganda's Oil and Gas Sector

By

Rebecca Nalumu Wamono1*, Prosie Kikabi*, and Johnny Mugisha**

*Uganda Investment Authority, Kampala, Uganda
**Makerere University, Kampala, Uganda

Hanna Nikkanen - CC: BY-NC-SA

EXECUTIVE SUMMARY

Although Uganda has undertaken several strategic interventions since the oil discovery in 2006, specific interventions that promote local small and medium-sized enterprises (SMEs) to invest in the oil and gas value chain remain a challenge. In particular, a gap exists on available opportunities for SMEs to participate in the value chain, including potential business linkages and partnerships. In addition, there are constraints that deter their competitive advantage. It is important to identify these constraints and convert them into opportunities to realise both the local content and the national oil and gas policy objectives.

In light of this, this study sought to determine the present actors within the oil and gas value chain, and also establish the potential opportunities and business partnerships between SMEs and large oil companies. Additionally, this research addresses an SMEs' decisions and willingness to invest in the oil and gas value chain and likely constraints that may deter them from venturing into the oil and gas value chain.

Results from the study revealed that the main actors in the petroleum value chain include government, transnational oil companies, and large-scale foreign and domestic direct and indirect service providers. There is typically minimal involvement of SMEs. Although business partnerships existed at the vertical and horizontal levels, the linkages were poor: only 10 percent of SMEs had permanent contractual terms to supply oil companies. Additionally, Uganda was at the infantry stage of the oil and gas value chain, which did not offer many business opportunities for SMEs. However, indirect services could be provided at this stage.

The study further revealed that exploiting these opportunities would remain a challenge because most SMEs were fragmented, sole proprietors, and/or lacked substantial

capital, which affected their ability to supply in bulk. Similarly, the Logit model revealed that SME willingness to invest was determined by availability of investment capital, access to credit, information and fixed-assets. In addition, most SMEs lacked the desired international standards and certifications, implying that they were not prequalified in the mainstream procurement criteria required by the large oil companies. Other notable challenges included insufficient information on procedures for entering into contract agreements with oil companies, insufficient information on oil developments, prospects and existing business opportunities. Within that context, the study developed recommendations to enable SME investment in the sector.

INTRODUCTION

Like other economies, SMEs in Uganda play a key role in enhancing economic growth and poverty eradication. They constitute 80 percent of the private sector and employ more than 1.5 million people, including marginalised groups such as the women, youth and disabled (MFPED, 2007). However, most studies conducted on SMEs emphasize their economic significance and constraints, and place little emphasis on their investment potential, competitive advantage, opportunities and prevailing barriers to investment in high capital value chains, such as oil and gas.

METHODOLOGY

A total of 220 registered SMEs located in Buliisa, Gulu, Hoima, Masindi and Kampala were selected from a cross-section of sectors. Questionnaires were administered to selected SMEs and a checklist of questions was used to interview key government institutions, local district authorities, selected domestic companies who conduct business with the oil companies, as well as the existing oil companies. Data was collected, edited and analysed using N-VIVO and the Statistical Package for Social Scientists. Using the Logit model, ten variables were regressed against the dependent variable "willingness to invest." The dependent variable was treated as a dichotomous variable taking on values 1= willingness to invest and 0 = no willingness.

RESULTS AND CONCLUSIONS

Results of the study showed that the oil and gas chain was at the upstream/infantry level with no existing middle and down levels yet. The upstream level involved four main actors, namely: government, transnational oil companies, large scale enterprises (both national and international) and local SMEs. Government was the major player whose key function was to provide the enabling regulatory and institutional framework to facilitate exploration, refinement, transportation, storage and investment in the sector. The private sector was dominated by transnational oil corporations (TNCs) involved in the provision of specialized activities such as oil appraisals, exploration, seismic surveys and well drilling. The large-scale domestic and foreign enterprises provided direct services such as equipment supplies, civil and engineering works, environment services, professional consulting services, international freight services, as well as clearing and forwarding services. SMEs were the least-involved actors within the sector supplying indirect services such as agricultural produce, lodging and conference facilities, plumbing, vehicle spare parts, fuel, event management services, medical services, transportation services, supplying building materials and electrical services.

> **...SMEs in Uganda play a key role in enhancing economic growth and poverty eradication. They constitute 80 percent of the private sector and employ more than 1.5 million people...**

The study assessed the strength of vertical partnerships, that is, supplier-buyer and horizontal relations between the participating SMEs. The dimensions used for vertical relationships were whether there were formal agreements (contracts and memoranda of understanding) between the suppliers (SMEs) and the TNCs. Likewise, for horizontal relations, the study sought mutual understanding in the form of partnerships to trade and form associations, cooperatives, consortiums and clusters amongst participating SMEs. The findings revealed that 90 percent of SMEs were not in permanent contractual terms to supply, and neither had they signed memoranda of understanding with the oil companies. The findings

also revealed that 92.7 percent were willing to partner (vertically) with the oil companies or form vertical business partnerships with the large domestic and foreign companies, if investment opportunities were made available.

The oil and gas value chain was comprised of various activities that translated into investment opportunities in the industry. These business opportunities were classified into specialized, direct and indirect services. The specialized services included seismic surveys and well drilling, while the direct services were relatively specialized—including infield services, inspections, international freight services, civil, electrical and mechanical engineering, environmental services, infield transport and specialist trades. Indirect services included catering, human resources, custom clearance, training, hotel/accommodation, emergency services, information and communication technology services, medical services, security, crane hire, waste management, office supplies and freight forwarding.

Since Uganda was at the infantry stage, where the demand for specialized services was intense, more services and opportunities were available for oil companies. However, more indirect and less specialized opportunities would be available during the field development and oil production stages of the oil value chain.

Results of the Chi-square test revealed several factors that were strongly associated with SME willingness to invest. These included the size of investment capital, ownership of fixed assets, knowledge of the oil business, time spent in business and access to information. Other factors strongly associated included access to power and infrastructure, such as roads, access to credit and cost of capital. The direction of association and contribution of each independent variable to the dependent variable was further explained by the Logit regression model.

Willingness to invest in oil and gas was the dependent variable regressed against investment capital, access to credit, information flow, knowledge of oil business, owning fixed assets, age of business, access to power, access to other infrastructure and policy awareness. The strongest predictors of SME "Willingness to Invest" (WTI), according to the

model, were investment capital, access to credit, information and owning fixed assets.

In conclusion, SMEs play an important role in Uganda's economy since they constitute the majority in the private sector and have invested in a wide range of primary sectors. For sectors such as oil and gas, which are highly specialised and require large sums of capital investments, specific government interventions need to be formulated to enable SME entry. Like other primary sectors of the economy, SMEs have also invested in the oil and gas sector but their investments have largely been minimal and concentrated in noncore/specialised services. This includes investments in food supply, logistics, plumbing, supplying building materials and casual labour contracting. This phenomenon can be explained by several factors, notably the lack of substantial operating capital to supply on a large scale; inability to advance their technology and employ skilled manpower; lack of knowledge and information about the oil opportunities; and lack of information about oil company procurement policies. For instance, services required by oil companies in certain sectors, such as transport and logistics, are deemed complex and some SMEs lacked international quality certifications, while others were not aware of them. Although few SMEs were providing services in the industry, their participation could be augmented by enhancing backward and forward linkages with oil companies or their contracted companies. It is evident that a vibrant industrial structure is achievable where SMEs and large enterprises not only co-exist but also function in a symbiotic relationship (Uganda Investment Authority, 2010).

The national communication strategy for the oil and gas sector should target sensitization and awareness creation for SMEs concerning upcoming plans, developments and opportunities in the sector.

The need to redistribute wealth to the areas that are producing the oil resource is equally important. Supporting the private sector, specifically SMEs, to relocate or expand their businesses to the upcountry areas should be considered. Findings indicated that most SMEs operating in the oil and gas sector were located in Kampala, and few were identified in the

upcountry areas where oil exploration was ongoing. The legislative framework for investment in the sector was drafted but had not been enacted into law. Although the draft Petroleum Bill provided for local content and prioritized Ugandan legal entities in the supply of Goods and Services, provisions with respect to financial resources and investment incentives for SMEs needed consideration.

RECOMMENDATIONS

- Expedite the development of the Local Content Policy and Act to provide the enabling legal and institutional framework for investment in the sector. The policy should provide for SME participation and identify specific sectors for SME investment.

- The national communication strategy for the oil and gas sector should target sensitization and awareness creation for SMEs concerning upcoming plans, developments and opportunities in the sector.

- Government, in collaboration with oil companies, should document procedures, policies and certifications demanded by oil companies, which would help enable SMEs to understand their contract needs/ requirements.

- In line with the above recommendation, a contract management and tendering training program for SMEs should be created in joint partnership with the oil companies. This would help SMEs understand the demands of the oil companies and enable oil companies to understand the local SME sector and the environment in which they operate.

- SMEs operating in similar sectors, such as agriculture and metal fabrication, and those within the same localities should be encouraged to form strategic partnerships, such as cooperatives, clusters, consortiums and joint ventures with large contractors and associations. This would complement their ability to supply quality products to large oil companies. Such partnerships will improve SME access to information, skills, technology and financial services.

- Oil companies should review their pre-qualification requirements and systems for contracts that can be supplied by SMEs.

- Develop a comprehensive business linkages program for the sector to support TNCs that would like to use services of SMEs. Within this program, a database and profile of potential SME service providers should be developed to support local supply, production and distribution capabilities of SMEs.

- Provide investment incentives to the following groups:

  - SMEs willing to invest upcountry or in rural areas to redistribute wealth and development in upcountry districts that are challenged with lack of infrastructure (transport, energy, telecommunication and water, among others).

  - Large domestic companies that are already doing business with oil companies be encouraged to subcontract SMEs in the provision and supply of goods and services—especially those that are not directly linked with their current business operations.

- Develop a national SME Investment Plan for the oil and gas industry to guide government in the development of strategic interventions and policies that enhance future SME investment in the oil sector.

REFERENCES

Aneke, P. (2002). The role of major operators in the development of local content in the Nigerian oil and gas industry. A paper delivered during the national seminar on the Dynamics of Equipment Leasing and Contract Financing for Local Contractors in the Oil and Gas sector, Port Harcourt, Nigeria.

Babu, B.V., Humbad, A. and Kumar, S. 2009. Carbon credits for energy self-sufficiency in rural India. A case study. Energy Education, science and Technology part A: Energy, Science and Research.

Banga M, Razack B. Lokina and Adolf F. Mkenda (2011). Households' Willingness to Pay for Improved Solid Waste Collection Services in Kampala City, Uganda. *The Journal of Environment Development* 2011 20: 428.

Heum, P., Quale, C., karlsen, J.E., Kragha, M. and Osahon G., (2003). Enhancement of Local Content in the Upstream Oil and Gas Industry in Nigeria: A comprehensive and viable policy approach; joint study by SNF-Institute for Research in Economics and Business Administration, Bergen, Norway SNF Report No. 25/03 (August).

Ministry of Finance, Planning and Economic Development (2007). Development of a National Micro, Small and Medium Enterprises (MSMEs) Policy and Strategy, Draft report 2007