

# Doing Business with Saudi Aramco: The IKTVA Program

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Doing business with Saudi Aramco, the World's largest oil and gas company, is the essential feature for many local and international companies operating in the Oil Field Services and Equipment ("OFSE ") and related sectors in Saudi Arabia.

Historically, Saudi Aramco awarded contracts primarily based on lowest cost and technical capabilities. While those are still key elements for winning work from Saudi Aramco, it has recently moved to making localization of goods and services and promoting and expanding the value of local content a cornerstone of its supplier' selection process.

"Made in Saudi Arabia" has been announced as crucial to the long-term economic well-being and growth of Saudi Arabia with foreign investment being an essential part of accomplishing it. To this end, in December 2015 Saudi Aramco announced it was introducing the In Kingdom Total Value Added Program ("IKTVA"). During 2017, compliance with IKTVA has become a key component for doing business and contracting with Saudi Aramco.

Requirements for doing business with Saudi Aramco

There are a range of requirements for companies wishing to do business with Saudi Aramco in addition to IKTVA including:

- Pre-qualification through online registration as an approved supplier. For those wishing to register as international manufacturers or suppliers or existing registered international manufacturers or suppliers wishing to offer additional products or services they must first contact Saudi Aramco's affiliates in the relevant home jurisdiction ( ie Aramco Services Company, Aramco Overseas Company or Aramco Asia Company depending on relevant jurisdiction) for evaluation of the business need;
- Adherence to Saudi Aramco's detailed policies and procedures including the Suppliers Safety Management System Manual;
- Promoting Saudisation;
- Adhering and agreeing to Saudi Aramco's business ethics including the Supplier Code of Conduct;
- Entering into approved conditions for supply and contracting;
- For work to be performed in Saudi Arabia, technical and financial qualifications must be approved and contractors must be properly registered and licenced to conduct business in Saudi Arabia; and
- If using a local agent, the agency agreement must be registered with the Ministry of Commerce and Investment.

The requirements apply to both local and international companies.

Saudi Aramco's Electronic Contracting Network is a comprehensive web based system handling most activities during the procurement of contracts and online contractor registration.

## **IKTVA Program**

The IKTVA Program was initiated by Saudi Aramco with the following aims :

- doubling the percentage of locally produced energy related goods and services contracted by Saudi Aramco to 70% by 2021;
- increasing the export of Saudi-made energy related goods and services to 30% by 2021; and
- increasing employment opportunities for Saudis.

This program is in line with the localisation initiatives of the National Transformation Program and Saudi Arabia's Vision 2030 by promoting local content development, providing numerous job opportunities for a growing Saudi population and stimulating the diversification of the Saudi economy.

Saudi Aramco describe the IKTV Program as the key localization initiative for the OFSE Sector and as a systematic, fair and transparent mechanism for making local content the basis of Saudi Aramco's procurement process.

#### Priorities of the IKVA program

Saudi Aramco highlights transparency, consistency and uniformity as the priorities of the IKTV program in order to create a level playing field for local and international suppliers.

Transparency in application and process and access to information, and consistency in evaluations for both goods and services suppliers is provided in order to create supplier-focused partnerships and investment stability and assurance.

IKTV is regarded as a value-creation program allowing suppliers to work with Saudi Aramco for their mutual benefit, to increase opportunities for suppliers and to create a globally competitive Saudi industrial base.

#### Supplier's IKTV Formula

The IKTV Program requires suppliers to self-report on application and on an ongoing basis their quantitative and qualitative data in the following major categories:-

- A. Localized goods and services;
- B. Salaries paid to Saudis;
- C. Training and development of Saudis;
- D. Supplier development spend;
- r. Local Research & Development;
- E. Company revenue (spend from Saudi Aramco only).

Supplier IKTV Formula:  $IKTV \% = [(A+B+C+D+r)/E] \times 100$

The IKTV ratios allow Saudi Aramco to calculate the percentage of its spending that remains in Saudi Arabia or that helps develop Saudi Arabia's capabilities and supply chain, and will be used to determine the award of contracts.

The above data must be verified by an Aramco certified third party and submitted to Saudi Aramco prior to participating in the IKTV Program. Suppliers are also required to submit verified IKTV reports including the above data annually to Saudi Aramco.

For large projects and contracts, some suppliers may be required to provide interim verified IKTV reports or reports related to a particular project.

Suppliers are encouraged to increase their IKTV score with the potential to increase business with Saudi Aramco and in the Kingdom generally.

#### IKTV Process

The IKTV Program process involves the following main phases:

1. The IKTV Program will firstly create a 3-year IKTV baseline score for suppliers based on their

- spreadsheet/survey and data submission, which is measured through key metrics for local value creation. The IKTVA spreadsheet/survey can be submitted by the supplier to Saudi Aramco for initial review before completion of its audit by a Saudi Aramco approved accountant;
2. Once the IKTVA baseline score has been identified, Saudi Aramco and each supplier will jointly develop a 5 year IKTVA action plan to increase the supplier's IKTVA ratio;
  3. Finally, on an ongoing basis the IKTVA Program will measure the performance of suppliers through annual reporting and KPIs to track their progress and ensure that local value creation is continued.

#### How is Saudi Aramco Supporting Suppliers?

As part of creating a level playing field for suppliers, the Supplier Solution Center ("SSC") has been established to monitor suppliers' performance and to ensure their proactive development.

The roles and support functions of the SSC are :

- Assist suppliers in completing the pre-registration requirements;
- Analysing suppliers' performance and lost opportunities to construct support programs for existing suppliers; and
- Providing technical coordination support to existing and new business suppliers.

#### How will IKTVA affect doing business with Saudi Aramco?

Local value creation in all aspects of Saudi Aramco's business is currently one of its key strategies, which makes complying with IKTVA crucial to winning business with Saudi Aramco.

Saudi Aramco has made IKTVA participation one of the main components when evaluating suppliers' proposals. However, this does not mean that Aramco is abandoning their long-standing commitment to cost, quality, safety and the environment. There is still some uncertainty on the extent that the IKTVA score will be taken into account when contract awards are decided and, although the IKTVA ratio will be a very important factor, it is assumed that quality and cost will remain a top priority.

#### What does it mean for local and international companies?

Saudi Aramco's new focus on localization and specifically the introduction of the IKTVA program is leading many companies who supply to Saudi Aramco to reconsider how they operate in Saudi Arabia. The IKTVA score is of great importance to Saudi Aramco and it is a key component in determining the contract award. Therefore, showing current and forward-looking measures for localization is vital for companies that wish to do business with Saudi Aramco.

The OFSE sector in Saudi Arabia contains a large number of distribution arrangements and joint ventures between international and local companies. Historically, international manufacturers have appointed local Saudi distributors and agents to supply their products imported from overseas with associated arrangements for servicing and maintenance. This is because Saudi regulations restricted trading activities to Saudi individuals and companies and also the cost and difficulty of establishing and operating a local entity. However, Saudi Arabia has increasingly relaxed foreign investment law, and recently allowed foreign entities to establish or own trading companies, subject to strict conditions and substantial capital and other commitments.

Continuing to be competitive in the Saudi OFSE Sector and meeting the IKTVA objectives is encouraging companies to consider moving from distribution models and/or final assembly operations to developing and establishing local manufacturing and research and development capabilities either alone or through a local joint venture partner in Saudi Arabia.

Localization may require restructuring of supply chains and distribution arrangements as well as establishing manufacturing, service or trading entities in Saudi Arabia. This is likely to require significant investment in Saudi Arabia for international suppliers, as manufacturing centres, warehouses and other facilities operations may have to be established in Saudi Arabia. This may also encourage some international companies to partner or contract with local companies for assembly or local manufacture.

International companies will need to consider carefully the intellectual property licensing and quality control implications as well as the usual risks inherent in joint ventures.

Saudi Arabia is encouraging investment by making the process of establishing and licensing companies in Saudi Arabia easier and quicker, although this can still remain a lengthy and challenging process. Other incentives may be available such as low cost industrial land.

Saudisation (localization of workforce) will continue to be an imperative for companies operating in Saudi Arabia. Reaching Saudi Aramco's 2020 target of 70% for Saudi employees is likely to be challenging. Sufficient numbers of appropriately qualified and skilled Saudi employees may not be available. However, showing a commitment to create jobs for Saudis may initially be adequate (one of the successful examples is General Electric's female training centres, which are committed to creating jobs for women).

It is expected that the "made in Saudi" requirements of IKTVA and related Saudisation requirements will result in companies dealing with Saudi Aramco:

- Increasing the size and scale of their local operations;
- Continuing to focus on Saudisation with increased focus of training;
- Restructuring their supply chain arrangements with a move away from some distribution arrangements;
- Establishing more manufacturing and trading entities either 100% foreign owned or in joint venture arrangements; and
- Entering into greater numbers of strategic partnerships or joint ventures for local provision of assembly, manufacturing or services.

#### Achievements of the IKTVA Program

Although the IKTVA Program is relatively new and developing, it is having a positive impact. A significant number of arrangements have been entered into between Saudi Aramco and international companies as part of the IKTVA Program, including with McDermott, Schlumberger, General Electric, Honeywell, Jacobs Engineering and Siemens.

In conclusion, the IKTVA Program is a key factor in doing business with Saudi Aramco, and is heavily influencing the way that companies dealing with Saudi Aramco develop and structure their operations and business model to meet the "made in Saudi" requirements in the OFSE sector. This is likely to lead to international companies setting up local manufacturing and assembly operations as well as service entities either through 100% foreign owned companies or through strategic partnerships and Joint Ventures with Saudi companies and the restructuring of supply chain and distribution arrangements.

Al Tamimi & Company's Corporate and Commercial Team regularly advises on projects and contracts with Saudi Aramco. For further information please contact Grahame Nelson (g.nelson@tamimi.com) Head of Riyadh Office or Jonathan Reardon (j.reardon@tamimi.com) Head of Al Khobar Office.