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Key takeaways

- Earlier this year, Saudi Arabia's Local Content and Government Procurement Authority (LCGPA) published the Economic Participation (EP) policy, which represents a major escalation of the Kingdom's efforts to use its procurement power as leverage to increase local investment by multinational companies.
- The EP policy, which was released with little warning and without public consultation, applies to government contracts in which the value of imported goods and services exceeds SAR 100 million (~$27 million). To be eligible to bid on such contracts, companies must demonstrate that their level of local "economic participation" will equal at least 35 percent of the value of imported content.
- The policy defines several categories of eligible economic participation, including local manufacturing, subcontracting, technology and knowledge transfer, export promotion, and research and development. Each category is assigned its own range of valuation multiples when counted toward a company's economic participation total.
- To qualify as economic participation, projects must meet several criteria: they must create new value for the Kingdom beyond what is required for the contract, be linked to the contract in question, and be financially self-sustaining beyond the contract period.
- The EP policy is at a nascent stage, and some details, especially with regard to enforcement, are still unclear and likely to evolve. Nevertheless, we understand that EP requirements have already begun to be included in some tenders.
- For companies whose business in the Kingdom depends on large government contracts, the EP policy presents complicated compliance, government relations, investment, and risk management challenges. Companies should therefore start developing strategies now to comply with EP requirements, minimize risks to their business, and support their long-term growth objectives in the Kingdom. (See below for more on considerations for companies.)

Broader context

The EP policy is the latest in a series of policy changes expanding local content requirements in the Kingdom. The Saudi government is using an increasingly complex array of sticks and carrots to attract greater investment by multinational companies. These include:

- **The Regional Headquarters (RHQ) Program:** In February 2021, the Saudi government announced that by January 2024 companies will need to establish regional headquarters in Saudi Arabia to remain eligible for government procurement. Since then, the Saudi government has published more detailed guidance on the requirements and benefits of establishing an RHQ in the Kingdom, launched an RHQ licensing process, and introduced Ministry of Finance procurement controls, set to enter into effect on January 1, 2024, that sharply limit the ability of government entities to do business with companies that do not have regional headquarters in the Kingdom. (See here for our most recent analysis of the RHQ Program.)

- **Local content requirements:** Since late 2019, when it introduced its first local content regulations, Saudi Arabia has embedded various local content requirements in the procurement process, developed sophisticated mechanisms for local content measurement, and introduced several forms of local content preference. Key local content requirements include: a mandatory list of products that must be sourced locally, the submission of baseline and target local content scores during the tender process, the use of local content scores in commercial evaluation, and special contracting methods (including offtake guarantees) for projects that involve local manufacturing and knowledge transfer in strategic industries. The LCGPA has begun applying local content requirements to progressively smaller government contracts as well as procurement by semi-government entities and state-owned enterprises.

- **Classification rules for imported goods:** In April 2023, the Ministry of Industry and Mineral Resources published new draft regulations for indexing, classifying, and coding local and imported products and services. To house the information, the regulations have called for the creation of a national database, which is intended for use in procurement by government entities and state-owned enterprises. Companies will have to index their products and services in the database when bidding on projects. The database will also be linked to the customs and tax systems.

- **Incentive packages:** In line with its National Investment Strategy, which sets significantly increased targets for foreign direct investment, the Saudi government is introducing a wide range of new incentive schemes, including Special Economic Zones, sector-based incentives, and tailored incentive packages for individual investment projects. These incentive programs, many of which are still in development, could offer significant benefits beyond standard local content preference mechanisms.

The overall direction of policy is clear: the Saudi government is increasingly aggressive in using a combination of procurement pressure and incentives to increase investment and localization by foreign multinationals. However, the details of the local content landscape, including the EP policy, will continue to evolve.

What we know about the EP policy

While the Saudi government often announces major policy changes before formulating the policy details, this was not the case with the EP policy. Although gaps remain, the level of detail in the EP policy suggests that the LCGPA has spent considerable time developing the policy, likely with the support of outside experts, and with an eye toward implementation. When the policy was announced, it already included detailed explanations of what qualifies as economic participation, how economic participation will be considered as part of the procurement process, and how economic participation levels will be calculated. It even includes a template to assist companies in preparing economic participation proposals to submit as part of the tender process.

Key principles

The EP policy lays out several key principles which are clearly aimed at making it difficult for companies to simply count their existing investments in the Kingdom toward the economic participation threshold.

- **Additionality:** EP projects must create new value for Saudi Arabia incremental to what is required for a contract (e.g., opening of a new facility or expansion of an existing facility, introduction of new products or services, etc.).
- **Causality:** Bidders must demonstrate that the EP project would not have happened in the absence of the contract – in other words, that the project was not part of the company's existing planned investments in the Kingdom.
- **Sustainability:** All EP projects must be economically viable and operationally sustainable beyond the contract period.
- **Mutual benefit:** EP projects should be mutually beneficial for the company and for the Saudi government and should not add to the cost of procured goods or services.

Eligible activities and valuation factors

The EP policy defines several categories of economic participation (see table below). Within each category, the EP policy lists different sub-categories, each of which is assigned its own valuation factor (or multiple). A company's overall EP score – which must exceed at least 35 percent of the value of imported goods and services under the contract – is based on the sum of each eligible EP activity multiplied by its valuation factor. In general, activities that are highly sought after by the Saudi government, such as research and development, receive higher valuation factors than lower valued-added categories, like subcontracting.

Eligible Categories	Valuation Factor
Subcontracting: Purchasing local products or services from a local company as part of a commercial agreement	1
Localization of Manufacturing or Services: Helping local beneficiaries establish new services or manufacturing capabilities within their service portfolio (e.g., training or technical assistance)	0.5-2

Knowledge Transfer: Transferring technical know-how to a local beneficiary	0.5-2
Technology Transfer: Includes technical tools and techniques, training, technical assistance, and providing local access to the technology	0.5-3
Export Promotion: Includes the export of Saudi goods or services, improving the profitability of Saudi products, or activities to promote Saudi products	0.5-3
Investment: A capital injection dedicated to a new or existing facility or export sales directly linked to the investment	1-3
Research and Development: Systematic activities that focus on applied research and aim at discovering solutions to problems or creating new goods and knowledge	3

In addition to these categories, the LGCPA may also include one or more bonus categories to incentivize specific EP projects.

Consideration of EP proposals in the procurement process

Companies are required to submit an EP proposal, demonstrating how they plan to meet EP requirements by the end of the contract period, as part of their tender bid. Among other components, the proposal should present a clear overarching case for why the company will meet EP requirements, supported by a list of qualifying EP projects; background and context on these projects; rationale for why these projects qualify as particular categories of economic participation and, by extension, for specific valuation factors; and information on how the company will implement these projects and the timelines involved.

The EP proposal will be considered by the LCGPA as part of the tender evaluation process (specifically the commercial evaluation). If a bidder wins the contract, they must formally sign the EP commitment at the same time as the contract (or before) and must submit a performance bond within 30 days of the contract signing.

What is still unclear

- **How broadly will EP requirements apply.** We have heard of EP requirements already being included in some tenders in the pharmaceutical sector, but it is unclear how widely the requirements will be extended to other sectors and on what timeline. Similarly, while the focus of the EP policy seems for now to be on government procurement, if past is precedent, it is possible that EP requirements may be extended in the longer term to procurement by semi-government entities and state-owned enterprises, such as the Public Investment Fund, Saudi Aramco, and the giga-projects.
- **How to "prove" that key EP principles are met.** Although the EP policy describes in broad terms what companies need to include in their EP proposals, it does not specify exactly how companies should prove that their proposed EP projects meet the policy requirements. For example, what evidence is needed *ex ante* to demonstrate incremental impact? How do companies prove causality – that an investment would not have happened without the contract? How is the quantum of investment in the Kingdom

evaluated (new or net investment)? What defines “sustainability” (e.g., return on investment, profits, etc.)?

- **How will direct vs. indirect EP be defined in practice.** The EP policy defines direct EP as “projects directly related to the sector or industry from which the government procurement contract originates” whereas indirect EP is defined as “projects unrelated to the sector or industry from which the contract originates.” While this definition makes sense in principle, the distinction may be less black and white in practice. For example, do investments in support services (e.g., data centers, logistics, back-office support) necessary to the delivery of core services under the contract count as direct or indirect EP?

- **How strictly will EP requirements be enforced.** The EP policy indicates that the LCGPA will monitor compliance on an ongoing basis and “certify” at the end of the project whether a company has met its EP credit commitments. However, it is not clear how compliance will work in practice. For example, will the LCGPA introduce strict auditing requirements? If similar to past local content requirements, then the LCGPA will likely introduce auditing requirements at some point, but they are not (yet) outlined in the EP policy document.

- **Potential for policy flexibility.** Senior Saudi officials have stressed to us that they understand the EP policy is a cause of concern for many companies and are open to constructive dialogue, raising the possibility that some forms of policy flexibility (e.g. temporary waivers or delays of enforcement) may be available. However, the LCGPA is known to be strict in enforcing local content rules, so waivers are not likely to be widely available (if they are at all) and companies will need to make a compelling argument for any policy flexibility.

Considerations for companies

How your organization can prepare

Companies can begin taking a number of practical steps to prepare for EP requirements, even before they see them in tenders for the first time.

- **Educate senior executives about this development.** The EP policy is a high-stakes policy change that should be on executives’ radar. Taking time now to educate leadership about the EP policy will save valuable time later when internal approvals are needed for EP commitments in the Kingdom.

- **Understand your organization’s potential exposure** to EP requirements by estimating the share of business in the Kingdom that involves contacts whose imported goods and services are valued at more than SAR 100 million. Carefully note the dates of any large upcoming tenders that may be subject to the EP policy.

- **Measure your organization’s economic participation baseline** by comparing existing and planned investments in the Kingdom against EP requirements. Calculate the quantum of unmet economic participation versus the 35 percent threshold.

- **Identify what kinds of EP your organization would consider**. Even at this early stage, it is worth evaluating what kinds of additional investment your organization would consider making in the Kingdom. These investments should be aligned with your long-term strategy and goals in the Kingdom.

- **Invest in relationships with the LCGPA.** Do not wait until EP requirements appear in a tender to begin engaging with the LCGPA. Companies that take time now to build positive relationships with the LCGPA, among other stakeholders, and gather information about EP requirements will be in a much better position down the line.

- **Consider joining forces with other companies and organizations.** Business councils, industry organizations, and embassies are already actively lobbying the Saudi government to reopen the EP policy for public consultation and allow for a more reasonable timeframe for compliance. Participating in these efforts will help organizations keep apprised of EP-related developments and amplify the impact of engagement with relevant authorities.

What to do when EP requirements appear in a tender

Taking the steps above will help ensure your organization has a head start in preparing for EP requirements. If and when EP requirements appear in a tender for which your company plans to bid, you will need to quickly develop and implement a plan to comply. This will require:

- **Conducting a detailed baseline assessment and gap analysis:** Calculate the value of all planned investments in the Kingdom (including tactical spend, research and development, training activities, and any other investments / expenses). Compare these investments against the eligible EP activities and identify those investments that satisfy EP requirements. Arrive at a “baseline economic participation percentage” by assigning appropriate valuation factors to eligible existing / planned investments. Compare this against EP requirements to calculate the “gap” in unmet EP percentage.

- **Developing a holistic strategy to fill the unmet EP percentage** while simultaneously minimizing the dollar value of new commitments and advancing your long-term goals in the Kingdom. This strategy will need to address a wide range of compliance, government relations, investment, and risk management considerations. Once this strategy has been approved by leadership, you will need to transform this strategy into a formal EP proposal in line with the template provided in the EP policy document.

- **Obtaining approval from the LCGPA.** As you work on your EP proposal, and certainly before you submit it for approval, you should regularly engage with the LCGPA to ask questions, validate assumptions, and ensure that your thinking is aligned with the policy requirements. This way, by the time you officially submit your EP proposal as part of the tender proposal, its approval by the LCGPA is hopefully just a formality.

For many companies, even with the proper planning, the amount of additional investment required will make it difficult to comply with EP requirements in time. Companies should therefore consider, in parallel, making a case to the LCGPA and other relevant stakeholders for appropriate policy flexibility (e.g., a waiver from or delay of EP requirements), pointing to your long-term commitment to the Kingdom, broader track record on local content issues, and earnest efforts to comply with EP requirements despite the challenging timeline.

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