Business Strategy and CSR in Fragile States:  
The Case of WesternZagros’ Kurdistan Venture

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WesternZagros’ Kurdistan venture is a case study of how business can use corporate social responsibility as part of their strategy in fragile states. Institutional, resource-based and stakeholder theory are used to develop a theoretical framework, which is applied through the case study to examine how businesses can use CSR as part of a business strategy and also contribute to society.

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1. Introduction

WesternZagros was among the first foreign companies to make a deal with the Kurdistan Regional Government, “KRG”, which governs the semi-autonomous region in north-eastern Iraq. This region, “Kurdistan”, has one of the last untapped major conventional oil reserves on earth. It provides an excellent case study for examining how corporate social responsibility “CSR” can be part of business strategy in a fragile state. Since WesternZagros began exploration in Kurdistan in 2006, many more companies have entered the region and the unresolved issues between the KRG and the central government in Iraq have become more complicated. The status of the KRG’s Oil law, which governs exploration, development, production, exports and revenue sharing continues to be ambiguous thereby affecting oil exports, revenue sharing and the investment climate.

WesternZagros started work in the Kurdistan area in late 2003, not long after the U.S. led invasion of Iraq. Simon Hatfield, CEO of WesternZagros realized that the Kurdistan region provided a much better opportunity than other areas of Iraq since it was virtually undeveloped and relatively safe. As well, the nascent government of the semi-autonomous region was very interested in oil development. By 2007, WesternZagros had become a publically traded company, after divesture by Western Oil Sands after its acquisition by Marathon Oil. WesternZagros was the first company to sign a Memorandum of Understanding with the KRG, and as this case study will examine it has used CSR practices as a key aspect of its strategy for operating in this fragile region. Now it is one of over 40 companies operating in the region and has rights to about 5 percent of the area under exploration, development or production. (WesternZagros, 2012)

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To set the theoretical context for the case study, section 2 examines the tenets of CSR and the use of institutional, resource-based and stakeholder theory in business strategy in fragile states. Section 3 integrates these in a theoretical model, which is applied in section 4 to the case study “WesternZagros’ Kurdistan Venture”. The case study covers events and activities from 2003 to 2011 and is based on secondary data and selected interviews with WesternZagros’ management team. Section 5 summarizes our conclusions and implications.

This case study demonstrates that business can make socially responsible decisions that support their overall strategies and make substantial contribution to capacity building in communities, governance and institutions. It also provides a framework which can be used to conduct future case studies of business CSR practices in fragile states. Our motivation for conducting this case study was to examine how WesternZagros managed its strategy and operations in a fragile state. Using grounded theory what became increasingly evident as we evaluated their actions was an emergent CSR strategy that was initially motivated by senior managers’ concerns for the people in the communities which WesternZagros was developing their oil and gas operations. In making sense of WesternZagros’ emergent CSR strategy it was also apposite to develop a theoretical framework for future case studies. This framework will be useful to advancing research in exploring the implications of CSR in fragile states, which is a nascent research area ((see for example, Jamali, 2007).

2. Management Theory and Understanding the Role of CSR in Business Strategy in Fragile States

In contemporary contexts organizations must develop, implement and adjust strategy to external factors and events that at best have a range of outcomes but may in reality be largely unknowable. Although there is no single accepted definition of a fragile state, such states are incapable of assuring basic security and economic opportunities for their citizens, maintaining continuity of governance, ensuring the rule of law and justice, providing basic capacity as well as being prone to violence and conflict. As such, fragile states have highly uncertain environments for doing business, at least partly because there are few institutions. In such environments, sense making is a critical organizational activity that must be integrated with the need to make strategic and operating decisions which will determine future options for the business, but will also further change the environment in which the business functions. CSR may be part of those strategic and operating decisions.

2.1 Defining CSR

The first comprehensive conception of CSR was put forth by Carroll who suggested that business has economic, legal, ethical and discretionary responsibility to society (Carroll, 1979). Economic responsibilities include society's expectation that organizations will produce goods and services that are needed and will sell them at a reasonable price. Legal responsibilities include compliance with laws and regulations in all aspects of their activities. Ethical responsibilities refer to societal expectations “above and beyond” the law and reflect the emerging norms related to the actions and impacts of business.
Finally, discretionary responsibilities of business refer to society's expectation that organizations are good citizens, and these can range considerably given the societal context. Academic and practitioner interest and work in CSR continues to grow, and clearly cannot be reviewed within the scope of this paper. Our case study is based on our interpretation of CSR as the understanding and commitment by business that it has a responsibility to society and that it responds to this commitment through products, services and actions that aim to increase social welfare, minimize adverse and maximise beneficial physical and environmental impact while generating sustained economic value.

2.2 Stakeholder, Institutional and Resource Based Theory

Several management theories could be of use in understanding business strategy in fragile states. To develop the theoretical framework for the case study in this paper, we integrated contributions from three theories.

Institutional theory suggests that organizations are compelled to conform to collective norms and beliefs and adhere to rules and regulations (Oliver, 1991). Organizations respond to pressures from the external environment such as those generated by governments, societal expectations, interest groups, other businesses and various institutions that populate the environment (DiMaggio and Powell, 1983, Oliver, 1991).

In fragile states the external environment may be insufficiently populated with institutions. This "institutional sparseness" creates greater scope for internally generated decisions and behaviours, which means that businesses would be expected to have more influence on the emergent business environment. As such the impact of business decisions is greater, as is now recognized by organizations such as Human Rights Watch, Global Witness and the U.N. Global Compact. We integrate institutional theory in our theoretical model by using it to examine how WesternZagros' actions have influenced the environment in the Kurdistan area.

Resource based theory suggests that organizations respond to competitive pressures by acquiring resources and developing capabilities that are tacit, intangible, unique, complex, path dependent or create barriers to entry (Barney, 1991, Barney, 2001, Eisenhardt and Martin, 2000, Oliver, 1997, Wernerfelt, 1995, Wernerfelt, 1984). We integrate the resource based view in our theoretical framework by examining how WesternZagros identified and created relationships that contributed to capacity and institution building expertise, but simultaneously helped its business strategy.

Stakeholder theory proposes that there are organizations, groups and individuals who have a stake in the performance of a business. Although the theory is now widely applied to diverse problems, one of its core propositions is the notion that business should be acting socially responsibly towards its stakeholders. These can include shareholders, creditors, employees, suppliers, customers and local communities (Freeman, 1984). Among the concerns of the theory is identifying stakeholders and their role in the performance of the business. Its ideas have been used to examine many issues relating to social responsibility, business and society and "the theory of the firm", although mostly for large existing businesses. We integrate stakeholder theory in our theoretical
framework by examining WesternZagros’ identification and development of stakeholder relationships.

3. Theoretical Framework and Research Approach

Figure 1 depicts the environments in which business and other organizations make decisions and undertake action. The general and industry environment levels will be familiar and comprise the usual political-legal, economic, social-cultural and technological “PEST” factors along with the dynamics that shape an industry such as rivalry, entry-exit conditions, suppliers, customers and substitute and complementary products and services. Grounded theory was used to conduct the research for this case study. Grounded theory can be used to conceptualize “what is going on” by using empirical research, and is a blend of deductive and inductive reasoning that aims to generate theory (Bryant & Charmaz, 2007). The theoretical framework that is developed below was developed through the use of grounded theory. It organizes how CSR can be used as part of a strategy by businesses in fragile states by influencing the development of institutions and positive stakeholder relationships in the institutionally sparse environment, while simultaneously developing firm level capabilities.

In a fragile state, businesses can have considerable impact on factors that would be fully operational in a developed country. Within the general external environment these factors span all the PEST categories. Capacity building in the economic, social-cultural, technological and political-legal spheres of a fragile state could be expected to involve socially responsible practices that increase the resiliency of the relationship between business and the stakeholders that benefit most directly. Within the industry environment, businesses could be expected to have the most impact through the development of capacity generating value chains and socially responsible corporate conduct. By being socially responsible in their influence on these factors, businesses can be expected contribute positively to the environment because aligning business and other stakeholder interests would be expected to contribute to more resilient institutions, regulations and relationships. To examine this conception, we examine the experience of WesternZagros in the Kurdistan region. The evidence base for the case study includes a review of research by NGOs, academic studies, industry reports, news items as well as information obtained from WesternZagros through their annual reports, webpages and interviews with selected senior managers.
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Figure 1: Areas of the business environment that may be developed through the corporate social responsibility practices of business

4. Case Study: WesternZagros’ Kurdistan Venture

WesternZagros’ work to improve the capacity of the regions in which they are exploring and developing oil production can be understood from two very different perspectives. One perspective is that winning the hearts and minds of the people increases their commitment and stake in WesternZagros and that all this is “just good business”, which also happens to improve the business environment and produce broader benefits. The other view is that companies such as WesternZagros could be doing quite a bit less in terms of capacity development, since the oil exploration and development activity would
still be benefitting the region economically. However, they have chosen to support the people in the Kurdistan region through socially responsible choices that increase capacity in the general and industry environments. The subsequent sections of the case study suggest the evidence supports the latter view.

4.1 WesternZagros Entry into Kurdistan

WesternZagros was a very early entrant into the Kurdistan region. Iraq has the world's third largest conventional oil reserves, and industry observers suggest that the Kurdistan region accounts for 20% to 40% of these reserves. The area's turbulent history meant there had been very little development of the oil and gas industry and that the terrain and governance was underdeveloped physically, economically and socially. The Garmian region in which WesternZagros' operates receives less than 12 inches of rain annually and experiences temperatures in excess of 50 degrees Celsius. Much of the region is mountainous and can at best support subsistence farming. Combined with the destruction of many villages and forced population relocation due to war and conflict, life has been very difficult for the people in the 400 or so villages in the area of the oil and gas exploration blocks. Although WesternZagros' managers did not set out to assist the development of the region through socially responsible practices when they initially entered the area, their commitment soon became evident. By 2009, their website stated “WesternZagros believes our reputation is a critical component in the creation of long-term value for our shareholders. We also recognize that ultimate success is measured by our behaviour beyond the bottom line. Protecting and enhancing our reputation and license to operate is a significant element of sustained success and requires us to commit to corporate social responsibility across our organization” (WesternZagros, 2011a) Many of their CSR initiatives and their impact are discussed in the sections that follow. These sections are organized by the specifics that are listed under the PEST and industry factors in Figure 1.

4.2 Resource Management Institutions

The resource curse that has afflicted many resource rich developing countries may be largely explained by poor governance (Sachs, 1995, Brunnschweiler, 2008) Hence, businesses entering areas with underdeveloped institutions can work to strengthen them for the benefit of all stakeholders. However, the opportunity to influence regulations and legislation would also create first mover advantages through specific benefits to the business and better relationships with government officials and other stakeholders. In 2006 when WesternZagros was negotiating the first exploration contract with the KRG, their CEO strongly encouraged the involvement of an independent third party to create an approach for production sharing arrangements. As a result the KRG has developed Production Sharing Contracts, “PSCs”, which better align host government and investor interests than other arrangements such as those used elsewhere in Iraq, and which some industry experts see as being adverse to development, creating incentives for oil companies to increase costs and creating situations which could result in major losses in government revenue and oil production (KRG, 2008)
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During the creation of the first working PSC, WesternZagros became the first company active in the Kurdistan region and during this time the KRG completed its permanent production sharing arrangement. WesternZagros’ early entry into the Kurdistan area enabled it to have significant influence on its partner company, when partnerships became a requirement of the PSC in 2008. Under the 2008 arrangement WesternZagros has 40% working interest and it selected Talisman to have another 40% working interest along with the required 20% working interest for the KRG. WesternZagros was allowed to forgo a portion of the capacity building fee due to its early entry, while Talisman had to pay the full amount of $220 million. The capacity building fee is required under the PSC to contribute to the rehabilitation and development of communities within the exploration areas through social capacity building and physical infrastructure. WesternZagros has paid the continuing and new capacity building fee in subsequent years. However, as the subsequent sections indicate, WesternZagros has pursued a significant amount of capacity building in its exploration and development areas voluntarily, thereby making it consistent with the “discretionary” level of corporate social responsibility. These externally oriented capacity building activities along with management choices with respect to corporate conduct and occupational health, safety and environmental standards have enabled WesternZagros to build relationships in the region that improve the expectations on how business can operate across the region.

4.3 Corporate Conduct

From commencement of its operations in the Kurdistan region, WesternZagros has adopted the International Code of Ethics for Canadian Business, thereby modelling standards for other business in the region. In addition to reliance on regional security apparatus, it has also obtained regular advice from a private security provider and implemented an Emergency and Security Response Plan. The senior management team has been transparent and proactive in developing relationships with government officials and community leaders. In 2011, WesternZagros became one of 31 organizations to join and support the United Nations Global Compact in Iraq, a number that has now increased to over 75 companies. (WesternZagros, 2011b). The company is now committed to continuous review of its performance against this framework of universally accepted principles in the areas of human rights, labour, environment and anti-corruption. By adhering to the highest standards in internal business activities and their dealings with other businesses, community leaders, NGOs and government officials, WesternZagros has built strong relationships which improve communication, mutual understanding and improve the external environment.

4.4 Occupational Health, Safety and Environmental Standards

WesternZagros had committed to meeting local regulations, but as is typical for a fast developing regulatory environment, standards and regulations were still emerging. When local regulations or standards did not exist or were not fully developed or stated, WesternZagros adopted western and international standards and most often complied with the Alberta Energy Resources Conservation Board requirements in its Kurdistan operations. These standards were typically higher than were expected locally and created delays in processes on occasion. However, adhering to Canadian standards remained
part of WesternZagros’ vision to act responsibly in its operations in Kurdistan. WesternZagros maintained high safety standards and announced that in the year before May, 2008, which was their first full year in Kurdistan, there had been no Lost Time Incidents “LTI”. This was an impressive record for the first year of exploration that involved seismic programs, well site construction and transportation of equipment and other supplies for the drilling operations (WesternZagros, 2008). By 2011, they had performed over 1.7 million hours of work safety, reflecting a safety culture, which they also extended through partnerships with local communities who are now included in the company’s safety and emergency procedures.

4.5 Human Security

A precursive component of capacity building of any type is developing human security, which comprises access to shelter, water, food, health services as well as personal, community, economic and political security. In their early trips, WesternZagros personnel contributed to the immediate needs of the people in area. They brought suitcases of amoxicillin and other requested medical supplies, quickly helped to repair or drill water wells and repair health clinics. In subsequent years they continued work in these areas by identifying priorities and working with NGOs and local partners to improve physical, education, health and local community security.

4.6 Physical Capacity

Basic physical infrastructure such as wells, irrigation and agricultural production had been seriously damaged during the Iran-Iraq war and subsequent years. Many of the villages in the area were destroyed and their citizens killed or forcibly relocated during the Anfal genocide of the Saddam Hussein regime. Almost immediately after arriving in the exploration area, WesternZagros personnel began to drill water wells and irrigation channels, an endeavour that the company has expanded significantly in the last 5 years. By 2010 WesternZagros and its coventurers had drilled water well in over 17 villages, repaired another 8 wells, built water supply pipelines, water sanitation facilities and constructed numerous sumps and pits to provide water access for livestock as well irrigation channels in over 40 communities. Through their early work to build physical infrastructure, other companies in the area have become involved, and local and international NGOs have become participants in water and sanitation technology development in the area. By late 2009, the Center for Affordable Water and Sanitation Technology conducted a biosand and water filter training course in the Sulimaniyah, a key city in Kurdistan, thereby improving the capacity of people in the area to build and maintain biosand technology. WesternZagros planned to continue to analyze possibilities for a sustainable strategy for water accessibility as part of their strategic efforts to provide drought relief to rural communities (WesternZagros, 2010)

4.7 Economic Capacity

In fragile states the institutions and relationships that comprise the essentials of basic social capacity and communities are absent or only partly or sporadically functioning. Early in their exploration efforts WesternZagros management chose to “conduct business
in a way that optimized the benefits for the citizens of the Kurdistan Region” by training the local population, both on site and in Canada, and including these employees and community leaders in important decisions that would impact their lives.

WesternZagros hired workers for its exploration operations from local villages. Due to the turbulent local history, there were very few skilled workers available in the region. These workers had to be trained in jobs requiring technical skills. While it would have been efficient for WesternZagros to keep these trained workers and move them from site to site, WesternZagros found itself facing the challenge of village boundaries. If it retained all its trained workers from previous sites, it would not be able to hire more workers from nearby villages so it had to opt for keeping some of the trained workers while also hiring new workers to ensure the local villages gained benefit from its operations. While this was not the most effective or efficient strategy for WesternZagros they believed it was the socially responsible thing to do. It also increased stakeholder commitment. Much of Hatfield’s strategy in Kurdistan rested on doing the right thing to build sustainable relationships and opportunities for WesternZagros. By 2007 they had created 400 jobs, and developed supply chains that further built local capacity whenever possible, instead of importing supplies. This created another 50 jobs and also created capacity to supply the oil and gas industry as it grew in the region in the future (WesternZagros, 2007).

4.8 Health Capacity

WesternZagros had a vision to provide accessible and affordable health care for the residents in their Block and this was considered a high priority in their corporate social responsibility program. In early trips to the country, Hatfield and his people focused on basic health needs, but more recently their involvement in the health care had been through the repair of medical centres, provision of medical supplies and sponsorship of medical teams to provide health care. They had a number of successes. In 2008, WesternZagros and its partners funded a medical clinic in Kalar, which is in the southern edge of the WesternZagros block where Canadian medical staff worked with the Kurdish medical team to provide diagnosis and treatment of patients (WesternZagros, 2009b). Another successful initiative was a joint venture with Foothills Medical Centre in Calgary and WesternZagros donated much needed, sophisticated surgical equipment to the hospital in Kifri in the southern edge of the block (WesternZagros, 2009b). In 2009, WesternZagros sent supplies to a clinic Hazi Kanin, in the northern part of the block that provides health care for surrounding villages. (WesternZagros, 2009b). WesternZagros had also partnered with the NGO Project CURE, which donated and delivered much needed medical equipment and supplies to the Garmian region. WesternZagros distributed these supplies to the clinics in and around the block (WesternZagros, 2009b).

4.9 Education Capacity

WesternZagros has contributed to education capacity through training and education aimed at industry needs as well as the general needs of the communities in which it operates. As part of its social responsibility program, WesternZagros sent selected government employees to the University of Calgary (Webster, 2009). It also sponsored of
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an academic scholarship program for graduate studies in technical and business related fields (WesternZagros, 2009).

In addition to training and education directly related to the oil industry, WesternZagros has assisted in the establishment, repair and upgrading of schools from when it entered the region in 2006 to date. Their focus has been on donating school supplies and making water tanks operational so that water was available for sanitation and washing. Ensuring the schools had computers is part of their ongoing program to build knowledge and capacity of the residents, and in particular, children in their region (WesternZagros 2009b). In the current year, WesternZagros aims to work with the Education Ministry, to carry out structural renovations to two primary schools and provide furnishings to others.

Through improved education and training for adults, WesternZagros also hoped to provide residents in local villages with the capability to improve the infrastructure needed to grow cash crops and thereby improve the long-term sustainability of the region.

4.10 Local “Community” Capacity

WesternZagros chose local suppliers for materials, labour and other needs whenever possible. It was committed to building capacity and contributing to local communities and economies, by purchasing food from local farmers and retailers. This was a deliberate strategy to invest in the local community as WesternZagros had a transportation infrastructure set up for its exploration activities which it could have used to import its food more cost-effectively. To help the local government and communities, it did, however, bring in supplies for local schools and medical facilities through its infrastructure. To make a contribution to the social-cultural life of the communities in which they operate, they have focused on the development of youth sport. They have built community soccer fields and donated (balls, jerseys etc.). More recently, the partnered with the Heartland Alliance NGO group to purchase a mobile library to service the children and youth in the rural regions within the KRG.

5. Conclusions and Implications

WesternZagros is committed to conducting business in a socially responsible manner. In late 2011, the United National Development Program and the Iraqi Council of Ministers Secretariat launched the UN Global Compact in Iraq. WesternZagros Ltd. is among the 31 Iraqi companies, civil society organizations and multinational enterprises that have joined this initiative. The company is also supporting the Extractive Industries Transparency Initiative (EITI and has committed to open disclosure, accessibility of records, maintaining fiscal responsibility and sustainable business practices. Perhaps most importantly, WesternZagros' leadership has stated publically that it is responsible for integrating corporate responsibility considerations into all decision-making in a timely and consistent manner and that WesternZagros' employees are expected to execute business decisions accordingly through appropriate controls.

WesternZagros' experience in the Kurdistan area of Iraq illustrates that corporate social responsibility can be a valuable aspect of a business strategy in a fragile region. The
company’s actions have contributed to the capacity of the region, and have contributed to the expectation that businesses can do more than focus on their own needs and goals and be successful.

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