

# Shared value, shared responsibility

A new approach to managing contracting chains in the oil and gas sector

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## New frontiers, new risks

- **Complex contracting chains:** Oil majors are increasingly seeking efficiencies by contracting out project activities to specialised service companies; chains become more complex when governments impose targets for local procurement.
- **Environmental and social risk management:** From early assessments to communication and oversight, effective management is critical throughout the chain to ensure good social and environmental performance.
- **Shared responsibility:** Responsibility needs to be shared throughout the contracting chain, across company departments, and between government and industry, with space for independent third-party oversight.

In today's oil and gas industry, high prices and concerns about energy security are driving expansion into ever more sensitive environments with greater technological, political and social risks. From the deep waters of the Russian Arctic to the tar sands in the Congo Basin, new technological challenges and natural hazards are fast becoming the norm.

Less well known are the environmental and social challenges the industry faces as a result of its complex contracting chains. While most people are familiar with a handful of brands such as BP, Shell and ExxonMobil, 70 per cent or more of oil and gas industry activities are typically contracted out to service providers and their subcontractors. The fallout from the April 2010 Gulf of Mexico disaster has shone a spotlight on alleged systemic failures and ongoing difficulties

in contracting relationships.

As the governments of oil producing countries – from Nigeria to Kazakhstan to Venezuela – seek to take greater control of their oil and gas resources, there are pressures to expand the role of local businesses in chains of contractors. Government targets for local hiring and procurement in international projects increase the challenges of managing contracting chains, with issues of governance, cross-cultural communication and capacity to meet international social and environmental standards.

**Shared value, shared responsibility** draws on three years of research and interviews within the sector to highlight an array of critical challenges facing oil and gas companies involved in complex supply chains, and to identify urgent and longer-term actions for progress.



US COAST GUARD

### Deepwater Horizon: a wake-up call

The devastating blow-out at BP's Macondo platform in the Gulf of Mexico in April 2010 offered a dramatic lesson: oil companies need to ensure that responsibility for good performance and effective risk management is shared throughout the contracting chain. It also served as a reminder that the risks of poor contracting chain management are not limited to developing countries.

The causes of the blow-out involved a diffuse network of relationships and responsibilities – one typical of the sector. Not only BP, but eight other companies have faced investigations of their roles, including Transocean, Hyundai Heavy Industries, Halliburton, Anadarko, Mitsui and Cameron International. The US government itself has not escaped blame in its role as regulator.

Poor coordination among the companies in this chain is thought to have played a significant part in the disaster. Both the US government and BP's internal investigation have cited possible contributing factors such as failure to communicate and lack of common standards and procedures.

Addressing these problems and preventing future disasters requires not only fixing systems and protocols, but changing the culture of the industry.

# Why good contracting chain management is essential

## Complex contracting chains raise a number of questions:

- Who is responsible for ensuring that contractors and subcontractors are properly prepared to address all risks, however unlikely?
- What actions must an operating company take to check that their contractors and subcontractors can meet their contractual requirements and that they work to international good-practice standards?
- How can high standards for environmental and social performance be maintained, even when speed and low cost of delivery are priorities?

Many risks and opportunities in the oil and gas industry relate to the work of major service contractors such as Halliburton, Transocean, Schlumberger and AMEC. These specialised companies have global reach and revenues as high as US\$15-20 billion annually. At the same time, an increasing number of contractors and subcontractors based in host countries are securing contracts with major oil and gas projects.

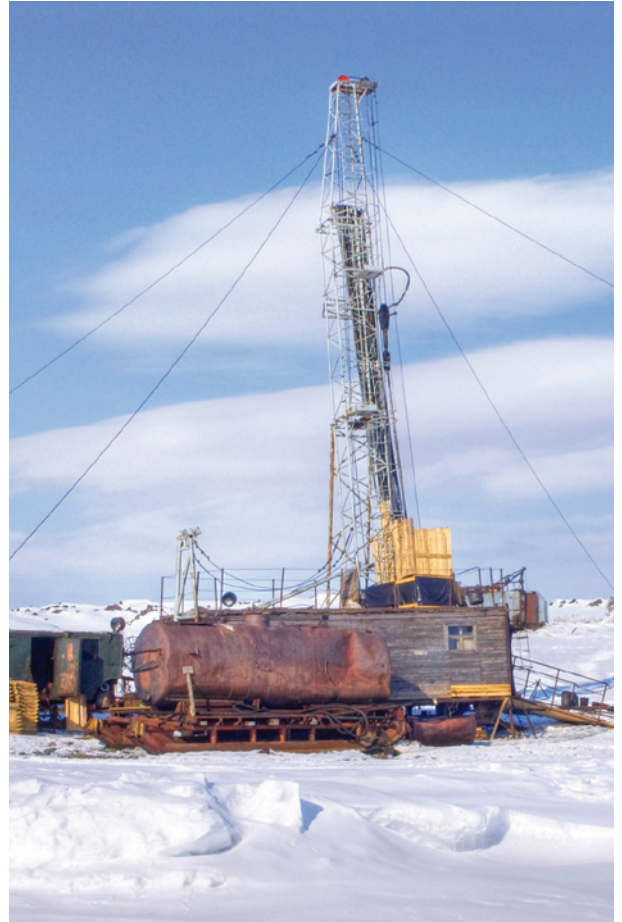
## Shared value: local content and local economic benefit

Oil and gas resources have long offered the promise of wealth and better development prospects, yet while Norway ranks number 1 in the UN's Human Development Index, other oil-rich countries such as Nigeria, Venezuela, Iran and Angola have failed to realise the full potential of their deposits. Today, governments are increasingly trying to maximise the sector's socio-economic benefits by setting minimum require-

ments for 'local content' (hiring local people and sourcing goods and services from local firms). National oil companies (NOCs) are also on the rise; however analysis of their activities lies beyond the scope of our research.

The ability of an operating company to meet local procurement targets depends on the available workforce. The skills needed may range from construction work to catering to clothing and equipment manufacture. **Shared value, shared responsibility** focuses primarily on construction activities, which have the greatest impact on local environments and communities.

Specialised contractors are increasing in number within some oil-producing countries, with rising demand from large-scale projects. However, in many regions of the world, the local procurement targets may be unrealistic. The challenge is to optimise local content in oil and gas projects – and thus share their value – while also preserving high standards of health and safety, environmental protection and societal wellbeing.



**The challenge is how to optimise local content in oil and gas projects, in order to maximise socio-economic benefits, while also preserving high standards of health and safety, environmental protection and societal wellbeing**

## Shared responsibility: beyond the legal contract

One of the main challenges for the contracting chain system is spreading stewardship responsibilities throughout the chain. External stakeholders – neighbouring communities, host governments, civil society – increasingly expect oil and gas companies to be accountable for their social and environmental impacts. This has become widely enshrined in national legislation and regulatory frameworks. In response, operating companies have developed comprehensive approaches to stakeholder consultation. However, these

engagement processes are frequently criticised for failing to translate knowledge and understanding into internal improvement and behavioural change further down the contracting chain.

The primary tool for managing contractor responsibilities and performance remains the legal contract, and many procedures and processes have evolved around it. In practice, this means that focus tends to be greatest on the relationship between operating companies and first-tier contractors, while effective management of the rest of the contracting chain is assumed — and less attention is given to relationships with the rest of the chain. Moreover, the contracts themselves tend to incentivise cost and speed of delivery, which often comes at the expense of good environmental and social performance.

Another potential obstacle to effective management of



contractor performance relates to a range of business functions.

Different departments — such as project management,

procurement, local content, health, safety and environment (HSE) and external affairs — need to operate in harmony, and align their objectives, policies and initiatives. Improvements in internal corporate synergy and organisational effectiveness are essential.

## Performance standards on the rise

Oil and gas projects are increasingly subject to a variety of environmental, social and other performance standards, including:

- Companies' internal standards
- International standards (e.g. ISO 9000 or 14000 series)
- Voluntary codes (e.g. the Voluntary Principles for Security and Human Rights; the UN Global Compact)
- Lenders' performance standards (including those of the International Finance Corporation and other international financial institutions)

These standards have potential to simplify, coordinate and make consistent the expectations and practices employed throughout a project. Yet the extent to which operating companies specify and support their uptake across contracting chains remains inconsistent.

*Focus tends to be greatest on the relationship between operating companies and first-tier contractors, while effective management of the rest of the contracting chain receives less attention*

## Evolving responsibilities

The responsibilities taken on by companies are constantly evolving. *Shared value, shared responsibility* emphasises the growing importance of *managerial responsibility* — the extremely difficult task of applying standards and implementing procedures across the entire contracting chain to ensure good performance. Managerial responsibility extends over and

**Figure: Expectations, performance and consequences**

Environmental and social responsibilities		Risks of failure
<p><b>Legal responsibility</b></p> <p><i>Specified, formally binding and compliance-based; enforced by government regulators and contract holders</i></p>	<ul style="list-style-type: none"> <li>• Legal compliance</li> <li>• Conformity to international standards included in investment agreements and contracts</li> <li>• Meeting local-content targets</li> <li>• Carrying out mandatory public consultation and social investment</li> <li>• Implementing adequate emergency-response procedures</li> </ul>	<ul style="list-style-type: none"> <li>• Legal sanctions, fines and penalties</li> <li>• Contractual disputes</li> <li>• Court cases and associated costs and delays</li> </ul>
<p><b>Responsibility to stakeholders</b></p> <p><i>Responsiveness to the expectations of stakeholders for good performance beyond legal and contractual compliance</i></p>	<ul style="list-style-type: none"> <li>• Meeting good-practice standards not included in national legislation or contracts</li> <li>• Transparency</li> <li>• Ensuring meaningful and responsive engagement with stakeholders</li> <li>• Respect for and protection of the local environment and livelihoods over and above legal obligations to do so</li> <li>• Development of beneficial and equitable social programmes for local communities on a voluntary basis</li> </ul>	<ul style="list-style-type: none"> <li>• Reputational damage</li> <li>• Loss of social licence to operate</li> <li>• Loss of future investment opportunities</li> </ul>
<p><b>Managerial responsibility</b></p> <p><i>Efforts applied by contract holders to maintain good environmental and social performance throughout the contracting chain</i></p>	<ul style="list-style-type: none"> <li>• A culture of shared risk and responsibility</li> <li>• Effective communication throughout the chain</li> <li>• Training in technical and managerial skills and cultural awareness</li> <li>• Technology transfer</li> <li>• Effective oversight and monitoring</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of control over project outcomes and impacts</li> <li>• Inability to meet legal responsibilities and responsibilities to stakeholders</li> </ul>

above legal requirements, and requires more than the adoption of standards and procedures on paper or simple consultation with stakeholders.

Such activities as good communications, training, oversight and corporate culture

are familiar to virtually all businesses, but are too often taken for granted in complex situations involving many organisations and an array of obligations. As with other evolving responsibilities, failure to attend to these needs carries risks such as

*Managerial responsibility requires more than the adoption of standards and procedures on paper*

increased costs and delays, increased financial liability, contractual disputes, negative social and environmental consequences, community tension, reputational damage and, ultimately, loss of investment opportunities. ■

# The challenges

The specific problems faced by international oil companies (IOCs) and their contractors in upholding their various responsibilities vary from one situation to another. We have identified three broad sets of factors that hamper effective chain-wide performance:

## 1 Lack of a sense of shared responsibility throughout the contracting chain and across stakeholder groups.

Responsibilities are typically fragmented across a project. There is a need for shared ownership of activities and outcomes overall, rather than just the individual tasks taken on by each partner.

- **Links are weak between IOCs and subcontractors**, such that IOCs may engage closely with their lead contractors, but not with subcontractors further down the chain.
- **A ‘tick-box’ mentality undermines implementation of standards, systems and procedures**; the focus is completing procedures on paper, rather than supporting partners to deliver results.
- **Contractors and subcontractors are less visible than operators**, encouraging players in the contracting chain to delegate responsibilities instead of ensuring collective accountability.
- **Companies and governments lack mutual understanding**, leading to differences in attitude towards sustainability criteria, such as environmental regulation and local content.
- **Advance planning is often inadequate**, with the typical project lifecycle limiting companies’ ability to plan for expected outcomes, challenges and shortfalls.

## 2 Inadequate implementation of systems and procedures to enforce standards and incentivise good performance.

It is not enough simply to adopt standards and policies on paper; they have to be implemented and enforced.

- **Commitments are subject to negotiation between IOCs and partners**, including governments; this means that an IOC cannot guarantee that a project in which it has a minority share will deliver on all of its performance standards.

- **Procurement processes pay insufficient attention to environmental and social standards**, even when those standards enjoy high levels of support within companies.
- **Contracts fail to incentivise good social and environmental performance**, lacking an appropriate balance of penalties and incentives, and lacking ring-fenced monies for social and environmental performance.
- **Procedures for harmonising standards between companies in the chain are confusing and complex**, and may involve legal obligations, corporate codes of conduct, international initiatives and international financial institutions’ requirements.
- **Enforcement of standards is difficult across dispersed contracting chains**, given the lack of direct oversight and limited ability to transmit incentives and penalties down the chain.
- **Public engagement and reporting remains limited**, which reduces accountability throughout the chain.

## 3 Cultural and contextual challenges in widely differing regions of the world.

Companies must come prepared to address the many contextual factors in a new country, including the perception that international best practices do not always apply.

- **Underdeveloped contractor markets pose risks as well as opportunities**, as there may be a lack of competition or insufficient time for building capacities to serve a project’s needs.
- **Corruption and patronage hamper effective contractor management**, limiting the potential to deliver local economic benefits and ensure environmental and social protection.
- **Limited understanding of local culture and practice increases risks** and reduces operators’ influence over behaviours that may undermine success. ■

# Taking action

**D**iagnosis of the unique challenges in each project will require collaboration and commitment across the contracting chain — as will the efforts to resolve problems. Creating resilient, responsive and high-performing relationships among partners is a long-term process.

Here we propose seven key actions primarily aimed at operating companies and lead contractors. The actions also offer guidance for governments, civil society organisations and others who seek to collaborate with companies or to provide oversight of oil industry activities.

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## Action 1: Collaborate on early-stage planning and assessments

- Carry out an early-stage assessment of workforce capacity, in collaboration with government agencies and local experts, covering levels of skill and technical challenge, capacity, technical training and contractor management.
- Complete environmental and social impact assessments as early as possible, including a risk assessment focusing on the contracting chain.
- Identify and address stakeholder expectations and perceptions relating to local enterprise development.
- Develop a policy and action plan on local content and a strategy to optimise local content.
- Clarify up front the legal obligations, environmental and social standards and evaluation methods to be used.

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## Action 2: Invest in capacity building in underdeveloped local markets

- Fund programmes to build capacity in the local workforce and businesses, including educational programmes and training in international standards, in collaboration with local government and/or educational establishments.
- Encourage joint public-private initiatives, which may also qualify for public funding.
- Engage with and support existing local and national associations of contractors and suppliers to build enterprise and workforce capacities.

## Action 3: Encourage uptake of standards through procurement processes

- Include health, safety, environmental and social stipulations in prequalification processes and tender requirements.
- Increase transparency and accessibility of tender processes, e.g. through websites and community notice-boards, supplier workshops or e-procurement systems.
- Resist pressure from local authorities to engage or support development of specific enterprises.

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## Action 4: Ensure that contracts incentivise good practice

- Balance incentives for cost, schedule and responsible performance to make sure that all these objectives are met.
- Ring-fence budget lines for environmental and social protection, or be prepared to allocate additional funds when the need arises.
- Allow contractors to review and discuss technical specifications in advance of signing contracts; capture feedback and lessons learned post-signing.
- Prioritise development of bridging documents with lead contractors, to align approaches and agree expectations and means of assessing conformity during the project cycle.
- Work with contractors to include environmental and social standards in all subcontracts and create mechanisms to support their implementation.
- Complete environmental, social and health impact assessments before signing contracts wherever feasible.
- Extend transparency and anti-corruption practices and systems to contractors (and require that they are extended to subcontractors), along with training and awareness-raising.

### Action 5: Build capacities and trust on the job

- Set aside sufficient budget for contractor capacity building on the job and develop a long-term management plan to ensure social and environmental skills and knowledge are up to date.
- Assist contractors with developing their own environmental and social management plans, and assist their efforts to extend these to subcontractors.
- Ensure internal reporting, communication and feedback mechanisms are effective and in line with international good practice.
- Consider adopting longer-term contractual relations with the aim of building contractors' capacities and mutual trust over time.
- Work to develop cultural awareness among contractors and subcontractors, to facilitate their engagement with local communities.

### Action 6: Establish excellent communication and oversight throughout the chain

- Ensure open lines of communication between operators, contractors and subcontractors.
- Establish mechanisms to enable contractors to improve and learn from one another.
- Ensure sufficient on-site supervision and monitoring, co-ordinating efforts with government, lenders and others to avoid overload or confusion among supervisory staff or contractors.
- Implement effective feedback mechanisms to enable contractors to influence decision-making.
- Require first-tier contractors to include subcontractors' health, safety and environmental performance in internal reporting.

- Ensure that confidential company hotlines feed into response mechanisms for improved practice.
- Provide community liaison officers (CLOs) with authority to work with contractors and subcontractors, and encourage contractors and subcontractors to take on their own CLOs where appropriate.

### Action 7: Build trust and accountability with external stakeholders

- Encourage more public reporting of performance, using a systematic reporting framework such as the Global Reporting Initiative Guidelines or guidance from the International Petroleum Industry Environmental Conservation Association, and including information about contractors.
- Indicate clearly in public documents the responsibilities of different members of the contracting chain.
- Encourage contractors and subcontractors to implement effective mechanisms for responding to community grievances.
- Encourage more direct engagement of contractors and subcontractors with civil society organisations, including direct involvement in public consultation activities.
- Provide training in community relations for contractors and subcontractors.
- Consider independent, citizens' oversight groups as providers of effective third-party oversight. ■

# Future vision

Success in delivering good social and environmental outcomes requires commitment, time and resources – including financial investment. The potential to increase effectiveness, build social licence to operate and deliver on performance commitments is significant. But it will require a concerted effort across the industry – both top-down and bottom-up, and across stakeholder groups. This includes:

- **Culture of teamwork and shared ownership:** IOCs, governments, NOCs, lead contractors and subcontractors will need to develop tools and attitudes that support a joint approach to project success.
- **Less reliance on paper exercises, more on culture and communication:** In the execution of projects, partners must support one another in identifying and resolving problems and challenges, not avoiding them or deferring them to others.
- **Emphasis on long-term time horizon and outcomes,** regardless of the timeline of individual activities: contractors and subcontractors should be encouraged to see how their roles contribute to the overall performance of the project and broader sustainable development goals.
- **Agreement to improved industry-wide practices to increase capacities and participation among local firms:** This may include common procurement practices, a code of conduct or industry commitment, common audit mechanisms and other tools.
- **Commitment from all companies in the chain** to engage meaningfully with external stakeholders at all levels, ensuring that issues and concerns are addressed appropriately and adequately.



We remain committed to supporting and encouraging the good practices and changes in attitudes that can help underpin the oil and gas sector's success in delivering good environmental and social outcomes. ■

The full 50-page report can be downloaded at:  
<http://pubs.iied.org/16026IIED.html>  
 and contains company case studies and full references.



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