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FOCUS: ROUNDTABLE FOR SUSTAINABLE PALM OIL (RSPO) – Part 1, the Growers' Perspective

RSPO

Roundtable on Sustainable Palm Oil

OR

ISPO?

Indonesian Sustainable Palm Oil

OR

???

Palm Oil Strategic Analysis

26 August 2010 **Issue 002**

Sustainability of the RSPO – the 7-year itch?

- The RSPO will face competition from the upcoming ISPO standard.
- Take-up of CSPO has lagged and its premium has fallen from USD40/mt to USD6/mt.
- NGO campaigns against oil palm growers have been escalating.
- Internal RSPO issues have yet to be resolved, including its procedures and its resourcing.
- **How to 'save' the RSPO? We have some ideas, from the growers' perspective.**

EDITORIAL

The world-touring photography exhibition on the Penan by Matthias Klum of the National Geographic[1] visually highlights the issues faced by the rainforest and its natives in the face of oil palm acreage expansion. We suspect that few can view it without some feeling of disquiet. We encourage readers to click on the link at the bottom of this page. On the other hand, palm oil is the most efficient oil crop and it is a major contributor to socio-economic development. An estimated 4.5 million people earning their living from it, mostly in developing countries.

With the RSPO General Assembly looming in less than three months, it as an opportune time to review the status and effectiveness of the RSPO. For the last seven years, it has attempted to address the negative environmental and social issues in the palm oil industry, by introducing standards for the production of RSPO certified sustainable palm oil (CSPO). It is a valiant effort.

Many internal issues remain but can be summarised as such: (niceties aside) the growers have a difficult deal (pages 3-4). CSPO take-up has disappointed; the CSPO premium has collapsed; costs and opportunity cost of certification are expected to increase; RSPO procedures and resources have been criticized; and greenhouse gas (GHG) emissions and peat lands issues chafe at growers.

It seems that the only growers able to bear with the RSPO are the public-listed companies, who already have the best practices and as such can afford its standards. In particular, those who have European Union (EU) trade interests. Meanwhile, mid-sized growers and smallholders are being left behind. Many good companies have also chosen not to join, as they are leery of the inherent risks of the "high-pay cum low-say" situation. Moreover, it is thought that errant growers are studiously avoiding it, while accelerating land clearance. If so, the RSPO may have generated some unintended damage while giving a 'pat' to the big boys.

Externally, the RSPO is facing pressures from the EU regulators and NGOs. Its standards don't quite fit in with the regulations of the EU Renewable Energy Directive. Anti-palm oil attacks have escalated, with non-RSPO NGOs delivering some 'slaps' to heavyweight members of the RSPO (page 7).

At a strategic level, we can ask: why is the palm oil sector subject to perhaps the most stringent standards for any agricultural product? How does it compare to the Roundtable for Responsible Soy Association (RTRS), a sister initiative? Well, the RSPO reported in May 2010, that Brazilian soybean interests had staged a walkout of the RTRS, abandoning their executive board role. Brazil and Indonesia have adopted a similar, two-part play strategy, for their key agricultural exports. In 2006, Brazil had a two-year moratorium on trade in soy originated in deforested areas within the Amazon Biome; and in April 2010, it launched its own sustainability certification for its soybeans. In May 2010, Indonesia announced both a two-year moratorium on deforestation and the intention to launch its own Indonesian Sustainable Palm Oil (ISPO). Will Malaysia make a similar move...MSPO?

The RSPO has achieved a lot in just seven years: it will soon hit three million mt/year or 8% of global palm oil output. But it is at a critical phase. It needs to fight for its relevance among competitive and other external pressures. It needs to build capacity, reconsider its procedures and perhaps even its strategy. It needs to be a lot more inclusive. In this issue, we suggest that the RSPO listens to its growers. We offer various ideas, taking their viewpoint (pages 5-6). We will endeavor to present other stakeholder perspectives in our next issue.

Lastly, we are chuffed that our recent comments on certification issues, to the World Bank Group's e-consultation for its Palm Oil framework, were substantially quoted in the preliminary draft. However, we are more pleased to have received a lot of feedback from our readers, for our very first issue. A big thank you to all, for your support and interest.

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[1] National Geographic website photo gallery feature, "Borneo's Moment of Truth - The majestic forests are vanishing in smoke and sawdust, but there's still hope for the island's fabled biodiversity—if the palm oil rush can be slowed." Click here: http://ngm.nationalgeographic.com/2008/11/borneo/klum-photography.

BACKGROUND

RSPO – status & issues

Bottom Line:

Not so happy:
Growers & some NGOs

Disquieted to neutral?
Consumer goods manufacturers (better pacing their take-up rate)

Happy:
Other NGOs & everyone else

Very happy:
Consultants & certifiers

The RSPO is a not-for-profit association that unites stakeholders from seven sectors of the palm oil industry supply chain together with NGOs, with the aim to develop and implement global standards for sustainable palm oil. Once a grower joins, a commitment must be made to adopt its standards (Principles & Criteria). The stakeholders are: (1) oil palm growers, (2) palm oil processors & traders, (3) consumer goods manufacturers, (4) retailers, (5) banks & investors, (6) environmental NGOs, and (7) social NGOs. The structure is based on the "roundtable" concept, giving rights to each.

In Executive Board and Working Group decision-making, growers' interests are represented by four votes. The combined two NGO sectors have four votes, and can neutralize the growers' votes. Other stakeholders have two votes each (look at the pie chart, below right). There are 360 RSPO members, of which 85 (24%) are palm oil growers, 140 are palm oil processors & traders, 107 are consumer goods manufacturers & retailers, eight are banks & investors, and 20 are NGOs. Growers had limited success in gaining majority vote acceptance of their key resolutions at last year's General Assembly.

Roundtable seems fair, but who pays?

All costs leading to RSPO certification are directly borne by the growers. Certification is for five years and there are annual surveillance assessments to monitor continued compliance. These costs are supposed to be off-set by CSPO premiums paid by consumer goods manufacturers such as Unilever (who will absorb or pass on the higher cost). However, in the short history of the CSPO trade, buying has lagged the growers' output. Now, growers are also concerned that the costs (direct, indirect & opportunity foregone) of sustainability increases with every proposed revision of the RSPO Principles and Criteria. This is an annual worry for them. Lastly, RSPO growers are also not getting public goodwill in return for their sustainability efforts. The industry as a whole continues to come under public censure via NGO campaigns.

And who plays?

In the RSPO, the clear winners are the NGOs. Other non-grower sectors, in particular the bankers, traders and retailers are inclined to align to the NGOs for altruistic and corporate social responsibility (CSR) reasons. After all, these stakeholders incur few costs and yet, they get to set high specification sustainability standards (for the growers and at the growers' cost).

The financial gainers are consultants and certifiers. A new business has been born. They face no market risk, and irrespective of the CSPO premium (or lack of), their services are required.

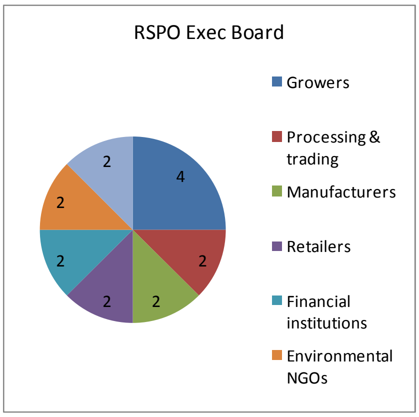
Source: Khor Reports Data: RSPO (2010)

RSPO milestones

- 2001 - WWF conceptualized RSPO, based largely on the Forest Stewardship Council (FSC).
- 2002 - Informal discussions between Unilever, WWF, MPOA, Aarhus, Sainsbury, Golden Hope (now Sime Darby), and Migros.
- Aug 2003 – 1st Roundtable (RT) Meeting.
- Apr 2004 - RSPO established, registered in Switzerland.
- Nov 2005 - RSPO Principles and Criteria launched
- Nov 2007 - RSPO Revised Principles & Criteria launched
- Mid 2008 – 1st sustainable palm oil production units were certified
- Nov 2008 – Arrival of 1st shipment of CSPO to Rotterdam, Europe
- End 2010 - production capacity of CSPO+CSPK at about 3 million mt/year or 8% of world production capacity.

Data: RSPO (2010)

Who is the boss?



Data: RSPO (2010)

RSPO has more supply than demand interest*

Oversupply of CSPO, take-up of 54% (up from 30%), BUT with a collapse in premium to USD6/mt via Green Palm

Higher prices in direct deals, but smaller volumes & more costly supply chain via UTZ Certified

Hot button topics

- Smallholders certification
- GHG & peat lands
- Procedural concerns
- Risk of ad hoc change to P&C (an annual concern?)

RSPO - key statistics

- **The RSPO reports that its members produce about 40% of the world's palm oil and are buyers of more than 20%. Supply interest exceeds demand interest.**
- Total production to date of CSPO is 2,464,626 mt (the figure for total purchases to date of CSPO has eluded us so far).
- The supply chain systems for CSPO are: (i) Book & Claim (Green Palm) and (ii) Mass Balance / Segregated (UTZ Certified).
- By early 2010, RSPO reported over 1.5 million mt of CSPO produced vs. some 450,000 mt sold via Green Palm - a dismal market take-up of 30%.
- RSPO and Green Palm do not report on their websites the take-up of CSPO since inception. RSPO instead presents the recent 12 months of data, over which period take-up has improved to 60%. But the most recent month's rate was 54% (Jul 2010).
- The current production area is 493,689 Ha. Production capacity for certified palm oil (CSPO) is 2,343,692 mt/year. Production capacity of CSPO+CSPK: 2,892,856 mt/year.
- UTZ Certified (alternative to Green Palm) reports 2,218 transactions, with a total volume traced of 266,723 mt, presumably since inception. Pricing data is not disclosed. Although there is talk of high premiums, a preliminary check with traders suggests that this was partly due to the small-volume effect, and also to cover the more costly supply chain methods.
- Green Palm reports USD765,754 contribution to RSPO (12-month?), and UTZ Certified reports USD 266,723 (since inception). This gives a total of over USD 1 million of contributions to RSPO.

RSPO's Aug 2009 - July 2010 statistics

- RSPO-certified oil supplied was 1.6 million mt; RSPO-certified oil purchased was 60% or 0.95 million mt (including certificates).
- CSPO sold was 949,414 mt. UTZ Certified reports 206,118 mt and Green Palm did 743,296 mt.

Source: Khor Reports, Data: RSPO (2010), UTZ Certified (2010)

Anti-palm oil campaigns & RSPO's role

While growers have ramped up the production of CSPO, NGOs have also ramped up their campaign against both growers and buyers. An emblematic case is Greenpeace vs. Sinar Mas. The NGO targeted the buyers Unilever and Nestle and the grower Sinar Mas. It resulted in the boycott of the latter's CSPO by the two multi-nationals. Greenpeace has since expanded its campaign against the Indonesian company (details, page 7).

What we find odd in the whole episode is the very low key presence of the RSPO in the matter. The RSPO has a Grievance Process, and Unilever, Nestle and Sinar Mas are all members. But, there has been a lot more focus on individual efforts by the companies. Moreover, the RSPO seemed to sidestep the issue in its 24th Mar 2010 press statement, "RSPO response to public allegations of non-sustainable practices." It was shy to name names and make meaningful comment on the case.

The Sinar Mas case has been running for two years. It raises pertinent questions about the role of the RSPO. Should attacks on members be strongly defended by the RSPO? Should RSPO form an independent investigative panel? In view of this saga, is it a surprise that Indonesian growers (a clear target with rapid and very large scale land bank expansion) sought an alternative to the RSPO? Hence, the ISPO?

The headlines...

***40% vs 20%**

RSPO members' potential production vs. buyer capacity of global palm oil – an imbalance of interest

30% to 54%↑ $40 to $6↓

Market take-up of CSPO rising but USD/mt premium falling (Green Palm) with oversupply (early 2010 vs. recent).

3 million or 8%

MT/year or % of total CSPO+CSPK production capacity available by end 2010.

STRATEGIC ANALYSIS & OPTIONS

What might growers want of the RSPO?

Growers are concerned with various problems at the RSPO – CSPO oversupply, falling premium, NGO attacks, annual worry about addition to P&Cs.

RSPO faces new external pressures –new certification standard - ISPO, Brazil soybean interests set a precedent by walking out of the RTRS, new regulations.

Khor Reports supports efforts to achieve a high rate of sustainable palm oil production & usage**

Major uncertainties for the Growers

- **The market take-up of CSPO has lagged**. The market take-up of the RSPO certified product was only some 30%, up to early this year; and it was 56% in the most recent month reported. NGOs have been pressuring buyers to use CSPO. The market is still young, but while growers are moving into an even faster RSPO implementation phase, buying has yet to catch up.
- **In the meantime, the CSPO premium (via Green Palm) has collapsed to USD6/mt**. Industry sources recall that some USD40/mt was 'hoped for' when certification started and that's where Green Palm certificate prices started. Current bidding stands at USD4.50/mt. Direct deals are priced higher (there is no price disclosure) but volumes are said to be small. The low premium will make it difficult for mid-sized growers and smallholders to join the RSPO.
- **Palm oil products discount to competitor oils has been narrowing.** In the case of palm kernel oil, it now trades at a premium to coconut oil. Could this make the additional premium of growing significance?
- **NGO attacks on RSPO members are escalating**, while the RSPO does not seem to take a strong stance in support. Its Grievance Process is not prominent.
- **Troubling events at the last RSPO Roundtable (Nov 2009) on procedures**: a) a General Assembly floor vote for a moratorium on an HCV area raised all sorts of questions on procedure; and b) the growers were unable to establish a protocol for a protocol schedule for significant changes to the Principles & Criteria (P&C). This would replace the current 'ad hoc' approach, where growers have annual worries about the introduction of significant new standards e.g. on new plantings, peat lands and so forth. They asked for a five-year protocol on major P&C changes.
- **Indonesia to launch its own sustainability standards** – Indonesian Sustainable Palm Oil (ISPO), for which details are not yet known.
- **Brazil soybean interests exit the RTRS**, and introduce their own sustainability certification, the "Soja Plus Program."
- **A multitude of new regulations are emerging** e.g. EU-RED, US RSF2, and others are mooted like carbon border adjustments etc. How will RSPO certification align with all these?

Source: Khor Reports

Khor Reports considers ideas, options and scenarios for the RSPO. Some are controversial, but we hope that you will appreciate that we aim to encourage an open exchange of ideas; with this goal in mind: **<u>to achieve a high rate of sustainable palm oil production and usage, cost-effectively.</u>

This is in line with the World Bank Group's indicative initial findings for its Palm Oil Sector framework. On the matter of certification: there was general agreement that certification should be made less costly to implement, be more palatable for the producers, enjoy industry wide support, and that costs should be more evenly distributed. Smallholder efforts must be supported.

We think that it is the role of a strategic analyst to consider a wider range of possibilities than the norm. The ideas are our own, distilled from conversations with the entire palm oil supply-chain, from our analysis of certification for other commodities and by learning from history.

The options are not mutually exclusive, they are not exhaustive, they have quite different implications and they need to be considered with due care. The options should provoke some critical thinking. So, here we go – we start with the radical:

STRATEGIC ANALYSIS & OPTIONS

Khor Reports 'options' range from radical to incremental – majority control / vetoes, cost-sharing, 'pick & choose' certification, a more multi-tier RSPO, fix the market overhang.

Option A: Majority control / veto powers

If the growers and consumer goods manufacturers are footing most of the sustainability bill, then logically they should have control of the RSPO. Governments may also subsidise RSPO certification efforts and may want to have a say? We all know that it is easy to order the biggest steak for dinner when you don't have to pay for it. If this is too much to digest, perhaps those who pay can be granted veto power? Think of how the UN Security Council operates.

Option B: Cost-sharing

Could the cost of sustainability certification be more evenly distributed between all the stakeholders? To bankers, retailers and even the NGOs? The sustainability costs could be treated as an investment, where all stakeholders must participate in sharing the burden and the rewards of CSPO premiums.

For instance, if a grower wishes to make his plantation sustainable, he should be entitled to ask other stakeholders to contribute. A cost-sharing system could see the grower footing 50% of the bill, the bankers and investors 10%, retailers 10%, and the food manufacturer 10%, the processors and traders 10%, and the environmental NGOs 5% and social NGOs 5%. All premiums gained from the CSPO could be paid out proportionately. By the same token, all losses will be absorbed proportionately too. To be truly altruistic, surpluses could go toward smallholder certification, and environmental and social projects.

Option C: Growers to "pick & choose"

Growers should not be pressured to go "100% RSPO", but they should decide on the ratio. For this, we take the cue from the timber sector that chooses from the Forest Stewardship Council (FSC) and other certifications to meet market specific demands. For its 56,000 ha in Malaysia, the Samling Group rejected the FSC standard, and adopted the Malaysian Timber Certification Council (MTCC). However in reacting to market demands, Samling have chosen to adopt the FSC for its operations in New Zealand (35,000 ha) and Guyana (570,000 ha, but currently suspended).

Skeptics may view this policy as "green washing". However, it is hard to deny that it is driven by supply and demand. In our study, we found that this modus operandi is not unique to Asian timber companies.

Weyerhaeuser, arguably the world's largest timber company, with revenue of USD17 billion in 2008, also takes this approach. It does not use the FSC (the 'gold' standard). Instead, it opts for the FSI (Sustainable Forestry Initiative, a North American sustainability initiative) for its staggering 17 million ha of US and Canadian operations because "*FSC standards in North America (although not in some other regions) generally discourage some silvicultural practices that are important to intensive, commercial forest management*". Weyerhaeuser does use the FSC, but somewhat sparingly– for only 9,000 ha of its 140,000 ha Uruguay operations.

Option D: A more multi-tier RSPO

A multi-tier CSPO market and more variation in RSPO standards would be more practical for growers. This is already being done in part, to accommodate smallholders. Could this approach be widened so that the RSPO becomes a lot more inclusive? Offer various specifications, cost and pricing points for both the growers and the buyers?

Option E: Fix the market overhang

We all know that the current partial take-up and low CSPO premium is hampering growth of RSPO membership and certification. Buyer members could discuss with growers how to segment the market, and set price formulae to better 'clear' the market (so that supply = demand). An alternative is to halt further additions to CSPO production capacity, until a lot more CSPO produced has been purchased. Perhaps in clearing the overhang, a better price may emerge, and the wary growers and smallholders will join.

NEWS WATCH

NGO attention on the palm oil sector

NGO attacks on Nestle and Unilever are working – buying policies are changing

Many of the 'best' growers are already RSPO members…

…but NGO campaigns have escalated e.g. IOI and Wilmar, recently targeted

Many NGOs are single-issue focussed

"The campaign against palm oil", The Economist, 24 June 2010

- This feature story by the globally influential magazine, The Economist, describes it dramatically as "The other oil spill…. Palm oil is a popular, cheap commodity, which green activists are doing their best to turn into a commercial liability. Companies are finding them impossible to ignore."
- "Even though it takes only 4% of the global total, Unilever is the world's biggest buyer, making it an obvious target for activists. Kraft and General Mills, two big American food companies, HSBC, a huge bank, and Cargill, an American agribusiness giant, have also come in for criticism. In the past few months, Nestle, another food giant, has been attacked in a spoof online advertisement that shows an office worker eating a finger of KitKat. The chocolate digit turns out to belong to an orang-utan, with bloody consequences… These attacks are proving potent. Companies are changing their buying policies … and paying more attention to the distant reaches of their supply chains."

Greenpeace vs. Sinar Mas

1. In April 2008, Greenpeace published a report entitled "How Unilever Palm Oil Suppliers Are Burning Up Borneo". The main target grower company was identified as Sinar Mas.
2. Sinar Mas is a member of the RSPO and Greenpeace is not. In Nov 2009 Unilever suspended all palm oil purchases from the grower, as did Nestle, in Mar 2010 (both are RSPO members). Abengoa, HSBC and Carrefour are among those who have also been drawn in.
3. Aug 2010, two RSPO certified independent bodies Control Union Certifications and BSI Group (engaged by Sinar Mas itself), cleared the company of environmental wrong doings. They concluded that the claims were exaggerated.
4. Despite the findings, which Greenpeace refutes, Unilever issued a statement that it is not ready to lift its boycott.
5. Greenpeace is now planning a roadshow in Hong Kong, Singapore and Malaysia to present Sinar Mas wrongdoings, to the company's shareholders (via Golden Agri-Resources Ltd). It is also plans to meet the Singapore stock exchange and financial regulator.
6. The RSPO has been very low-key throughout.

Source: Bloomberg and other news articles

IOI in the spotlight

IOI, a Malaysian corporate darling, with strong best practices, has also come under NGO attacks.

1. Migros (Swiss supermarket) asks questions of IOI. Link: http://www.freemalaysiatoday.com/fmt-english/news/general/7327-alleged-malpractices-migros-wants-the-truth-from-ioi, 28 June 2010.
2. The Miri High Court declared four natives the winner in a class action suit against the Sarawak government, Land Custody and Development Authority and IOI Pelita Plantation Sdn Bhd, end March 2010. Link to news article: http://hornbillunleashed.wordpress.com/2010/04/04/6268/
3. FOE report on IOI, "Too Green to be True: IOI Corporation in Ketapang District, West Kalimantan," Mar 2010. Link: http://www.foeeurope.org/publications/2010/Too_Green_to_be_True0310.pdf

Source: as indicated

Palm oil supply chain under pressure…

NGO attacks on…	NGOs within the RSPO	NGOs outside the RSPO
Unilever, Nestle, Kraft, General Mills, Carrefour, Abengoa, Cargill; HSBC; Wilmar, IOI, Sinar Mas…..	WWF (lead NGO), Flora & Fauna Int'l, Conservation Int'l, Wetlands Int'l, Oxfam, Sawit Watch…..	Greenpeace, Friends of the Earth……

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