



## SUSTAINABILITY FOCUS

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### Palm oil: Towards sustainable production

**Palm oil is an agricultural product that is increasingly attracting global and multi-stakeholder attention.**

This short piece will examine the business and investment risks that arise from being associated with environmentally or socially destructive palm oil production, as well as highlight opportunities that can be gained from implementing a more sustainable approach. A description of the three Roundtable on Sustainable Palm Oil Certifications will be provided alongside a summary of Vigeo's recent findings on European Food companies' approach to this topical commodity.



## Background

**Palm oil is used in approximately half of packaged supermarket products and is an important raw material in the manufacture of hygiene and personal care products (1).** The oil itself is extracted from the pulp of the oil palm fruit, which is then Refined, Bleached, and Deodorized (called RBDPO) and sold on the world's commodity markets. Indonesia and Malaysia remain the largest producers (85%), however other countries, including Thailand, Nigeria, Colombia, Brazil, Democratic Republic of Congo and Liberia, are all set to expand their production (2).

A number of diverse factors appear to be fueling the global boom. For instance, in the food industry many companies have switched to palm oil in response to government and consumer pressure to decrease the use of hydrogenated materials, avoiding so called 'transfats' (3). Another market demand has arisen from the recognition of the product's potential as a biofuel. On the supply side, it is attractive among growers as optimal production is 8 tonnes per hectare, making it the highest yielding edible oil (4).

Furthermore, in emerging economies it holds an esteemed reputation as a commodity that can be grown to bring about national economic development.

**Balancing out these desirable qualities are the widespread reports of the vast negative environmental and social impacts.** For example, Greenpeace report that the deforestation, draining and subsequent burning of peat-land areas that occurs as a result of converting land to palm oil production in Indonesia, is responsible for 4 per cent of global emissions every year (5).

Whilst at the more local level environmental concerns relate to the loss of endangered species due to destruction of habitats (for example, reported impact on orangutans in Indonesia) and the decrease in local biodiversity as rainforest becomes converted to monocultures. There is also a risk that human rights could be violated if local communities are not consulted and compensated when land is used. In addition, even if property rights are not directly violated, if surrounding land and water is polluted or over-exploited there is also the risk of severely impacting local communities' subsistence livelihoods.

## Business Risks and Opportunities

**In recent years, retail and consumer-goods companies have seen their use of palm oil come under heightened scrutiny from stakeholders, who have recognised these actors' potential influence over the supply chain.** Greenpeace, for example, continue to target Unilever and Nestlé who consume around 3.7% of the global palm oil output (6). Another active NGO is the WWF, who produces a palm oil scorecard as part of their attempts to raise awareness of extra-financial concerns among consumers and subsequently shape consumption patterns. In this context, any detected sluggishness on the part of companies may become a symbol for all-round corporate irresponsibility, a reputation that clearly represents a considerable market risk.

Another business risk that should not be underestimated is the involvement in related legal pursuits. Not only is there the requirement for production companies to meet national legal standards(7), there is also the potential that other governments could hold the consumer companies accountable for their social or environmental impact. In the UK for instance, the UK Companies Act (2006) explicitly mandates social and environmental reporting (8) and NGOs continue to push for a tighter framework to legally bind companies' to improve their social and environmental performance (9).



These risks are all the more present due to the UN Human Rights Council's recent endorsement of the 'Business and Human Rights' Special Representative's three pillars (including clarifying businesses' responsibility to respect existing international human rights standards).

**Beyond the opportunity to mitigate reputational and legal risks, sustainable palm oil production can also be linked to operational efficiency gains.** The Forest Footprint Disclosure project has documented that traditionally the industry has chosen to bring more land into production rather than working to improve yields on existing estates (10). However, with the current actual average yield being much lower than potential yield, many have questioned the effectiveness of this practice. For example, the CEO of Unilever advocates more sustainable practices, stating that "the yields from sustainable cultivated palm oil is four to five times higher than the yield if we were to do it by deforestation"(11).

A focus on increasing yield using sustainable methods on existing land therefore has both the potential to diminish further deforestation whilst improving profitability. As part of this sustainable approach, gains could also be made by implementing systems to closer manage inputs. Fertiliser usage optimisation, for instance, could foster operational savings, whilst limiting the negative environmental and community impacts.

## Use of Roundtable on Sustainable Palm Oil (RSPO) Certification Schemes in the Food Sector

Implementing due diligence measures and developing industry self-regulation can mitigate risks and enhance opportunities. It should therefore be seen as being in the business interests of all associated companies.

**The primary requirement to obtain the certification is to show that communities impacted by a plantation have given their Free, Prior and Informed Consent to allow the plantation to go ahead.** Social, environmental and community issues are then covered in the High Conservation Values framework which has to be assessed prior to planting (covers wildlife and biodiversity considerations, assessment of land needed to meet basic livelihood needs and cultural areas of importance). Once a plantation is established there are standards covering child labour, health and safety, wages, unionisation and skills training (16). The Grower Certification (GreenPalm) is a popular option, whereby the grower receives one certificate for each tonne

of palm oil they produce sustainably. The consumer-goods company can buy the certificate online, supporting the sustainable production of palm oil by financially rewarding these growers. The consumer-goods company can then claim "this product supports the trade in sustainable palm oil". In October 2010, the GreenPalm website reported that there were around 3 million tonnes of palm oil certified under this scheme (13).

**The second certification option is entitled 'Mass Balance'.** This allows for mixing of RSPO and non-RSPO certified palm oil, with RSPO certified oil and its derivatives being monitored.



The most demanding certificate option is **the third option, the segregated supply chain certification, for which 100% of the palm oil can actually be traced from certified plantation to product, thus allowing the consumer goods company to claim “this product contains RSPO certified palm oil” (14)**. In 2009, the total volume of physically traced RSPO-certified palm oil was 100,000 metric tonnes, this figure was at 400,000 tonnes by 2010. This is only a small percentage of the total global trade, with market estimates for 2011 being a total production figure of around 48.3million tonnes (15).

In Vigeo’s 2011 rating of the European food sector, it was found that Unilever, Danone, Nestlé, Premier Foods and Associated British Foods are already buying GreenPalm certificates and/or some segregated palm oil and all have committed to a 100% ‘certified’ palm oil supply by 2015 (Danone aims to reach this target by 2014) (12).

Due to the multiple impacts of palm oil cultivation, food companies approach to palm oil is analysed by Vigeo in an number of sustainability drivers. **The use of any type of certified palm oil is valued in the Environmental domain within the sustainability driver entitled the ‘Protection of Biodiversity’ (ENV 1.4)**, this is seen as a measure to increase the sustainability of agricultural production. In the Community Involvement domain, the driver

entitled the ‘Promotion of the social and economic development’ (CIN 1.1) values companies’ participation in the RSPO in an item on participating in multi-stakeholder programmes. In addition, if companies clearly report the use of segregated certified palm oil then this is counted in this driver as a measure to avoid over-exploitation of land in local communities.

In order to avoid a company-biased approach, Vigeo’s methodology also includes a review of stakeholder sources, with relevant allegations being documented in the appropriate drivers in each review. For instance, in the European food sector rating, Greenpeace continued criticism of the environmental impact of Nestlé’s Group wide approach to palm oil was included in the aforementioned environmental sustainability driver. Another allegation was made directly against one of Unilever and Nestlé’s large suppliers of palm oil, IOI Corp. This supplier was sanctioned in April 2011 by the RSPO after allegations of deforestation and violations of property rights. This allegation was included in the Business Behaviour driver entitled ‘Integration of environmental factors in the supply chain’ (C&S2.3) and in the Human Rights driver, the ‘Respect for human rights standards and prevention of violations’ (HRT 1.1).

## Conclusion

Food companies can positively influence the palm oil boom by fuelling the demand for transparent and sustainably-focussed production. This is all the more important as these businesses develop their own operations in emerging markets such as China, where consumption of palm oil is particularly high. As highlighted, such an approach can increase operational efficiency and mitigate business risks. Vigeo’s review of these and other relevant ESG criteria can therefore provide investors with value-added analysis to aid them in their investment decisions.



## Notes and Sources

- 1) [http://www.wwf.org.uk/wwf\\_articles.cfm?unewsid=3714](http://www.wwf.org.uk/wwf_articles.cfm?unewsid=3714).
- 2) Photo Essay: How Palm Oil is made, Carolyn Fry, Institution of Engineering & Technology, February 2011 p6, and <http://www.forestdisclosure.com/page.asp?p=4723>
- 3) E.g. in the USA: <http://www.fda.gov/food/labelingnutrition/ConsumerInformation/ucm109832.htm>; in Japan: <http://www.ap-foodtechnology.com/Industry-drivers/Japan-calls-for-trans-fat-labeling> and in the EU: <http://www.foodmanufacture.co.uk/Regulation/Nestle-questions-trans-fat-labelling-proposals>
- 4) WWF presentation, Palm Oil seminar 08/03/11
- 5) Palm Oil factsheet: <http://www.greenpeace.org.uk/forests/palm-oil>
- 6) Unilever uses 3% of the global palm oil output (around one million tons each year): Unilever pledges to continue to buy CPO from Indonesia, The Jakarta Post, 06/05/ 10. Nestlé uses approximately 0.7% (320 000 metric tonnes): <http://www.nestle.com/CSV/RuralDevelopment/NestleImpactFarmer/OtherCommoditiesFarmerProgrammes/Pages/OtherCommoditiesFarmerProgrammes.aspx>. See <http://www.independent.co.uk/environment/nature/unilever-drops-major-palmoil-producer-1906474.html>; <http://www.greenpeace.org.uk/nestle-palm-oil-9> for Greenpeace campaign.
- 7) For instance, in 2011 the Malaysian state of Sarawak made it a legal requirement that an Environmental Impact Assessment is carried out before palm oil plantations are developed: <http://www.palmoilprices.net/news/sarawak-government-committed-to-sustainable-development-of-palm-oil-plantations/>
- 8) Providing an adequate framework for corporate disclosure: [http://www.oecd.org/document/15/0,3746,en\\_39048427\\_39049437\\_42246671\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/15/0,3746,en_39048427_39049437_42246671_1_1_1_1,00.html)
- 9) Corporate Accountability, Friends of the Earth, 2005
- 10) Forest Footprint Disclosure, Palm Oil: <http://www.forestdisclosure.com/page.asp?p=4723>
- 11) Unilever to launch leadership development centre here , TODAY (Singapore), 06/11/10
- 12) Vigeo published the Food 2011 review for clients in July 2011. Danone: target is to purchase 100% of its palm oil needs from segregated certified sources by the end of 2014; Premier Foods: 100% of the company's palm oil supply is currently certified through the Grower Certification, the target is to source 25% of annual palm oil requirements through "physically segregated" supply chain by 2011 and 100% by 2015; Associated British Foods: target to only use Certified Sustainable palm oil, or Identity Preserved palm oil, by 2015 (provided that supply is available); Nestlé: target is to source only palm oil from sources certified as sustainable by 2015 (unclear which certification). Unilever: balanced 1/3 of its total with Green Palm Certificates in 2010, currently uses some certified segregated oil and the aim is to buy Green Palm Certificates for the equivalent of the whole use by 2015.
- 13) Millionth GreenPalm certificate traded, <http://www.greenpalm.org/en/blog-press/blog/millionth-greenpalm-certificate-traded>
- 14) RSPO Supply chain certification systems, RSPO, November 2009
- 15) Research and Markets: Global Palm Oil Market Report: 2010 Edition, <http://www.businesswire.com/news/home/20110217005644/en/Research-Markets-Global-Palm-Oil-Market-Report>
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- 17) Photo Essay: How Palm Oil is made, Carolyn Fry, Institution of Engineering & Technology, February 2011

## Contacts

For further information, please contact the analysts:

Nikki Gwilliam [nikki.gwilliam@vigeo.com](mailto:nikki.gwilliam@vigeo.com) & Frederic Ghys [frederic.ghys@vigeo.com](mailto:frederic.ghys@vigeo.com)

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