

BANK

IMVO value chain – II

INTERNET CONSULTATION VERSION

**DBA's analysis of salient Human Rights
issues in the Palm Oil Value Chain
(Part I – interim report)**

The Hague, August 2018

- While working on this document, which will outline DBA's analysis of salient Human Rights issues in the Palm Oil Value Chain it transpired that the analysis will benefit from external review
- This will contribute to improving the analysis, correcting any possible errors still included and make it more comprehensive along the way
- This consultation version of the presentation is shared externally with these thoughts in mind
- With this version we invite any party that believes it can contribute to improving this version to do so and reach out to us with the proposed changes, corrections and/or other suggestions with regard to the underlying analysis
- Feedback can be submitted until the 30th of the September, 2018 to following email address: bankenconvenant@ser.nl

This document is an excerpt of the ongoing work of the DBA working group on value chains whereby the focus is on the salient human rights issues in the palm oil value chain'. This document is the output of a collaborative effort of the parties of the Dutch Banking Agreement

This document is a living document and still work in progress. Any feedback or suggestions will be very valuable to the working group and is therefore very welcome.

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The analysis presented here describes the overall global value chain of the palm oil sector. It describes the various steps and activity of the value chain, as well as the (type) players that are found in these steps. Although palm oil is being grown in many different countries and continents most of the oil palms are grown in Indonesia and Malaysia, therefore data of these countries is used to clarify the overall value chain. Moving forward the analysis might also include other geographies if this turns out to be warranted.

The presentation was drawn up with to objective of identifying the salient human rights issues in the global palm oil value chain in the light of the DBA.

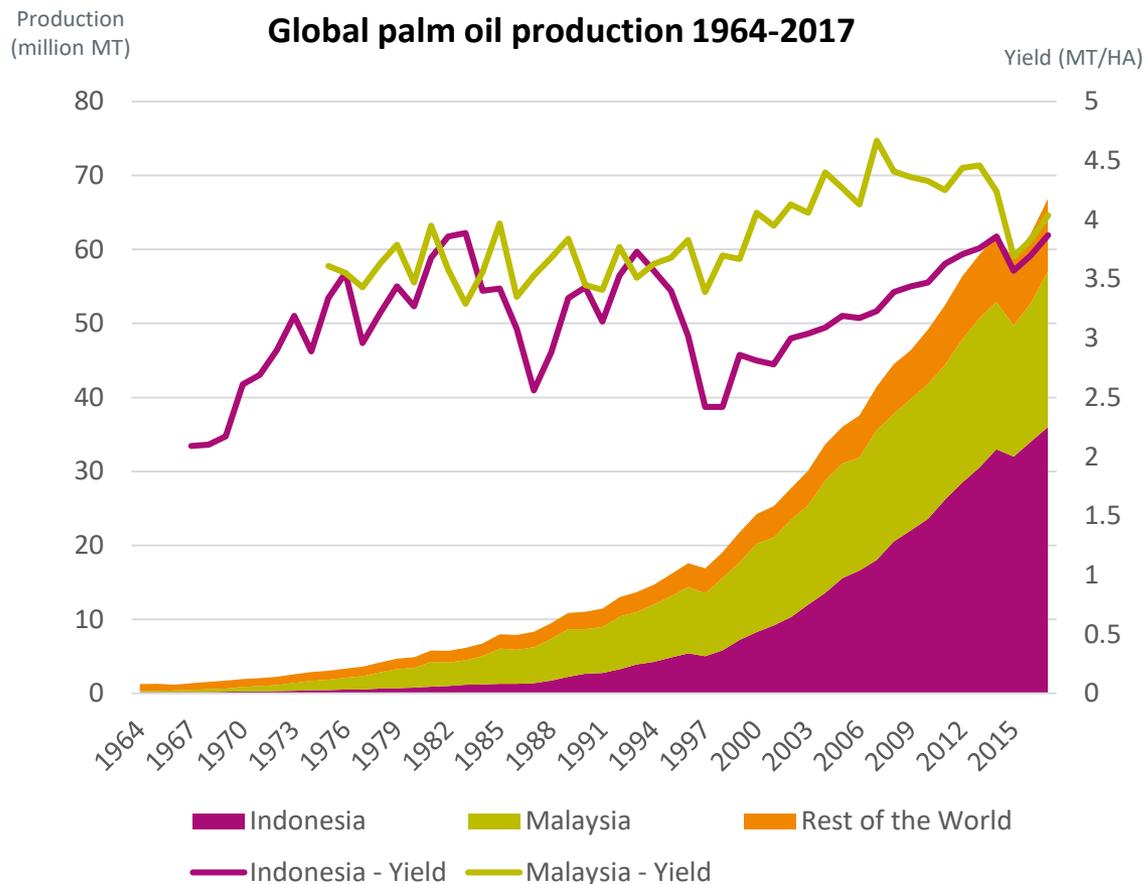
The analysis is based on desk research and interviews (with representatives from stakeholders in the working group) and a group expert meeting.

- I. An introduction to Palm Oil
- II. The Palm Oil Value Chain
- III. The Salient Human Rights Issues in Palm Oil
- IV. What role can the Dutch Banking Agreement play?
- V. Next Steps

I - An introduction to Palm Oil

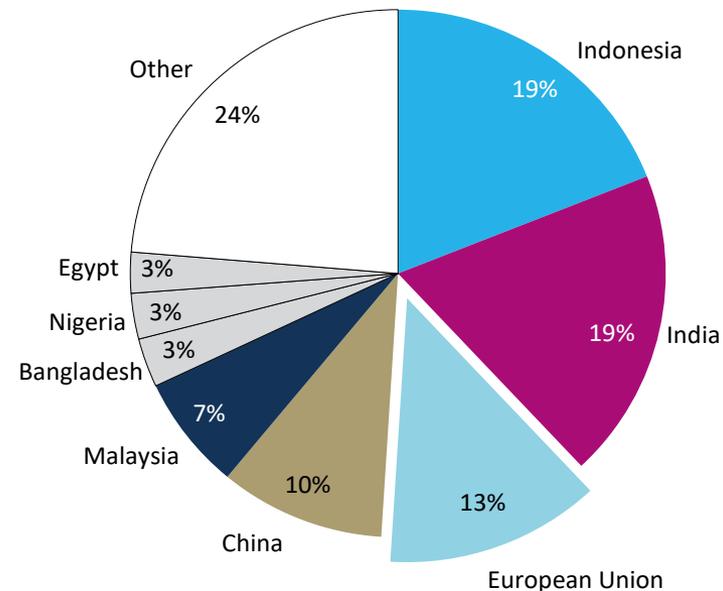
Palm Oil 101 – General Description and Developments

Palm oil is an edible vegetable oil the production of which has increased dramatically over the last decades



Palm oil consumption 2017

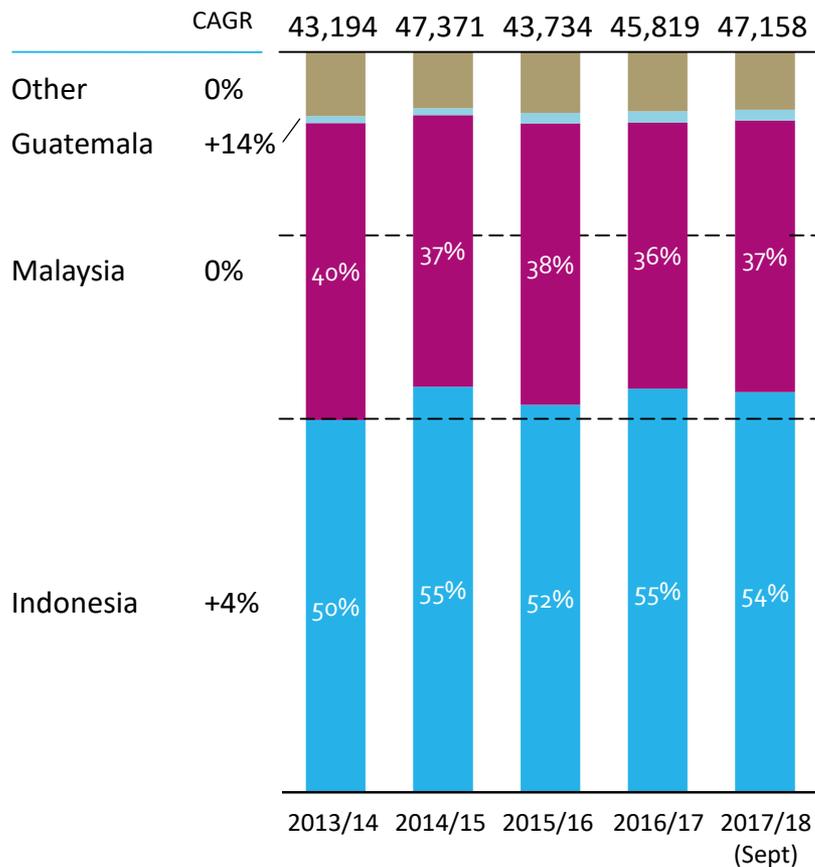
(% of global consumption)



Indonesia and Malaysia remain lead exporters of Palm Oil while the importer side is becoming more diffuse

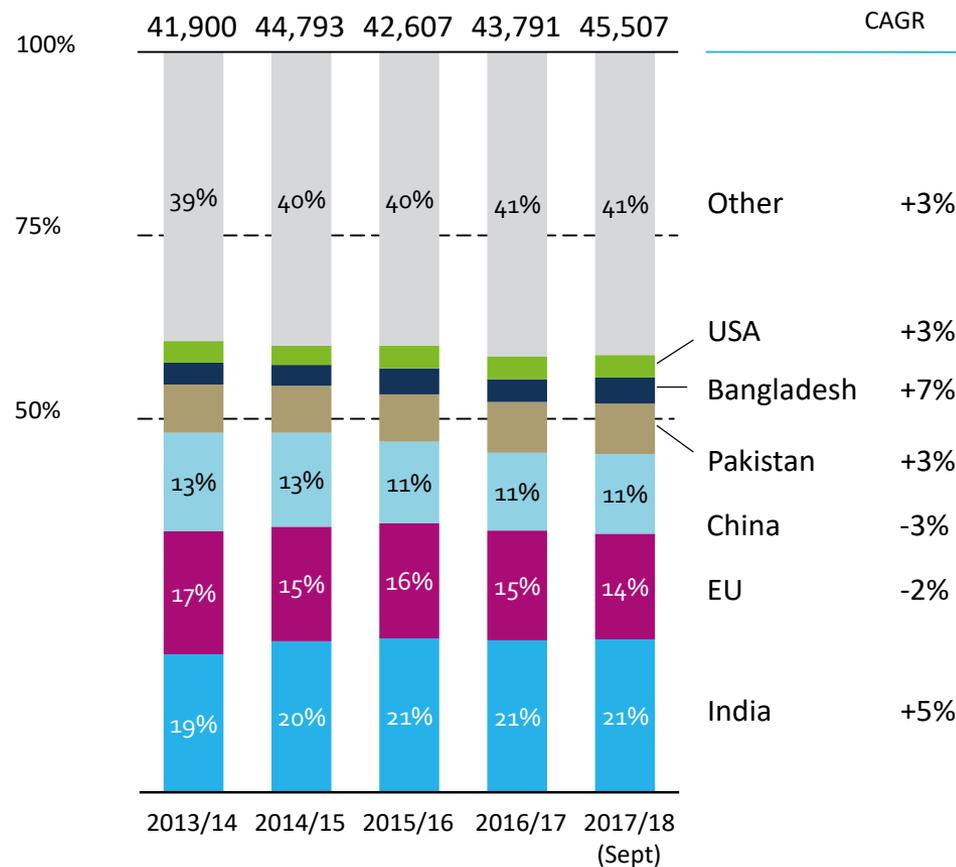
Global Palm Oil Exports 2013-2017

(Thousand Metric Tons and % breakdown)



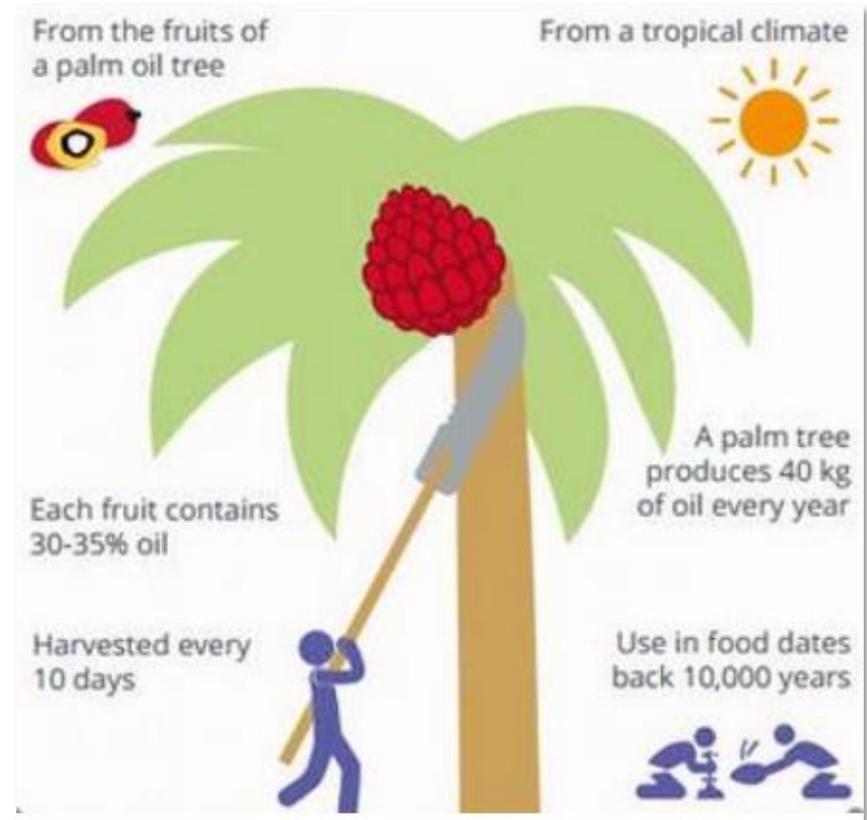
Global Palm Oil Imports 2013-2017

(Thousand Metric Tons and % breakdown)



The oil is derived from the African oil palm tree, today mostly cultivated in Malaysia and Indonesia

- Oil palms, or *Elaeis*, were brought to Southeast Asia from West Africa, at the beginning of the 20th century; they flourish where heat and rainfall are abundant
- Palm oil is extracted from the pulp of the fruit, is edible and used primarily in food products
 - Palm kernel oil is extracted from the seed of the fruit and is used mainly in the manufacture of soaps and cosmetics,
 - Palm kernel expeller (i.e. what remains after pressing) is used as a feed for livestock and biofuel for generating electricity.
- A contemporary, productive oil palm is a hybrid tree breed, has an average life of 25 yrs. and bears fruit after 3 years
- Crude palm oil (CPO) is refined to remove colours, odours and flavours and then processed into olein and stearin to produce a variety of oils and fats



Palm oil is used in many consumer goods ranging from food to cosmetics and as feedstock for biofuel



End products: margarine, cereals, crisps, sweets, baked goods, soaps, washing powders, cosmetics, animal feed, bio fuel, cooking oil.

Products



Palm oil in 50% of all supermarket products

Percentage will be lower once its not limited to packaged goods and fresh products are also included

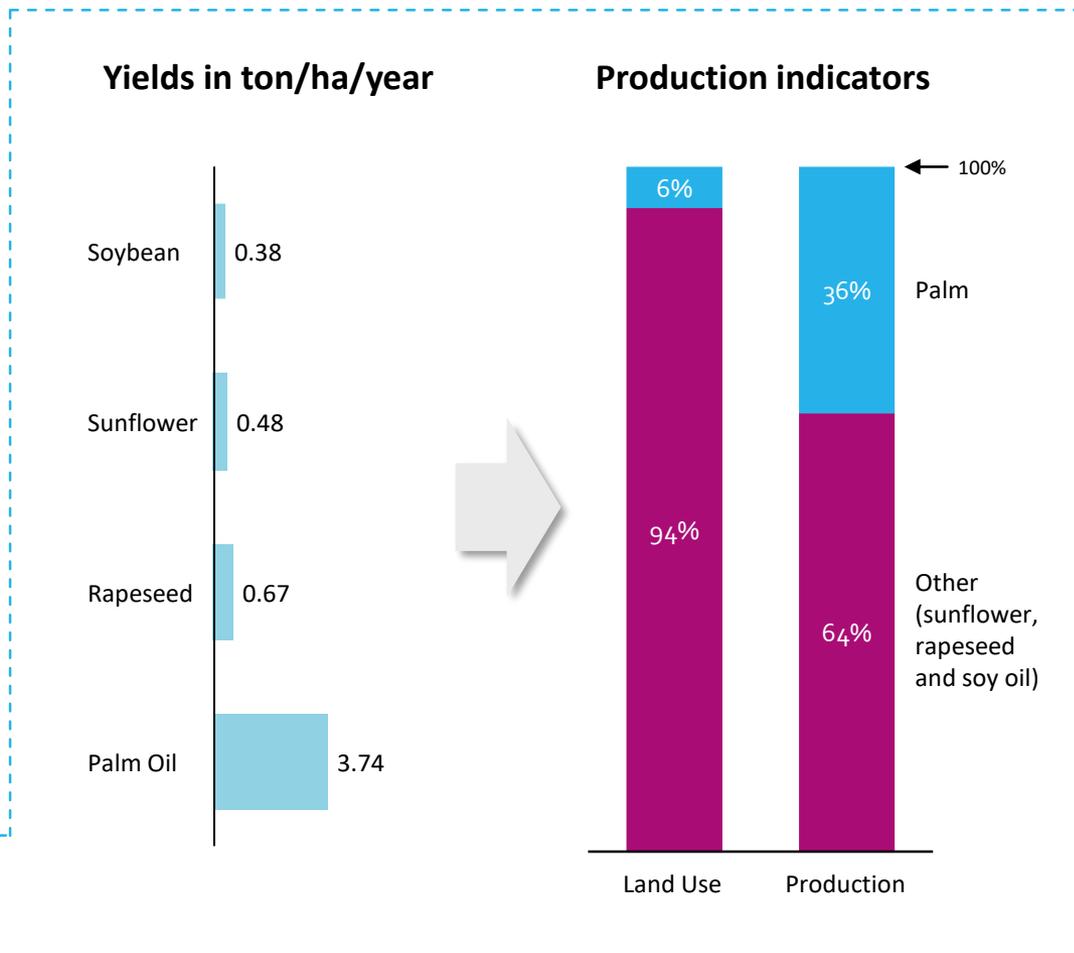
Palm Oil use in Europe



Please note that the working group continues to look for more recent use data in EU and further specifications

The attractiveness of palm oil comes in part from its product characteristics

- Good cooking properties [palm oil fats are solid at room temperature and therefore to solidify—as would be for the other oils—no need for hydrogenation, with associated unhealthy changes saturated/unsaturated as consequence]
- Good ingredient particularly in baked products, thanks to smooth and creamy texture and absence of smell
- Preservative effect that extends shelf life of products
- Currently GMO-free
- Highest-yielding and cleanest vegetable oil crop



The palm oil sector is a significant source of export revenues and employment

	Malaysia	Indonesia
Total production, KPO (million tons)	2.3	5.5
Total production, CPO (million tons)	19.2	27.8
Total exports, CPO (million USD)	2.99	4.98
Total exports, palm oil fractions (million USD)	10.08	13.56
No. of jobs in the palm oil sector (millions)	0.44	3.72
No. of smallholders in the palm oil sector (millions)	0.68	1.46
Total GDP (million USD)	310,616	793,728
Agricultural GDP (million USD)	28,278	106,254
Palm oil sector GDP (million USD)	11,756	14,279
Agricultural GDP / Total GDP (in %)	9.1	13.4
Palm oil sector GDP (million USD) (in %)	3.8	1.8

When assumed that this doesn't include indirectly associated workers or informal workers, the number would be considerably higher

For comparison: In 2016 the exports of the Indonesian palm oil sector amounted to USD 18.6 billion (~13% of total exports – meaning it has a significant impact on the overall Balance of Payments¹⁾

Sources: Malaysia: Department of Statistics Malaysia (2015), ITC (2016). Indonesia: Central Statistical Agency (2015), Ministry of Agriculture (2015), and ITC (2016). The year 2013 was selected since it is the last year for which official statistics in both Malaysia and Indonesia are considered final. Assumed exchange rate is MYR 3.28 per USD for Malaysia, and IDR 12,000 per USD for Indonesia.

After a couple of tumultuous years the price for palm oil has returned to historical levels

Palm Oil Monthly Price (1987 – 2017)



The public debate on the environmental and social issues surrounding Palm oil production has intensified



II - The Palm Oil Value Chain

From soil to end-consumer

The palm oil value chain is most lucrative upstream and has various large backward integrated players



Financing needs

Growers	Mill	Refinery	Traders	Manufacturer	Retailers	Consumer
Growing Harvest replanting finance (overcoming cash-dip)	Pressing Capital expenditures Working capital	Refining Capital expenditures Working capital	Trade Trade and commodity finance	Production	Selling	Consumption

Location

85%: Indonesia, Malaysia	Indonesia Malaysia	Indonesia Malaysia	Singapore (75%), Malaysia	Country of consumption	Globally	Globally
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Concentration

30% of production comes from smallholders	Larger plantations (60%) usually have their own mills	More than 70% of refining capacity is controlled by 8 players	Trade is the most concentrated, however diminishes as separate activity	Highly fragmented	Highly fragmented	Indonesia: 19%, India: 19%, EU: 13%, China: 10%, Malaysia: 7%.

Revenue/ton

\$100-300/ton

\$10-50/ton

\$10-20/ton

RSPO: +\$20-40/ton
(1,5 – 6%)

Financing

Small plantations: local banks at low interest rates. Larger plantation companies: many internationally active banks

syndicates with some internationally active banks

many internationally active banks

The further forward in the value chain, the more internationally active banks are involved

In Indonesia and Malaysia, production takes place by smallholders and plantation companies



- **Smallholders**
 - Independent: own/ use less than 50 ha (definition: RSPO)
 - Tied: contracted to a plantation company
 - Tied+: own both tied and independent small holdings
- **Small growers** manage 50 to 500 ha (incl. absentee landlords)
- **Plantation Companies**
 - Private
 - Government linkedown from a few hundred to more than 100k ha



Additional Notes on Finance

- For all growers: finance for (re-) planting / establishment, input finance and finance for renovation, rehabilitation and milling
- Large plantations: conduct replanting on regular basis and hence do not need additional capital finance for renovation (can finance this out of the own cash flow and or through working capital),
- Smallholders: need long term finance for renovation if using low productivity trees

Smallholders control a significant part of the planted areas but with lower productivity



Share of smallholders in production in Indonesia

Producers		Planted areas (%)	Production (%) ¹⁾
Small-holders	Tied	10%	
	Tied+	10%	
	Independent	22%	
	Total	42%	30%
Plantation companies	State owned plantations	8%	
	Private estates	50%	
	Total	58%	70%

Note: In 2014 the ten biggest growers accounted for more than 20% of the global palm oil production

	Prod. CPO (m tonnes)	Global Share (%)
FELDA	3,1	4,9%
GAR	2,4	3,8%
Sime Darby	2,2	3,5%
Wilmar	1,5	2,4%
KLK	1,1	1,7%
PT Salim Ivomas	1,0	1,6%
IOI	0,8	1,2%
Bumitama Agri	0,7	1,2%
PT Smart	0,7	1,2%
First Resources	0,7	1,1%
Total	14,2	22,6%

Much of the refining activity is done by a few large vertically integrated conglomerates



- **Refineries require**
 - Large upfront capital investments (hundreds of millions of dollars)
 - Stable CPO inputs
 - Good infrastructure and access to markets
- **Refinery conglomerates are supplied by**
 - Own mills and plantations
 - Large number of third party suppliers



Refinery conglomerates are also involved in production and trade



	Production (% of global supply)	Share of global trading
Wilmar	2,4%	43%
Musim Mas	0,4%	18%
GAR	3,8%	14%
IOI (Malaysia)	1,2%	10%
Cargill	0,6%	4%
KLK	1,7%	2%
Astra Agro	1,9%	<2%
Asian Agri/Apical	1,0%	<2%
Total	12,9%	91%

Please note that this overview is not exhaustive! There are other large players in the value chain (such as Bunge), however these tend to be less vertically integrated

The downstream steps in the palm oil value chain is highly fragmented



Ten 'biggest' palm oil purchasers (2015)

Company	Value (x 1000 ton)
Unilever	1,500 ton (~2%)
P&G	494 ton
PepsiCo	453 ton
Nestlé	418 ton
Unigrà	315 ton
Mondeléz	289 ton
Ferrero	181 ton
Colgate-Palmolive	174 ton
Godrej	150 ton
Reckitt Benckiser	126 ton

Note that Indian company Ruchi Soya is said to consume 1,500 000 ton²⁾

Note that Unilever and Nestle have published their list of suppliers [100s] and supplying mills [1300+]

- Highly fragmented manufacturing and retail market¹⁾
- Note that many overviews are somewhat Western centric overlooking players from emerging markets or indeed national companies
 - The vast majority of MNC's consume between 100 – 500, whereas national (e.g. Indonesian and Malaysian) companies consume < 100
 - Many overviews also often exclude bio-energy/ biofuel companies

III - The Salient Human Rights Issues in Palm Oil

From the institutional to the micro level

This section will contain an in-depth overview of the salient human rights risks in the global palm oil value chain

IV - What role can the Dutch Banking Agreement play?

Mitigating violations & Securing adherence

This section will be built on the analysis on the salient human rights risks in the global palm oil value chain (presented in the previous section) and discuss how the various parties of the DBA can ensure a better adherence to human rights in the global palm oil value chain

V – Next Steps

(to be determined)

We welcome your comments!

Please email any comments, observations, questions and suggestion to:

bankenconvenant@ser.nl

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