



**PALM OIL:**

**A BUSINESS CASE FOR SUSTAINABILITY**



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# EXECUTIVE SUMMARY

The destruction and degradation of tropical forests for oil palm cultivation has serious negative impacts on both wildlife and people, contributing significantly to the climate crisis.

To date, arguments used to persuade the palm oil industry to improve its practices have focused, quite rightly, on the ecological and moral cases for change. However, these arguments have not yet been enough to convince all actors in the industry to improve to the extent required. It is therefore crucial to make clearer the often overlooked argument for why companies should be urgently changing their practices – the business case.

ZSL’s SPOTT initiative scores palm oil, natural rubber and tropical forestry companies annually on over 100 sector-specific indicators regarding the public disclosure of their operations, policies and practices related to key environmental, social and governance issues.

To investigate the business case for sustainable palm oil, we commissioned an analysis of SPOTT assessment scores and financial performance data. The study found that on average, higher-scoring companies outperformed lower-scoring companies on a total return basis by around 20%, when comparing the top- and bottom-scoring halves of the dataset from 2014-19 (Fig. 2). The highest-scoring companies also appeared to show lower levels of volatility and more consistent returns (Fig. 3).

To complement this analysis, we considered various examples of the risks for companies that do not embrace sustainable palm oil, and opportunities available to those that do. In the second half of this report we explore these risks and opportunities through four different lenses – operational, financial, regulatory and reputational – and highlight how they build further on the business case for sustainable palm oil.

Financiers, buyers, and the general public are concerned about the environmental and social issues linked with unsustainable palm oil production, and the negative impacts of such practices on company profits and value are evident. Palm oil companies should make strong, binding commitments to sustainable practices – as outlined through SPOTT’s assessments and the PRI’s investor expectations statement (Box 4) – and should be able to prove that these are being implemented and monitored on the ground.

The positive business case for producing, procuring and financing sustainable palm oil has never been clearer, and industry laggards must take advantage of this opportunity or find themselves left behind.

## ACRONYMS AND INITIALISMS

<b>CPO</b>	Crude palm oil	<b>HCV</b>	High Conservation Value
<b>ESG</b>	Environmental, social and governance	<b>NDPE</b>	No Deforestation, No Peat, No Exploitation
<b>FFB</b>	Fresh fruit bunches	<b>PRI</b>	Principles for Responsible Investment
<b>FMCG</b>	Fast-moving consumer goods	<b>RSPO</b>	Roundtable on Sustainable Palm Oil
<b>GHG</b>	Greenhouse gas	<b>P&amp;C</b>	Principles and Criteria (of the RSPO)
<b>HCS</b>	High Carbon Stock	<b>POIG</b>	Palm Oil Innovation Group

# INTRODUCTION

## THE NEED FOR SUSTAINABLE PALM OIL PRODUCTION

Global palm oil production increased 15-fold between 1980 and 2014, fuelled by the oil's low production costs and versatility, and the crop's high yield. Demand for palm oil is expected to increase at an annual rate of 1.7% until 2050.<sup>1</sup>

Global forest loss is at an all-time high, with an estimated 3.6 million hectares of primary rainforest – an area the size of Belgium – lost in 2018 alone.<sup>2</sup> Alarming, this comes despite the commitment made by global corporations and governments to halve deforestation by 2020 in the 2014 New York Declaration on Forests (NYDF).

Oil palm development is one of the key drivers of tropical forest loss, with a particularly high impact in specific regions. In Indonesia and Malaysia it accounted for 47% and 16% respectively of all deforestation between 1972 and 2015.<sup>3</sup> While the rate of forest loss decreased in Indonesia by 40% in 2018 compared to the annual rate for 2002-2016, it also increased substantially in the same year in Ghana, Cote d'Ivoire, Papua New Guinea, Colombia, and the Democratic Republic of Congo<sup>4</sup> – some of the new frontiers of palm oil expansion.

Forests pull vast quantities of carbon out of the atmosphere: between 1990 and 2007 they sequestered the equivalent of 60% of global cumulative fossil fuel emissions over the same period.<sup>5</sup> Protecting forests is therefore essential to any strategy for staying within the 2°C warming limit outlined in the 2015 Paris Agreement – a crucial target if the worst human and environmental impacts of climate change are to be avoided.

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*“There is no greater collective risk we face today than climate breakdown. To reduce the palm oil sector’s contribution to this crisis, its impacts on the world’s forests must be addressed with urgency. To do so, Aviva engages with investee palm oil companies to push for best-practice implementation.”*

**Eugenie Mathieu**  
**Senior SRI Analyst**  
**Aviva Investors**

Tropical forest habitats also have some of the richest biodiversity on Earth, and their destruction and degradation through unsustainable oil palm development threatens many species. These include: the Bornean orangutan, which suffered a population decrease of around 100,000 from 1999 and 2015;<sup>6</sup> the Sumatran tiger, which has just two remaining viable breeding populations;<sup>7</sup> and the Sumatran rhinoceros, of which there are estimated to be fewer than 100 remaining in the wild.<sup>8</sup>



<sup>1</sup> Meijaard, E. *et al.* (eds.) (2018). Oil palm and biodiversity. A situation analysis by the IUCN Oil Palm Task Force. IUCN. <https://portals.iucn.org/library/sites/library/files/documents/2018-027-En.pdf>

<sup>2</sup> Weisse, M. & Dow-Gowman, C. (2019). The World Lost a Belgium-sized Area of Primary Rainforests Last Year. World Resources Institute, 25th Apr. <https://www.wri.org/blog/2019/04/world-lost-belgium-sized-area-primary-rainforests-last-year> [Accessed 19/11/19]

<sup>3</sup> Meijaard, E. *et al.* (eds.), Oil palm and biodiversity

<sup>4</sup> Weisse, M. & Dow-Gowman, C., The World Lost a Belgium-sized Area of Primary Rainforests Last Year

<sup>5</sup> Pan *et al.* (2011). A large and persistent carbon sink in the world's forests. *Science*, 333 (6045), p.988-993. <https://science.sciencemag.org/content/333/6045/988>

<sup>6</sup> Voigt, M. *et al.* (2018). Global demand for natural resources eliminated more than 100,000 Bornean orangutans. *Current Biology*, 28 (5), p.761-769. [https://www.cell.com/current-biology/fulltext/S0960-9822\(18\)30086-1](https://www.cell.com/current-biology/fulltext/S0960-9822(18)30086-1)

<sup>7</sup> Luskin, M.A. *et al.* (2017). Sumatran tiger survival threatened by deforestation despite increasing densities in parks. *Nature Communications*, 8(1): 1783. <https://www.nature.com/articles/s41467-017-01656-4>

<sup>8</sup> Hance, J. (2017). Worst-case scenario: There could be only 30 wild Sumatran rhinos left. *Mongabay*, 7th Nov. <https://news.mongabay.com/2017/11/worst-case-scenario-there-could-be-only-30-wild-sumatran-rhinos-left/> [Accessed 20/11/19]



Fire is often used to clear land for oil palm plantations, destroying natural forest and emitting vast quantities of greenhouse gases (GHGs). During the Indonesian haze crisis of 2015, daily emissions from forest fires at times exceeded those of the entire US economy,<sup>9</sup> and more than 100,000 premature deaths were estimated to have resulted from the haze which spread across much of Indonesia, Malaysia and Singapore.<sup>10</sup> These issues have resurfaced in Indonesia in 2019, with more than 66,000 fire alerts reported by Global Forest Watch (GFW) between January and September.<sup>11</sup>

The palm oil sector is also associated with the violation of the rights of local and indigenous communities, including those that rely on forests for their livelihoods. Land tenure insecurity is widespread and ‘land grabbing’ by companies to make way for oil palm plantations is an ongoing issue. This increases pressure on remaining resources as forest-dependent communities become displaced.<sup>12</sup> Furthermore, many sources have documented widespread discrimination, forced labour, low wages, and dangerous working conditions in the sector.

### BOX 1: WHAT IS SUSTAINABLE PALM OIL?



Sustainable palm oil is produced following social and environmental best practices. This includes protection of tropical forests, peatlands, High Conservation Value (HCV) areas, High Carbon Stock (HCS) forests, and other significant landscapes and habitats. Sustainable palm oil development respects legal and customary land rights and the rights of indigenous and local communities, and is produced in accordance with international norms on human and workers’ rights.

Palm oil certified under the Roundtable on Sustainable Palm Oil (RSPO) 2018 Principles and Criteria (P&C)<sup>13</sup> and/or verified by the Palm Oil Innovation Group (POIG) aligns with this definition. However, companies can also produce/procure uncertified palm oil to meet their sustainable sourcing commitments, if it aligns with or exceeds criteria within these certification standards and provides credible assurances to back these claims. The SPOTT palm oil indicator framework also details the key Environmental, Social and Governance (ESG) criteria that companies should consider to ensure the palm oil in their supply chains is produced more sustainably.

Despite all these concerns, the palm oil industry has also brought many benefits to producer countries such as Malaysia and Indonesia, by providing large-scale employment and boosting national economies.

An estimated 4.7 million people across these two countries are directly employed in the palm oil sector, with a further 11 million people<sup>14</sup> indirectly dependent on it.



<sup>9</sup>Harris, N. *et al.* (2015). Indonesia’s fire outbreaks producing more daily emissions than entire US economy. World Resources Institute, 16th Oct. <https://www.wri.org/blog/2015/10/indonesia-s-fire-outbreaks-producing-more-daily-emissions-entire-us-economy> [Accessed 19/11/19]

<sup>10</sup>Kopitz, S. *et al.* (2016). Public health impacts of the severe haze in Equatorial Asia in September–October 2015. *Environmental Research Letters* 11 (9). <https://iopscience.iop.org/article/10.1088/1748-9326/11/9/094023>

<sup>11</sup>Ummu Haniy, S., Hamzah, H. and Hanifah, M. (2019). Intense Forest Fires Threaten to Derail Indonesia’s Progress in Reducing Deforestation. World Resources Institute, 7th Oct. <https://www.wri.org/blog/2019/10/intense-forest-fires-threaten-derail-indonesia-s-progress-reducing-deforestation> [Accessed 20/11/19]

<sup>12</sup>Forest Peoples Programme & International Land Coalition (2010). Palm oil and indigenous peoples in South East Asia. [http://www.forestpeoples.org/sites/fpp/files/publication/2010/08/palmoilindigenouspeoplesoutheastasiafinalmceng\\_0.pdf](http://www.forestpeoples.org/sites/fpp/files/publication/2010/08/palmoilindigenouspeoplesoutheastasiafinalmceng_0.pdf)

<sup>13</sup>For details of the RSPO P&C see: <https://rspo.org/principles-and-criteria-review>

<sup>14</sup>Russell, M. (2018). Palm Oil: Economic And Environmental Impacts. European Parliamentary Research Service Blog, 19th Feb. <https://epthinktank.eu/2018/02/19/palm-oil-economic-and-environmental-impacts/> [Accessed 13/11/19]

## WHAT PROGRESS IS BEING MADE?

Despite the upsurge of No Deforestation, No Peat, No Exploitation (NDPE) commitments, and collective pledges under the NYDF and the Consumer Goods Forum to remove deforestation from agricultural supply chains by 2020, the private sector is far from reaching its goals. According to research by the Zoological Society of London's (ZSL's) SPOTT initiative (Box 2), progress by upstream companies is insufficient.<sup>15</sup>

### 2019 SPOTT assessment results

The most recent SPOTT palm oil assessment results showed:

- Only 32% of companies provided evidence for monitoring deforestation in their supply chain.
- Only 60% of companies had a clear commitment to zero deforestation.
- Only 22% of companies could trace 100% of their supply from their own mills back to plantation.
- No companies purchasing palm oil from external suppliers were able to trace 100% of their supply back to the plantation. Without knowing where all the palm oil they source is coming from, companies cannot prove that it is being produced in compliance with their sustainability requirements.

### BOX 2: WHAT IS SPOTT?

SPOTT is a free, online platform providing assessments of forest-risk commodity producers, processors and traders on the public disclosure of their operations, policies and practices related to key issues affecting people and wildlife. SPOTT scores palm oil, natural rubber and tropical forestry companies annually against over 100 sector-specific indicators. SPOTT is an initiative of the Zoological Society of London (ZSL).<sup>16</sup>



Although progress has been made in recent years, much more needs to be done, both to bring the 'laggards' up to the standard of the 'leaders', and to bring the whole sector to a higher level of transparency and sustainability.

This report looks at some of the key arguments for a business case for palm oil sustainability, drawing on existing examples to explore some of the opportunities that may be available to those companies that embrace sustainable palm oil production, and the kinds of risks that loom over those that do not.

*"Preserving ecosystems is not only vital for the current and future livelihoods of local communities who depend on them, it is crucial for habitats and the biodiversity they are home to, including species such as the Sumatran tiger or the African forest elephant. As a long-term investor, we challenge the businesses that we own on their impact on biodiversity and habitats."*

**Eugenie Mathieu**  
Senior SRI Analyst  
Aviva Investors

<sup>15</sup> ZSL (2019). ZSL Report finds majority of companies don't know origin of their palm oil <https://www.spott.org/news/zsl-report-finds-majority-of-companies-dont-know-origin-of-their-palm-oil/> [Accessed 19/11/19]

<sup>16</sup> For more information see [www.spott.org](http://www.spott.org)

# SPOTT SCORES AND FINANCIAL PERFORMANCE

In order to explore links between sustainability reporting and financial performance, ZSL commissioned a study<sup>17</sup> comparing the SPOTT assessment scores and engagement levels of listed palm oil companies with total return metrics.

## CUMULATIVE RETURNS

The cumulative return was compared between the ten highest- and lowest-scoring listed companies on SPOTT, and between those scoring in the top vs. the bottom half of the listed company ranking. These results were used to produce indices for 2014-2019, using a market-cap weighting (Figures 1 and 2).

### METHODOLOGY

- The overall score of a company on SPOTT<sup>18</sup> was taken for each assessment year, and the daily stock price changes used for the following year, up to the next SPOTT assessment.
- SPOTT assessment scores are from 2014-2018,<sup>19</sup> looking only at listed palm oil companies.
- The daily stock price changes were indexed for 2014-2019 (from end-September, as the last day before the final quarter, in which the assessments are published).



Figure 1: Index of cumulative return 2014-2019 for top 10 vs. bottom 10 listed SPOTT-assessed palm oil companies 2014-2018. Market-cap weighted.

<sup>17</sup> Conducted by independent consultant Andrew White, in collaboration with Global Property Research (GPR).

<sup>18</sup> See Box 2.

<sup>19</sup> Note this analysis did not include the latest SPOTT assessment results at time of writing, which were released in October 2019.

These index values (y-axis) show that the higher-scoring companies on SPOTT outperformed the lower-scoring ones over the five-year period to end-September 2019, on a total return basis. For the most part the top ten have been in the 'positive territory' (Figure 1), and the cumulative return of the top half ended the period almost unchanged (Figure 2). In contrast, the low-scoring companies have been in the 'negative territory' (Figures 1 and 2), and the return of the bottom half declined around 20% since the base year (Figure 2).

In Figure 2, we can see the performance gap between the top and bottom half of SPOTT companies widened between 2015-2019 to a difference of about 20%, which could suggest that environmental, social and governance (ESG) reporting and performance has been becoming a more critical issue over time.

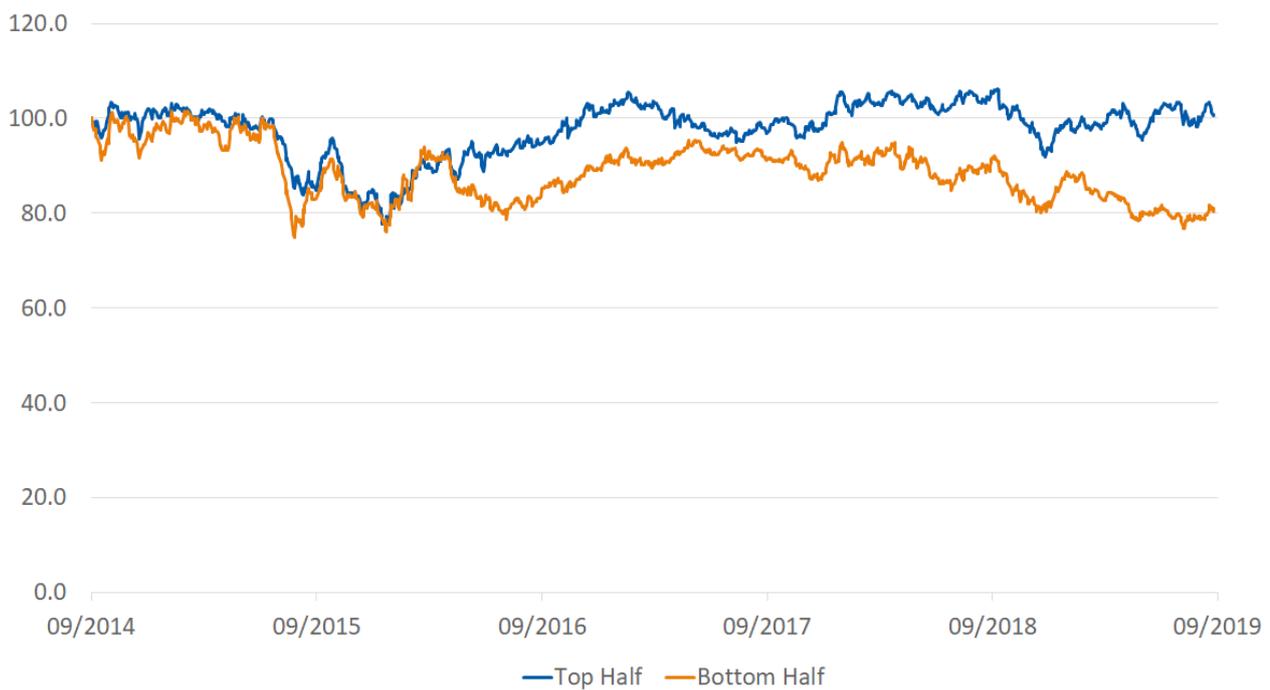


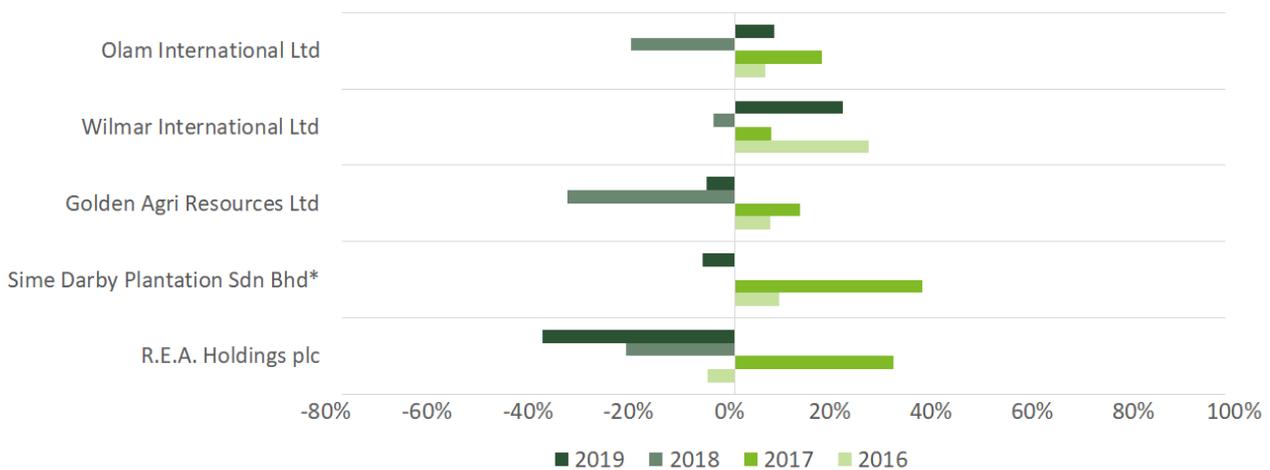
Figure 2: Index of cumulative return 2014-19 for top vs. bottom half of listed SPOTT-assessed palm oil companies 2014-18. Market-cap weighted.

## ANNUAL RETURNS

Some analysis was also done at the individual company level (Figure 3). Annual returns for the top- and bottom-five listed SPOTT palm oil companies were compared across the years 2016-2019 (not earlier due to availability of total return data).

Although the results are mixed, the overall trend indicates that high-scoring companies had more 'winning years' and fewer 'losing years' than the low-scoring companies, suggesting they may have lower levels of volatility and more consistent returns.

### Top five listed SPOTT-assessed palm oil companies 2015 - 2018



### Bottom five listed SPOTT-assessed palm oil companies 2015 - 2018

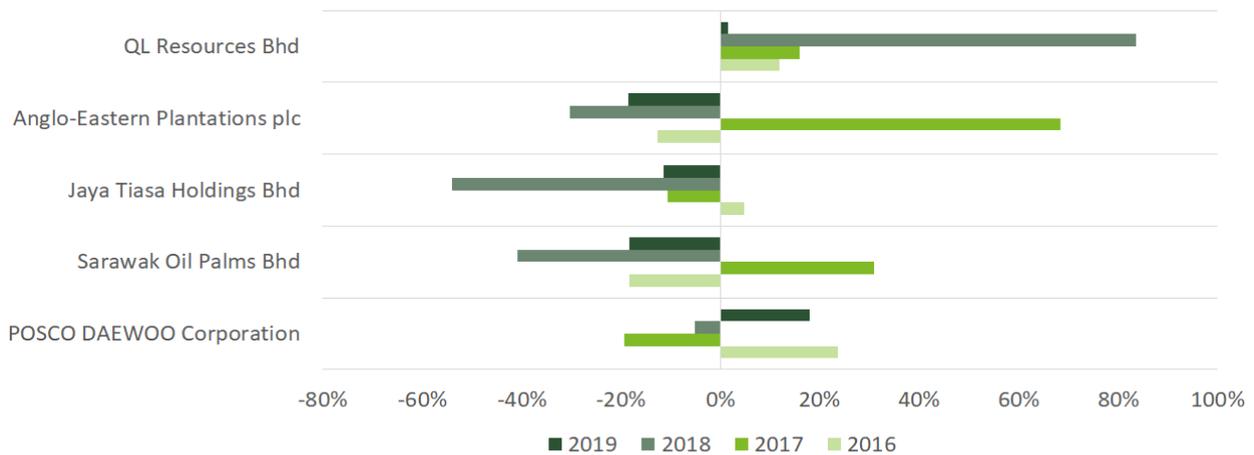


Figure 3: Annual returns 2016-2019 for top vs. bottom five listed SPOTT-assessed palm oil companies 2015-2018.

\* The ticker for Sime Darby plantation changed following its demerger. 2018 share price data was unavailable at the time of writing.

### BOX 3: LIMITATIONS OF THE ANALYSIS



The analyses presented here illuminate correlations, but direct causation of course can and should not be assumed.

When considering the links between sustainability and financial performance, it is crucial to consider the limitations of the types of analyses carried out. These include:

- The type of company observed, taking into account the degree of diversification and vertical integration, and the importance of palm oil to each company;
- Other extraneous factors affecting financial performance, which may affect companies equally or to different degrees, such as:
  - ◊ Commodity prices
  - ◊ Regional/geographic bias
  - ◊ Company size bias
  - ◊ Other developments in the palm oil market and more broadly in terms of global market trends impacting on business sentiment and share prices;
- In addition, in terms of commodity prices, lower commodity values may affect company revenues and ability to invest in sustainability initiatives.

# WHY GOOD PRACTICES ARE GOOD BUSINESS: IDENTIFYING RISKS AND OPPORTUNITIES

In 2017 CDP estimated up to US\$941 billion of corporate revenues depended upon deforestation-linked commodities.<sup>20</sup> Of 201 company submissions to CDP that year, 87% identified at least one deforestation-related risk with “potential to cause a substantive change in operations, revenues or costs”, and 32% reported that such risks had already impacted upon the company.<sup>21</sup>

Whilst the risks to companies producing and buying unsustainable palm oil are numerous, there are also many ways a move to sustainable practices brings real advantages. Here we explore some of these risks and opportunities, in relation to company finances, operations, reputation, and external regulation.



Figure 4: Summary of some of the business risks linked to unsustainable palm oil production, and opportunities available for companies that improve their practices.

<sup>20</sup> CDP (2017). From Risk to Revenue <https://www.cdp.net/en/research/global-reports/global-forests-report-2017>

<sup>21</sup> *Idem*

# FINANCIAL RISKS AND OPPORTUNITIES

Increasingly, financial institutions and buyers place sustainability-based conditions on palm oil sector companies' access to capital and markets. They might proactively exclude companies failing to meet their criteria, or cut ties after allegations occur.

At the same time, better management of ESG issues can support a company's performance.

A 2015 meta-study found over 2,200 academic studies in the previous 40 years examining the relationship between ESG factors and corporate financial performance. More than 90% of them found that ESG factors had a positive or neutral impact on financial returns.<sup>22</sup>

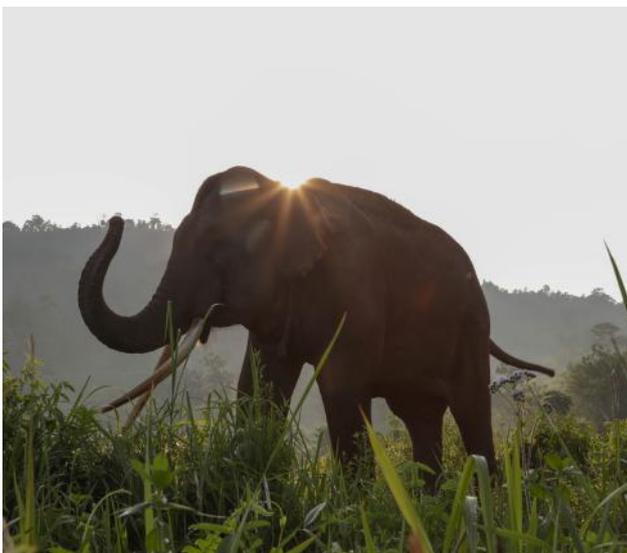
## BOX 4: INVESTOR EXPECTATIONS FOR THE PALM OIL SECTOR



In 2019, 58 global investors with approximately US\$7.9 trillion in assets under management, coordinated by the PRI, outlined clear expectations for companies across the palm oil value chain, including producers, refiners, traders, consumer goods manufacturers, retailers and banks.<sup>23</sup>

The investors encourage the companies they invest in to adopt responsible practices, including:

- To become members of the RSPO<sup>24</sup> and apply the RSPO's Principles and Criteria;
- To adopt and implement a publicly available No Deforestation, No Peat and No Exploitation (NDPE) policy, regardless of their certification status;
- To commit to full traceability of the palm oil they source and supply to the plantation level, and to participate in supply-chain-wide transparency efforts by mapping and disclosing their palm oil concession areas;
- To set time-bound plans and regularly report on progress and practices;
- To make efficient investments to improve palm oil yield and productivity.



*"Robeco is very committed to sustainability. Ensuring that palm oil is produced in a sustainable manner is not just a corporate responsibility issue for palm oil growers. Unsustainable practices create an extensive set of risks which are material not only for palm oil companies themselves but also for consumer goods companies and retailers further down the supply chain and – with a looming environmental crisis – society as a whole. This is the reason why, together with 57 other global investors, we have signed a statement outlining our expectations for the industry."*

**Peter van der Werf**  
**Senior Engagement Specialist**  
**Robeco**

<sup>22</sup> Friede, G., Busch, T., & Bassen, A. (2015). ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies. *Journal of Sustainable Finance & Investment* 5 (4) 210–33. <https://doi.org/10.1080/20430795.2015.1118917>.

<sup>23</sup> Principles for Responsible Investment (PRI) (2019). Fifty-six investors sign statement on sustainable palm oil. <https://www.unpri.org/news-and-press/fifty-six-investors-sign-statement-on-sustainable-palm-oil/4266.article>

<sup>24</sup> The Roundtable on Sustainable Palm Oil. See more information: <https://rspo.org/>

## FINANCIAL AND MARKET ACCESS RISKS

### Supply chain suspension and exclusion

In April 2016 Malaysian palm oil company IOI Corp had its RSPO certificates suspended, following a series of complaints against its subsidiaries in Indonesia. The suspension decision was made with regards to non-adherence to the RSPO Principles and Criteria (RSPO P&C) pertaining to the development of 141 ha of palm plantations on peatland, illegally clearing more land than was authorised, and not possessing environmental permits for two subsidiaries at the time of this clearing.<sup>25</sup> IOI's suspension, and the significant impact this had upon the company's share price, income and buyer contracts, has been extensively commented on, and is one of the clearest recent case studies demonstrating the concrete financial risks of a failure to implement sustainable palm oil production practices. Figure 5 shows the 17% share price drop the company experienced following its suspension. It should be noted that IOI subsequently made changes to its strategy and policies, which was picked up positively by analysts,<sup>26</sup> and this makes it also a good example of how companies can reduce such risks if they do make conscious efforts to improve.

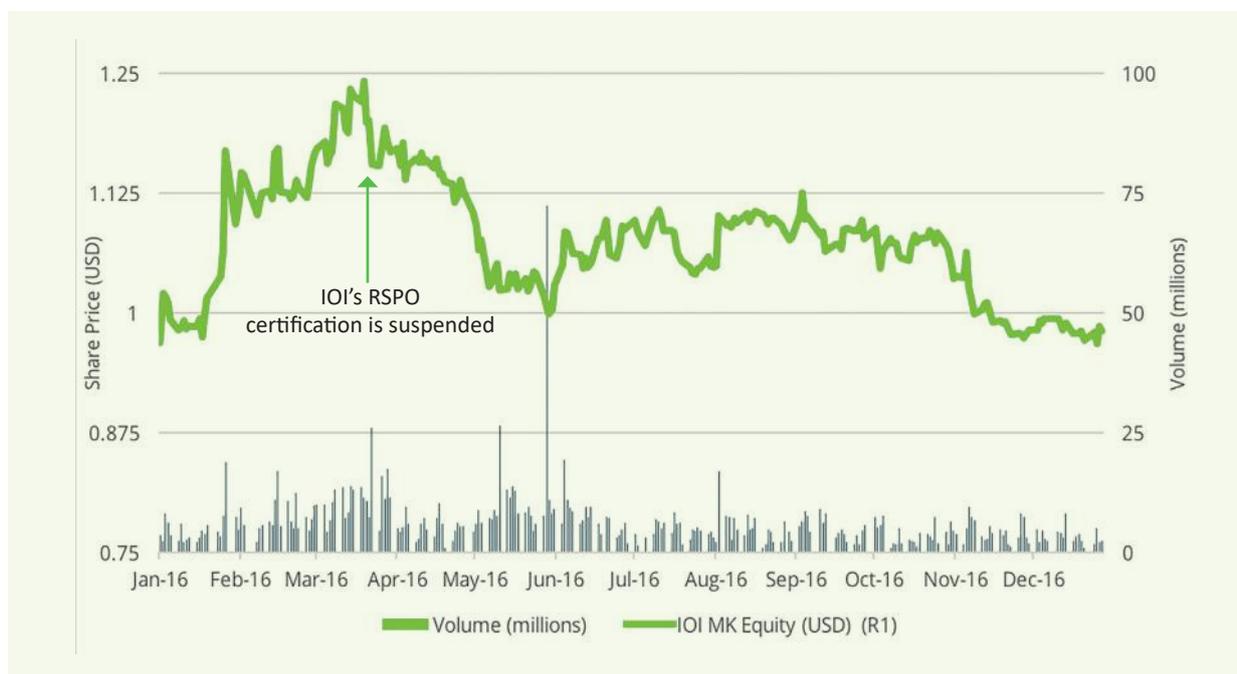


Figure 5: IOI share price change following RSPO suspension in 2016. Source: Ceres and Climate Advisers, 2017. 'Case study series: Business risks from deforestation', p.8.

More recently, in August 2019, a Chain Reaction Research report<sup>27</sup> noted that four palm oil companies which had been suspended from multiple buyers' supply chains for NDPE non-compliance were, on average, underperforming against benchmark indices. The authors noted that these companies "experienced reductions of USD 8-50 million in quarterly revenues, gross profit, EBITDA, and net profit per company", "saw higher receivables, inventories, and net debt" and that the "annual net profits of the suspended growers declined by USD 122 million (69 percent) since the first suspension events in 2015".<sup>28</sup> The report also found that, with several refiners having adopted new NDPE policies since 2017, the 'leakage market' for unsustainable palm oil has shrunk and is likely to continue to do so. Companies failing to implement NDPE commitments are therefore increasingly putting their own revenue at risk through market exclusion.<sup>29</sup>

<sup>25</sup> See RSPO letter to IOI, 14th March 2016. [https://ap8.salesforce.com/sfc/p/#90000000YoJi/a/90000000PXI3/AbYbJ8pzWzTbSFo\\_t\\_iZDh.ZyTgbTKiTO\\_whL2T\\_1pl](https://ap8.salesforce.com/sfc/p/#90000000YoJi/a/90000000PXI3/AbYbJ8pzWzTbSFo_t_iZDh.ZyTgbTKiTO_whL2T_1pl)

<sup>26</sup> Chong, J-H. (2017). IOI Corp downstream revenue seen rising on RSPO compliance — Moody's. The Edge Markets, 8th May. <https://www.theedgemarkets.com/article/ioi-corp-downstream-revenue-seen-rising-rspo-compliance-%E2%80%94-moodys> [Accessed 13/11/19]

<sup>27</sup> Chain Reaction Research (2019). Palm Oil Growers Suspended Over Deforestation Lose USD 1.1B in Equity Value. <https://chainreactionresearch.com/wp-content/uploads/2019/08/Palm-Oil-Growers-Suspended-Over-Deforestation-Lose-USD-1.1B-in-Equity-Value-3.pdf>

<sup>28</sup> *Idem*

<sup>29</sup> Chain Reaction Research (2018). Unsustainable Palm Oil Faces Increasing Market Access Risks: NDPE Sourcing Policies Cover 74 Percent of Southeast Asia's Refining Capacity (Updated Version). [https://chainreactionresearch.com/wp-content/uploads/2017/11/unsustainable-palm-oil-faces-increasing-market-access-risks-final-1\\_updated-july-2018.pdf](https://chainreactionresearch.com/wp-content/uploads/2017/11/unsustainable-palm-oil-faces-increasing-market-access-risks-final-1_updated-july-2018.pdf)

## Divestment and reduced access to capital

Less responsible companies are not only at risk of supply chain exclusion, but also exclusion from investment portfolios. Even where investors favour an engagement approach, there is usually a line beyond which a company clearly failing to improve its sustainability reporting and performance will not receive investment. For example, asset manager Robeco has a policy of engaging with those palm oil companies showing progress towards sustainability objectives, and yet excludes companies without RSPO membership and 20% certified plantations. This means palm oil companies make up a significant portion of companies on its exclusion list.<sup>30</sup>

Those companies that do receive investment may still lose it if they do not improve their practices. For example, Robeco requires companies to have 50% RSPO-certified plantations by 31<sup>st</sup> December 2021, to remain investible. There have been several high-profile divestments of palm oil companies in recent years due to ESG concerns – see Box 5 – demonstrating the waning tolerance of many investors for companies failing to comply with their sustainability policies.

There are also examples of companies that have lost key creditors due to a failure to act sustainably. Both Citigroup and Rabobank recently withdrew all financing of Indonesian palm oil producer Indofood Agri Resources, following its expulsion from the RSPO.<sup>31</sup>

### BOX 5: LOSING MAJOR INVESTORS



ABP is the largest pension fund in the Netherlands, and was the fifth largest pension fund in the world as of September 2019, with over US\$461 billion in total assets.<sup>32</sup> In June 2018 ABP announced it was divesting POSCO International, following a series of allegations, including a report that POSCO's subsidiary had intimidated local communities and cleared more than 27,000 ha, including primary tropical forest.<sup>33</sup> ABP stated that the slow response from POSCO International on issues such as these meant it had "lost faith in the company's willingness to improve".<sup>34</sup>

POSCO International was also excluded in 2015 by Norway's Government Pension Fund Global (GPF) – the world's largest sovereign wealth fund – along with companies Genting and IJM Plantations, due to concerns from the fund's Council on Ethics regarding deforestation and biodiversity impacts. In addition, between 2012 and 2018 GPF divested 34 companies it considered to be producing palm oil in an unsustainable manner,<sup>35</sup> contributing to a total of over 60 divestments by the fund across different sectors due to deforestation concerns, since 2012.<sup>36</sup>

These cases highlight not only the loss of investment that can result from unsustainable palm oil production, but also the importance of a company engaging seriously with its investors about such issues. As ABP noted in its statement on POSCO International, sustainability is becoming more and more crucial to investors,<sup>37</sup> and companies which fail to recognise this will find themselves increasingly left behind.

<sup>30</sup> Robeco (2019) Exclusion Policy Robeco. <https://www.robeco.com/docm/docu-exclusion-policy-and-list.pdf>

<sup>31</sup> Rainforest Action Network (2019). Citigroup Cancels Financing of Indonesian Food Giant Indofood Over Palm Oil Labor Abuses. 17th Jun. <https://www.ran.org/press-releases/citigroup-cancels-financing-of-indonesian-food-giant-indofood-over-palm-oil-labor-abuses/> [Accessed 06/11/19]

<sup>32</sup> Willis Towers Watson (2019). Top 20 pension funds' AUM declines for first time in seven years. 2nd Sept. <https://www.willistowerswatson.com/en-GB/News/2019/09/top-20-pension-funds-aum-declines-for-first-time-in-seven-years> [Accessed 18/10/19]

<sup>33</sup> Mighty Earth (2018). Largest Dutch pension fund involved in clearing rainforest. 14th May. <http://www.mightyearth.org/largest-dutch-pension-fund-involved-in-clearing-rainforest?preview=true> [Accessed 18/10/19]

<sup>34</sup> Preesman, L. (2018). ABP divests from palm oil firm amid public criticism. IPE, 28th June. <https://www.ipe.com/countries/netherlands/abp-divests-from-palm-oil-firm-amid-public-criticism/10025415.fullarticle> [Accessed 18/10/19]

<sup>35</sup> NBIM (2018). Responsible investment: Government Pension Fund Global. [https://www.nbim.no/contentassets/e1632963319146bbb040024114ca65af/responsible-investment\\_2018.pdf](https://www.nbim.no/contentassets/e1632963319146bbb040024114ca65af/responsible-investment_2018.pdf)

<sup>36</sup> Taylor, M. (2019). Norway's wealth fund ditches 33 palm oil firms over deforestation. Reuters, 28th Feb. <https://www.reuters.com/article/us-norway-pension-palmoil/norways-wealth-fund-ditches-33-palm-oil-firms-over-deforestation-idUSKCN1QH1MR> [Accessed 18/10/19]

<sup>37</sup> ABP (2018). ABP verkoopt aandelen palmoliebedrijf. 22nd June. <https://www.abp.nl/over-abp/actueel/nieuws/abp-verkoopt-aandelen-palmoliebedrijf.aspx> [Accessed 06/11/19]

## FINANCIAL AND MARKET ACCESS OPPORTUNITIES

### ESG-linked loans

An increasing number of structured products, such as ESG-linked loans, are being made available to soft commodity companies looking to improve the sustainability of their operations. In 2017, ING and Wilmar agreed to convert part of an existing revolving credit facility to a sustainability performance-linked loan, the first of its kind in the palm oil sector.<sup>38</sup> The company reached similar agreements with OCBC Bank<sup>39</sup> – the largest such loan by a Singaporean bank at that time – and DBS in 2018.<sup>40</sup> Similar products have recently been provided to others in tropical commodity supply chains, including a US\$2.3 billion sustainability-linked loan secured by agri-trader Cofco in 2019 involving more than 20 banks,<sup>41</sup> and an inaugural sustainability-linked bond for rubber production agreed in 2018 between PT Royal Lestari Utama and the Tropical Landscapes Finance Facility (TLFF).<sup>42</sup> These examples suggest companies committing to sustainability will find it easier and cheaper to borrow money.

### Sustainability linked to outperformance

There is a growing body of evidence indicating the financial benefit to both companies and investors when sustainable practices are followed. In July 2019 MSCI found that companies within the highest-rated quintile of ESG ratings outperformed those within the bottom quintile, with greater profitability and higher dividend yields.<sup>43</sup> A similar finding was shown in research by Goldman Sachs – companies with high ESG scores outperformed, when the top two quartiles were compared with the bottom two.<sup>44</sup>

The same trend can be seen specifically within the palm oil sector. In 2018, Climate Advisers and S-Network Global Indexes launched the 'Climate Advisers Better Palm Oil Index' (Ticker: CABPLM), an equity index designed to serve as a benchmark for globally traded stocks of palm oil producer companies that are RSPO members.<sup>45</sup>



Climate Advisers found that, over the preceding five years, these companies had outperformed the FTSE Bursa Malaysia Asian Palm Oil Plantation Index (USD) by approximately 6%,<sup>46</sup> and between December 2012 and April 2019, RSPO members outperformed non-members by 24.7%.<sup>47</sup> Although RSPO membership does not necessarily equate to 100% RSPO certification, it is a useful indication that a company is implementing key measures, and these findings indicate the significant benefits of integrating sustainable practices into palm oil production.

<sup>38</sup> Wilmar & ING (2017). Wilmar and ING collaborate on sustainable loan in Asia. 27th Nov. [https://wilmar-iframe.todayir.com/attachment/201809070219541710981721\\_en.pdf](https://wilmar-iframe.todayir.com/attachment/201809070219541710981721_en.pdf) [Accessed 19/11/19]

<sup>39</sup> OCBC (2018). OCBC Bank partners Wilmar on largest sustainability-linked bilateral loan by a Singapore bank [https://www.ocbc.com/group/media/release/2018/ocbc\\_partners\\_wilmar\\_on\\_largest\\_sustainability\\_linked\\_bilateral\\_loan.html](https://www.ocbc.com/group/media/release/2018/ocbc_partners_wilmar_on_largest_sustainability_linked_bilateral_loan.html) [Accessed 19/11/19]

<sup>40</sup> Santiago, C. (2018). Wilmar forges another collaboration through sustainability-linked loan. The Asset, 13th Aug. <https://esg.theasset.com/ESG/34860/wilmar-forges-another-collaboration-through-sustainability-linked-loan> [19/11/19]

<sup>41</sup> Bell, J. (2019). China's Cofco ups the ante with sustainability-linked loan. TFX news, 24th July. <https://www.txfnews.com/News/Article/6808/Chinas-Cofco-ups-the-ante-with-sustainability-linked-loan> [Accessed 25/10/19]

<sup>42</sup> The TLFF is a multi-stakeholder partnership between UNEP, The World Agroforestry Centre (ICRAF), BNP Paribas and ADM Capital. See: <https://www.convergence.finance/resource/4tO5LULlfeb6QJroKuVHJ1/view>

<sup>43</sup> Giese, G., Lee, L-E. *et al.* (2019). Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, And Performance. The Journal of Portfolio Management 45(5). <https://www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226> [Accessed 24/10/19]

<sup>44</sup> Giammattei, G. (2017). A Framework for Responsible Investing. RBC GAM. <https://global.rbcgam.com/resources/documents/pdf/whitepapers/responsible-investing-whitepaper.pdf> [Accessed 25/10/19]

<sup>45</sup> There are 18 stocks in the index. See more: <https://www.climateadvisers.com/projects/climate-advisers-better-palm-oil-index/>

<sup>46</sup> Climate Advisers (2018). Deforestation-Related Externalities Create Financial Risks and Poor Returns for Investors. 12th Sept. <https://www.climateadvisers.com/press-release-deforestation-related-externalities-create-financial-risks-and-poor-returns-for-investors-new-research-shows/> [Accessed 24/10/19]

<sup>47</sup> Climate Advisers (2019). Companies committed to sustainable palm oil production have had substantively stronger equity returns. <https://www.climateadvisers.com/news/companies-committed-to-sustainable-palm-oil-production-have-had-substantively-stronger-equity-returns/> [Accessed 24/10/19]

As can be seen in Figure 6,<sup>48</sup> the gap between RSPO members and non-members in the index has continued to grow, particularly since 2014. This may in part reflect palm oil companies' increased attention to sustainability in recent years, including the launch of the first NDPE commitments in 2013. This trend should be a wake-up call to those companies not yet implementing NDPE commitments and best practices.



Figure 6: Climate Advisers Better Palm Oil Index performance against benchmarks, 2012-2018.

*“The publicly listed producers we looked at outperformed their non-RSPO peers – they did nearly 25% better in terms of their equity returns in that seven-year period. To us, this is a clear indication that stewardship improves the bottom line.”*

**Sarah Lake**  
**Managing Director of Supply Chains**  
**Climate Advisers**

<sup>48</sup> Climate Advisers (2019). Climate Advisers better palm oil index. <https://www.climateadvisers.com/projects/climate-advisers-better-palm-oil-index/> [Accessed 24/10/19]

# OPERATIONAL RISKS AND OPPORTUNITIES

We consider ‘operational’ factors to be those affecting a company’s ability to function as normal and conduct its business activities on the ground. Though all risks and opportunities discussed in this report ultimately affect a company’s business activities, some are more direct than others. We look here at sustainability considerations that can have a clear impact on a company’s effectiveness and ability to produce palm oil.

## OPERATIONAL RISKS

Palm oil production is closely linked with local environmental conditions, with companies both potentially creating and being impacted by physical risks. It is sensitive to changes in factors such as weather patterns, soil quality and water regulation, but can also undermine the natural assets and ecosystem services that affect these factors, jeopardising future production. For example, oil palms do not grow as well in water-logged soils, and in many low-lying forest areas of Indonesia and Malaysia companies drain peat soils before planting.

Besides releasing carbon stored in the peat, drainage can lead to subsidence, putting both the crop and associated infrastructure at risk.<sup>49</sup> Subsidence can also increase the chances of flooding, which can delay fresh fruit bunch (FFB) harvesting and reduce mill crude palm oil (CPO) quality.<sup>50</sup> In extreme cases, flooded plantations must be abandoned altogether, becoming a stranded asset for the company and its financiers.

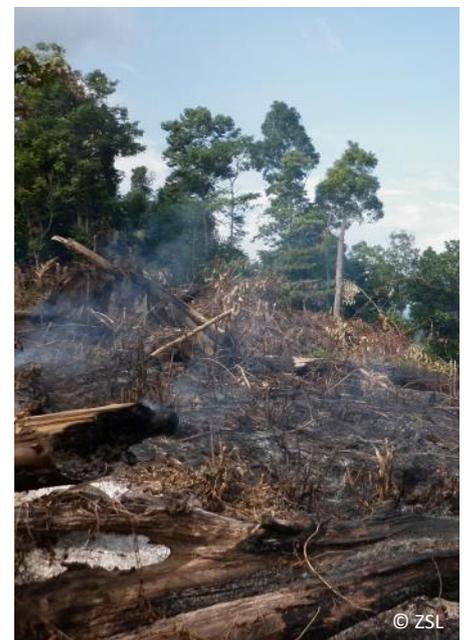
Additionally, where concessions contain undeveloped forests and peatlands, responsible production and sourcing policies may preclude

their future development as palm oil linked to deforestation and peat planting is increasingly rejected by buyers. As of May 2019, an estimated 28.4% of the total concession area for oil palm in Indonesia could be considered ‘stranded’, as its development would cause exclusions from NDPE supply chains and potential deforestation-related liabilities.<sup>51</sup>

Fire is another key issue associated with palm oil cultivation, often discussed in the context of the damage caused to forests and biodiversity. But it is also a physical risk to plantations and associated infrastructure. In addition, the haze resulting from fires can reduce solar radiation – a key climatic factor affecting oil palm yields<sup>52</sup> – leading to lower revenues.

By failing to prevent and control fires in and around concessions, companies risk losing not only revenues but also assets, as concessions may be sealed off or licences revoked. As of October 2019, the Indonesian government had sealed off plantations operated by 64 companies – effectively shutting down operations locally.<sup>53</sup>

The above risks are expected to escalate in coming decades, as the climate crisis increases the frequency and severity of extreme weather events. Agriculture, forestry and other land use (AFOLU) are estimated to contribute around a quarter of all GHG emissions,<sup>54</sup> and due to its scale and links with deforestation, fires, and peatland destruction, palm oil cultivation plays a significant role in this. Minimising its contribution to climate change is therefore not only within the palm oil industry’s power, but also in its best interest.



<sup>49</sup> Morel, A. *et al.* (2016). Stranded Assets in Palm Oil Production: A Case Study of Indonesia. Sustainable Finance Programme, SSEE, University of Oxford. Working Paper, July 2016. <https://ssrn.com/abstract=2809562>

<sup>50</sup> *Idem*

<sup>51</sup> Steinweg, T., Kuepper, B. & Piotrowski, M. (2019). 28 percent of Indonesia’s palm oil landbank is stranded. <https://chainreactionresearch.com/wp-content/uploads/2019/07/28-of-Indonesias-Landbank-Is-Stranded-3.pdf>

<sup>52</sup> Morel, A. *et al.*, Stranded Assets in Palm Oil Production.

<sup>53</sup> Jong, H-N. (2019) Indonesian enforcement questioned as fires flare up on the same concessions. Mongabay, 3rd Oct. <https://news.mongabay.com/2019/10/indonesia-forest-fires-palm-oil-pulp-paper-concession-greenpeace/> [Accessed 04/10/19]

<sup>54</sup> Smith, P. *et al.* (2014). ‘Agriculture, Forestry and Other Land Use (AFOLU)’. In: Edenhofer, O. *et al.* (Eds.) Climate Change 2014: Mitigation of Climate Change. Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change. Cambridge University Press, UK [https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc\\_wg3\\_ar5\\_chapter11.pdf](https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc_wg3_ar5_chapter11.pdf)

## OPERATIONAL OPPORTUNITIES

As negative impacts on local environmental conditions can impact negatively on plantations, the reverse can also be true – a company mitigating negative impacts may see benefits such as improved yields and revenues. A growing body of evidence supports this, with many examples focused on the benefits of RSPO certification, often viewed as a useful proxy for ‘sustainability’.

### Improved efficiencies

A 2012 study investigated the costs and benefits of producing palm oil in accordance with the RSPO Principles and Criteria (P&C), through a series of interviews with companies. It concluded that “business benefits gained from adopting the RSPO Principles and Criteria typically outweigh the costs of implementation—in many cases significantly”.<sup>55</sup> Some of these benefits are not surprising, such as increased access to capital and selling certified product for a higher premium. However, several operational benefits were also identified, many of which the companies had not anticipated.

### Higher yields

A study commissioned by the RSPO<sup>58</sup> found that companies with more than 40% of their land RSPO-certified had significantly higher yields of crude palm oil (CPO), attributable to implementing best management practices in oil palm estates. CPO prices were also higher, compared with companies with less than 20% RSPO-certified (see Table 1). These results were independent of other criteria such as the size of a company’s downstream activities or landbank.

Table 1: Data from Preusser (2015) study showing differences in CPO yield and average price between companies with more and less RSPO certification, in 2014.

	< 20% PLANTATIONS RSPO-CERTIFIED	> 40% PLANTATIONS RSPO-CERTIFIED	CHANGE
CPO YIELD (MT/ha)	3.64	4.92	+35%
AVERAGE CPO PRICE (RM/MT)	2,310	2,468	+7%

For example, the use of best management practices and improved documentation and auditing led to many small changes across company operations, which collectively created significant improvements in employee behaviour and efficiency.<sup>56</sup>

One company’s accident rate dropped 42%. Reduced chemical use through the implementation of the RSPO’s Integrated Pest Management (IPM) practices also led to annual cost savings of US\$250,000 across all estates for one company, and of US\$73,859 in just a single estate for another.

The study also highlighted the improved company relationships with employees, surrounding communities, and other local stakeholders as a result of implementing the RSPO P&C. Several companies reported significantly fewer disruptions to operations from disputes with workers or communities. Given the costly losses that can be incurred through disruptions – one estimate was more than US\$1 million in four days – a company noted that “if you prevent one shutdown during peak in the life of your plantation, right there it pays back for RSPO”.<sup>57</sup>

<sup>55</sup> WWF, FMO & CDC (2012). Profitability and Sustainability in Palm Oil Production. <https://wwf.panda.org/?204548/Profitability-and-Sustainability-in-Palm-Oil-Production>

<sup>56</sup> *Idem*

<sup>57</sup> *Idem*

<sup>58</sup> Preusser, S. (2015). Correlating Economic and Financial Viability with Sustainability for Palm Oil Plantations <https://rspo.org/articles/download/58c8da95c948794>

# REPUTATIONAL RISKS AND OPPORTUNITIES

Research by AMO Strategic Advisors found that approximately 35% of market capitalisation in the 15 leading market equity indices was linked to corporate reputation,<sup>59</sup> and a Chain Reaction Research analysis in 2019 found a similar trend.<sup>60</sup> These findings highlight how crucial it is for companies to consider how they are perceived, and the implications of this for their value.

## REPUTATIONAL RISKS

### Increasing consumer awareness

Ethical consumption is a growing trend, and companies risk losing access to certain markets by not adhering to consumer demands for sustainability. Several countries have made the labelling of palm oil on packaged goods mandatory, enabling greater consumer awareness. This can increase pressure on downstream manufacturers and retailers to buy from sustainable sources, or even to remove palm oil from their products altogether – such as when UK supermarket chain Iceland announced it would stop using palm oil in its own-brand products by end-2018.<sup>61</sup>

High-profile campaigns around palm oil's environmental impacts elevate consumer awareness and may further limit demand for palm-based products. Corporate value is put at risk by public campaigns, such as Greenpeace's recent 'Dying for a Cookie' campaign,<sup>62</sup> Rainforest Action Network's 'Snack Food 20' campaign,<sup>63</sup> and Iceland's 2018 Christmas advert, centred around the destruction of orangutan habitat, in which it announced its palm oil ban. This video had gained over six million views on YouTube by November 2019, demonstrating how much consumer attention even one retailer decision can attract.

Such campaigns are not limited only to European and North American consumer markets. In 2017, WWF released its Palm Oil Buyers' Scorecard for companies in Malaysia and Singapore, calling out major brands Polar Puffs & Cakes and Khong Guan on their insufficient efforts to source sustainable palm oil.<sup>64</sup> Consumer concern is also evident in Singapore – a student-led petition calling for Polar Puffs and food and beverage company Old Chang Kee to stop using unsustainable palm oil in their products reached over 8,000 signatures, and it was then reported that the latter had switched to RSPO-certified sources for its Singapore outlets.<sup>65</sup>

This increased spotlight on the industry, combined with the rise of 'palm-oil free' labels, suggests large-scale boycotts of unsustainable palm products are not unlikely.



<sup>59</sup> AMO Strategic Advisors (2019). What price reputation? Corporate Reputation Value Drivers: A Global Report by AMO. [https://www.amo-global.com/files/media/files/04411587427371e912e14b4b93476f48/AMO\\_What\\_Price\\_Reputation\\_report.pdf](https://www.amo-global.com/files/media/files/04411587427371e912e14b4b93476f48/AMO_What_Price_Reputation_report.pdf)

<sup>60</sup> Chain Reaction Research (2019). Deforestation-Driven Reputation Risk Could Become Material for FMCGs. <https://chainreactionresearch.com/wp-content/uploads/2019/05/Reputation-Risk-and-FMCGs.pdf>

<sup>61</sup> BBC (2018). Iceland supermarkets to ban palm oil in own-brand products. 10th Apr. <https://www.bbc.co.uk/news/business-43696948> [Accessed 02/10/19]

<sup>62</sup> Greenpeace International (2018) Dying for a cookie: How Mondelez is feeding the climate and extinction crisis. 13th Nov. <https://www.greenpeace.org/international/publication/19274/dying-cookie-mondelez-feeding-climate-extinction-crisis/> [Accessed 02/10/19]

<sup>63</sup> Rainforest Action Network (2013). The Snack Food 20 - Conflict Palm Oil. <https://www.ran.org/issue/snackfood20/> [Accessed 02/10/19]

<sup>64</sup> Bardies, G. & Westerhout, D. (2017). WWF palm oil buyers scorecard – Malaysia and Singapore 2017. <https://palmoil.sg/wp-content/uploads/2017/09/POBSReport.pdf> [Accessed 28/10/19]

<sup>65</sup> Change.org (2018). Petition update. <https://www.change.org/p/12497296/u/22332556> [Accessed 07/11/19]

## Downstream risks

This increased public concern represents a clear risk to palm oil producers and upstream processors, but downstream companies should not underestimate the risk to their businesses either. A 2019 analysis concluded that given the increasing awareness of deforestation and its climate impacts, we may see ‘value gaps’ of as much as 70% arise between fast-moving consumer goods companies (FMCGs), based upon their reputations.<sup>66</sup>



### BOX 6: CUTTING TIES



Many downstream corporate buyers have already taken action against palm oil producers failing to meet sustainability requirements. These are just a few recent examples.

- Following IOI Corp’s RSPO suspension in 2016, 27 of the company’s major corporate buyers suspended their procurement contracts, including Unilever, Kellogg’s and Mars.<sup>67</sup>
- In 2018 Boots UK Ltd, the UK’s largest pharmacy-led health and beauty retailer, ended its partnership with POSCO International<sup>68</sup> following the Mighty Earth campaign linking the palm oil company to large-scale deforestation in Indonesian Papua.<sup>69</sup>
- Multiple buyers – including Nestlé, Mars, Hershey’s, Kellogg’s, General Mills and Unilever – have cut ties with Indofood Agri Resources Ltd following concerns over its environmental and social practices, and several of its remaining buyers and partners are being pressured to do the same.<sup>70</sup>
- Major food and beverage company Mondelez International announced in November 2018 it was dropping 12 of its suppliers, due to sustainability breaches.<sup>71</sup> It also urged its remaining suppliers to work faster to stop deforestation, and to comprehensively map and monitor their own concessions and suppliers.

*“As financiers, buyers and the public increasingly seek to avoid the environmental destruction and human rights abuses associated with unsustainable palm oil production, companies that fail to change risk losing investment and access to consumer markets. Improving both the transparency of reporting and the sustainability of actions on the ground is vital for a company to earn a better reputation and achieve long-term profitability.”*

**Eleanor Spencer**

**SPOTT Engagement and Impacts Coordinator  
Zoological Society of London (ZSL)**

## REPUTATIONAL OPPORTUNITIES

Consumer expectations are changing and demand for sustainably produced consumer goods is rising. This comes as the 2020 deadline for many corporate commitments is fast approaching, with few, if any, companies expected to meet their targets. Corporate tracking platforms, such as SPOTT, Global Canopy’s Forest 500, and Supply Change, provide a resource for consumers, buyers and investors to easily track progress of individual companies in meeting their sustainability commitments, informing their purchasing and investment decisions. By improving sustainability practices and increasing transparency of reporting, companies can improve their reputation and provide assurances to interested stakeholders of their sustainability credentials. This in turn can lead to increased profitability and the long-term sustainability of companies. Sourcing certified sustainable palm oil and monitoring throughout the supply chain are some immediate actions that companies can take to assure stakeholders and improve their reputation.

<sup>66</sup> Chain Reaction Research (2019). Deforestation-Driven Reputation Risk Could Become Material for FMCGs. <https://chainreactionresearch.com/wp-content/uploads/2019/05/Reputation-Risk-and-FMCGs.pdf>

<sup>67</sup> Ceres & Climate Advisors, Case Study Series: Business Risks from Deforestation

<sup>68</sup> Formerly POSCO Daewoo.

<sup>69</sup> Mighty Earth (2018). Palm Oil Producer POSCO Daewoo dropped by UK drugstore chain Boots over deforestation. 30th Jan. <http://www.mightyearth.org/posco-daewoo-dropped-uk-chain-announces-moratorium/> [Accessed 07/11/19]

<sup>70</sup> Rainforest Action Network (2018). Palm Oil Giant Indofood Sanctioned Over Labor Rights Violations. 5th Nov. <https://www.ran.org/press-releases/palm-oil-giant-indofood-sanctioned-over-labor-rights-violations/> [Accessed 07/11/19]

<sup>71</sup> Mondelez International (2018). Mondelez International Calls for 100% Sustainability and 100% Transparency in Palm Oil Sourcing. 12th Nov. <https://ir.mondelezinternational.com/news-releases/news-release-details/mondelez-international-calls-100-sustainability-and-100> [Accessed 20/11/19]

# REGULATORY RISKS AND OPPORTUNITIES

The production of palm oil is governed by a complex array of regulatory tools across the supply chain, including financial regulations, mandatory public standards,<sup>72</sup> export tariffs and import regulations.<sup>73</sup> Companies are coming under growing pressure to produce and purchase sustainable palm oil, or risk fines, supply disruption, and restricted market access. Companies already doing so are at a competitive advantage, as they can demonstrate current compliance, and are more prepared for incoming requirements as regulation on sustainability in the sector tightens.

## REGULATORY RISKS

### Increasing government scrutiny

National and local governments have increased their scrutiny of palm oil companies in recent years, in part due to large-scale disasters such as the 2015 haze crisis in Indonesia, as well as pressure from producing countries. A recent report by BPK, a government audit agency in Indonesia, found that more than 80% of palm oil plantations in Indonesia were operating in violation of numerous regulations, echoing findings from 2016 by KPK, the country's anti-corruption agency.<sup>74</sup> A lack of enforcement and widespread corruption in the world's largest palm oil producing country means that large volumes of illegally produced palm oil are making their way into supply chains.

However, countries are increasingly taking action against companies operating unsustainably. Sampoerna subsidiary PT National Sago Prima was fined 1 trillion IDR (\$69 million USD) by the Indonesian government due to fires within its concessions in

2015 – the largest fine ever imposed on an Indonesian palm oil company, for environmental damages.<sup>75</sup> Singapore's Transboundary Haze Pollution Act<sup>76</sup> also gives Singaporean authorities the power to fine companies outside its national borders for haze pollution resulting from fires in their concessions, at a rate of \$100,000 a day.

### Supply chain disruption

Not only can non-compliance with regulations impact a company's bottom line through hefty fines, it can also jeopardise its license to operate. In an attempt to improve the reputation of Southeast Asian palm oil, Indonesia has declared a moratorium on the issuance of new licenses (and a review of existing ones), while the Malaysian government is considering a cap on the size of its palm oil estate.<sup>77</sup> As most of the world's palm oil is produced in these two countries, many unsustainable companies are at risk of losing their licenses to operate if they do not improve their practices. This could impact companies across the value chain.

In some cases regulatory action can target specific companies. In June 2019 a US-based plaintiff advocacy firm petitioned the US government to block imports of palm oil from FGV Holdings, one of Malaysia's largest agri-commodity companies. This was due to alleged violations of human and labour rights, including accusations of child labour, human trafficking and unsafe working conditions.<sup>78</sup> FGV responded highlighting actions already taken to mitigate some of the issues identified, and denying the child labour allegations.<sup>79</sup> If the petition is successful, the company could lose access to one of the largest markets for Malaysian palm oil.<sup>80</sup>

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***“As regulations in producing and consuming countries tighten, and new regulations are introduced, companies risk both their licenses to operate and ability to sell. It is therefore in their own best interests to improve their practices, to strengthen the long-term viability of their business.”***

**Michael Guindon**  
**SPOTT Palm Oil Technical Advisor**  
**Zoological Society of London (ZSL)**

<sup>72</sup> For example, Malaysian Sustainable Palm Oil (MSPO) and Indonesian Sustainable Palm Oil (ISPO).

<sup>73</sup> Pacheco, P. et al. (2018). Governing sustainable palm oil supply: Disconnects, complementarities, and antagonisms between state regulations and private standards. Regulation & Governance. <https://onlinelibrary.wiley.com/doi/epdf/10.1111/rego.12220>

<sup>74</sup> Jong, H-N. (2019). 81% of Indonesia's oil palm plantations flouting regulations, audit finds. Mongabay, 25th Aug. <https://news.mongabay.com/2019/08/81-of-indonesias-oil-palm-plantations-flouting-regulations-audit-finds/> [Accessed 29/10/19]

<sup>75</sup> Coconuts Jakarta (2019). Indonesia: Supreme Court upholds \$69 million fine against palm oil company over negligence that caused forest fires. Business & Human Rights Resource Centre, 2nd Jan. <https://www.business-humanrights.org/en/indonesia-supreme-court-upholds-69-million-fine-against-palm-oil-company-over-negligence-that-caused-forest-fires> [Accessed 29/10/19]

<sup>76</sup> Republic of Singapore (2014). Transboundary Haze Pollution Act 2014 (No. 24 of 2014). <https://sso.agc.gov.sg/Act/THPA2014> [Accessed 06/11/19]

<sup>77</sup> Jong, H-N (2019). 'Bring it on,' EU MP says of trade fight over palm biofuel phase-out. Mongabay, 15th Oct. <https://news.mongabay.com/2019/10/eu-palm-oil-biofuel-indonesia-malaysia-phaseout-wto/> [Accessed 29/10/19].

<sup>78</sup> Grant & Eisenhofer (2019). Grant & Eisenhofer ESG Institute Petitions U.S. Government. 24th June. [https://www.gelaw.com/press-release/ESG\\_Institute\\_Petition\\_06-24-19.pdf](https://www.gelaw.com/press-release/ESG_Institute_Petition_06-24-19.pdf) [Accessed 06/11/19]

<sup>79</sup> FGV Holdings Berhad (2019). FGV Holdings Berhad's Response to the Petition by Grant & Eisenhofer ESG Institute. 26th June. <http://www.fgvholdings.com/fgv-holdings-berhads-response-to-the-petition-by-grant-eisenhofer-esg-institute/> [Accessed 06/11/19]

<sup>80</sup> For Jan-Dec 2018, the USA was the seventh-largest export market for Malaysian palm oil. Malaysian Palm Oil Board (2019). Export of palm oil by destination: 2018 (tonnes). <http://bepi.mpob.gov.my/index.php/en/statistics/export/192-export-2018/867-export-of-palm-oil-to-major-destinations-2018.html> [Accessed 06/11/19]

## Consumer markets

Regulations in consumer countries can restrict market access for companies with unsustainable production practices.

In 2015, seven European Union (EU) member states signed the Amsterdam Declarations on deforestation and sustainable palm oil, stating their support for initiatives to eliminate deforestation by 2020, and for the private sector's commitment to 100% sustainable palm oil in Europe by 2020.

The EU also aims to phase out palm oil-based biofuels by 2030,<sup>81</sup> due to the deforestation, peatland destruction and high GHG emissions still associated with the palm oil industry. Norway has gone even further, becoming the first country to ban high-deforestation-risk feedstocks – including palm oil – from biofuels by 2020.

In Japan, corporate interest in sustainable palm oil has been increasing rapidly, with almost 40 Japanese companies joining the RSPO in 2018, and one of the country's largest supermarket chains, Aeon, committed to only sourcing sustainable palm oil for its own-brand products by 2020.<sup>82</sup> The number of Chinese companies joining the RSPO has also grown markedly in recent years, which is crucial as the country is one of the largest global importers of palm oil.

Considering these trends, laggards risk losing important buyers and access to key consumer markets.

## REGULATORY OPPORTUNITIES

Initiatives such as the China Sustainable Palm Oil Alliance and India Sustainable Palm Oil Coalition, which bring together stakeholders from across the sector, are working to increase demand for sustainable palm oil in India and China, both of which currently source minimal volumes of sustainable palm oil, even though, combined, they consume more than 25% of the world's palm oil.

Additionally, the Sustainable Sourcing Code for the Tokyo 2020 Olympics requires suppliers to use sustainable palm oil, including requirements for palm oil that is produced in compliance with laws and regulations.<sup>83</sup> As awareness of the negative impacts of unsustainable palm oil increases in these markets, governments will come under pressure to strengthen regulations governing the production of palm oil entering these markets – placing more sustainable companies at a competitive advantage.

Legal compliance can also reduce risks of companies receiving large fines. This can decrease their costs of production and help them retain customers with strong sustainable procurement policies and requirements for legally produced palm oil. Sourcing palm oil certified by the RSPO or POIG provides companies with a useful way to assure stakeholders that the palm oil they produce and/or purchase complies with relevant laws and regulations.



<sup>81</sup> EU Commission (2019). Commission Delegated Regulation (EU) 2019/807 of 13 March 2019. C/2019/2055, OJ L 133, 21.5.2019. [http://data.europa.eu/eli/reg\\_del/2019/807/oj](http://data.europa.eu/eli/reg_del/2019/807/oj) [Accessed 20/11/19]

<sup>82</sup> Hilton, S. & Sugiura, E. (2019). Asia's palm oil industry braces for backlash at home. Nikkei Asian Review, 9th Feb. <https://asia.nikkei.com/Business/Business-trends/Asia-s-palm-oil-industry-braces-for-backlash-at-home> [Accessed 20/11/19]

<sup>83</sup> Tokyo 2020 (2019). Sourcing Code for the Promotion of Sustainable Palm Oil. [https://tokyo2020.org/en/games/sustainability/data/sus-procurement/palmproducts-code\\_EN.pdf](https://tokyo2020.org/en/games/sustainability/data/sus-procurement/palmproducts-code_EN.pdf) [Accessed 11 November 2019]



## CONCLUSION AND CALL TO ACTION

Our research shows that SPOTT-assessed palm oil companies with stronger disclosure on the sustainability of their operations clearly outperformed those with weaker sustainability disclosure, over a five-year period. This new data is substantiated by extensive existing evidence of the risks of unsustainable palm oil production to a company's bottom line. Given the urgency with which action is needed to halt deforestation and biodiversity loss, this financial outperformance should provide a strong incentive for palm oil companies to immediately strengthen their sustainability practices to ensure a long-term future.

Companies that fail to address sustainability considerations in the production and procurement of palm oil face significant financial, operational, reputational and regulatory risks. These can not only impact a company's bottom line, but also its ability to operate and access to key markets. Conversely, companies that are more transparent and are leaders in disclosing and addressing environmental, social and governance issues can benefit from reduced regulatory scrutiny, decreased operational costs, a better corporate reputation and stronger financial performance.

Financiers, buyers, and the general public are concerned about the environmental and social issues linked with unsustainable palm oil production, and the negative impacts of such practices on company profits and value are evident. It should now be clear to companies across the supply chain that rapid and urgent action is needed.

### A CALL TO ACTION

ZSL echoes the call to action outlined by 58 investors in their expectations for the palm oil sector<sup>84</sup> and urges increased company disclosure of information on company operations, policies and practices on the ground. This includes companies adopting robust No Peat, No Deforestation, No Exploitation policies, improving traceability in their supply chain, disclosing land ownership maps and regularly reporting progress on implementation.

Additionally, it is crucial that commitments and best practices not only apply to a company's own operations, but also to that of all its suppliers, to address leakages.

Finally, supply chain actors, investors and banking institutions are encouraged to publish more information about the benefits and rewards related to the implementation of sustainable practices, to strengthen understanding of the business arguments for sustainable palm oil.

The positive business case for producing, procuring and financing sustainable palm oil has never been clearer, and industry laggards must take advantage of this opportunity or find themselves left behind.

<sup>84</sup> Principles for Responsible Investment (PRI) (2019). Fifty-six investors sign statement on sustainable palm oil. <https://www.unpri.org/news-and-press/fifty-six-investors-sign-statement-on-sustainable-palm-oil/4266.article>





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#### About SPOTT

Developed by the Zoological Society of London (ZSL), SPOTT is a free online platform supporting sustainable commodity production and trade. By tracking transparency, SPOTT incentivises the implementation of corporate best practice.



SPOTT assesses commodity producers and traders on the public disclosure of their policies, operations and commitments related to environmental, social and governance (ESG) issues. SPOTT scores tropical forestry, palm oil and natural rubber companies annually against over 100 sector-specific indicators to benchmark their progress over time. Investors, buyers and other key influencers can use SPOTT assessments to inform stakeholder engagement, manage ESG risk, and increase transparency across multiple industries.

For more information, visit [www.SPOTT.org](http://www.SPOTT.org).

#### About ZSL

ZSL (Zoological Society of London) is an international conservation charity working to create a world where wildlife thrives. From investigating the health threats facing animals to helping people and wildlife live alongside each other, ZSL is committed to bringing wildlife back from the brink of extinction. Our work is realised through our ground-breaking science, our field conservation around the world and engaging millions of people through our two zoos, ZSL London Zoo and ZSL Whipsnade Zoo.

For more information, visit [www.zsl.org](http://www.zsl.org).

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