



New risks in old supply chains: Where does your palm oil come from?

From lipstick to ice cream:
a survey of palm oil use and supply chain management

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Survey undertaken by ISIS Asset Management plc
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ISIS Asset Management

ISIS Asset Management is a UK-based asset manager with approximately £62 billion of funds under management (as at 31.10.03). We believe that companies that manage their social, environmental and ethical risks effectively are protecting shareholder value. ISIS regularly publishes research studies with a view to encouraging more socially responsible behaviour by companies, as we believe that active participation in such debates by investors can help lead to better risk management by companies. This study forms part of our ongoing biodiversity engagement programme.

ProForest

ProForest is an independent company working with natural resource management and specialising in practical approaches to sustainability. Projects range from international policy development to the practical implementation of requirements on the ground, with a particular focus on turning policy into practice. The roots of the company are in forestry, but this experience has been used to develop expertise in the wider natural resources sector.



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1 Introduction - Why palm oil, and why now?

Global consumption of palm oil has surged in the last decade, making this the single-largest traded edible oil and prompting major shifts in agricultural and land-use practices. Rapid conversion of tropical forest to oil palm plantations has raised renewed concerns about forest and biodiversity loss, as well as displacement of indigenous communities. A number of major companies are taking action, particularly those with a reputation for leadership in the fields of Corporate Social Responsibility and Social, Environmental and Ethical (SEE) risk management, while leading activist NGOs warn of irreversible damage to ecosystems and indigenous societies if demand for palm oil continues, as forecast, to increase.

Is this a risk for business?

Patterns such as this can give rise to real business risks for companies whose supply chain practices do not allow for close monitoring of the conditions under which key products or ingredients are sourced. ISIS Asset Management therefore undertook a survey of 27 investee companies known or believed to be large users of palm oil or palm oil-derived ingredients. Companies were asked to comment on the risk posed to their business by doubts over the ecological sustainability of commodities such as palm oil in their supply chains. They were also asked to comment on the systems they have in place, or are developing, for monitoring and managing these risks. The results of the survey are published in this report.

Scope

This report does not examine the health implications of increased palm oil use, an area that has attracted growing attention because of the oil's high content of saturated fat. However, we note that, irrespective of how healthy palm oil actually is, the growing debate over health and obesity is likely to turn the spotlight on 'hidden' ingredients such as palm oil.

From lipstick to ice cream: are there wider implications for investors?

Although fast-growing and nearly ubiquitous in food and cosmetic products, palm oil is just one of many traded commodities whose supply chain from original grower to ultimate consumer is a long and complex one. However, the concerns it raises, and the manner in which different companies have responded to them, are remarkably revealing about the quality of supply chain practices, and the reliability of claims made about them. Beyond the specific concerns associated with palm oil purchasing, this report explores the wider implications of complex supply chains, and the emerging demands of activists and consumers that companies can expect to face.

The report concludes that investors cannot afford to neglect these issues, and are well-advised to explore such concerns before they impact on the value of their holdings. Those companies that have poor supply chain practices are making themselves needlessly vulnerable.

As the context changes, companies face new challenges

This report has revealed that some companies manage the palm oil issue well, others not as well, and that the detail on the ground is often at odds with the high-level commitment expressed at headquarters. But how well companies are positioned to face up to this particular set of concerns may be symptomatic of a larger, more important question: do companies have adequate oversight over what they are buying, and can they assure their shareholders and customers that they have appropriately minimised key risks in their supply chain?

Complex and opaque supply chains are nothing new, and where quality control, hygiene, storage conditions and other factors likely to threaten product saleability have been an obstacle, companies have devised means to overcome them. What is changing is that the definition of product quality is expanding to encompass abstract notions related to product origin: impact on ecosystems and impact on communities. As consumers become concerned about such issues through a combination of globalised information, regulation and activism, new challenges have emerged to the way companies plan and supervise their sourcing.

The usual suspects

The study reveals that some companies have the situation broadly under control, at least insofar as palm oil sourcing is concerned. Unsurprisingly, some of those that perform well in this specialised area – such as Unilever, Body Shop and Marks & Spencer - are the so-called ‘usual suspects’, well-known for their commitment to matters of sustainable development. Other companies, such as Cadbury Schweppes and Compass Group, have been able to source from suppliers that are known to produce in line with sustainable development objectives. The record of such companies suggests that, despite the myriad obstacles cited by others during the survey, action is possible when management considers it a business imperative.

Fine words – shame about the facts

Finally, one of the most remarkable aspects of all in this report is the uniformly strong commitment to high standards, juxtaposed with the widely divergent reality on the ground. Indeed, it is rare to find a company that does not appear to have a good generic supply chain policy statement. Examining one commodity, palm oil, in some depth, reveals that policy is not matched by practice.

2 Executive summary

2.1 Overview

- Palm oil and its derivatives are used extensively in food, cosmetics, pharmaceuticals, detergents and many other products.
- As a versatile and cheap vegetable oil, palm oil use is forecast to double within twenty* years.
- The expansion of palm oil plantations, in Indonesia and elsewhere, may have severely negative consequences for biodiversity and local populations, and has therefore become an issue of concern to NGOs and government agencies.
- ISIS has undertaken a survey of twenty-seven investee companies which use palm oil.
- The results of the survey and its implications are presented in this report.

2.2 Key survey findings

- 100% of companies acknowledged that the ecological impacts associated with commodities in their supply chains were a potential risk for their business. [section 3.2.1]
- 67% felt that they were managing this risk adequately, usually through generic supply chain management procedures. [section 3.2.2 Chart 3]
- However, 83% did not appear to know where their palm oil originated [section 3.2.2 Chart 4] and the majority were unclear about whether they use significant quantities.
- 21% of companies are developing or considering developing supply chain policies specifically relating to palm oil. [section 3.2.3]

2.3 Key conclusions for investors

- In supply chains, ignorance is vulnerability: yet many companies that use palm oil do not appear to know how much they use or where it comes from.
- Companies are at risk of contravening their own published food quality, supply chain or sustainable development policies.
- Palm oil cultivation is often associated with negative social and environmental impacts, yet many companies that use palm oil, while acknowledging the generic importance of SEE risks in supply chains, seem to have little knowledge or understanding of the risks related to palm oil in their supply chain.
- There is a particular risk of customer and consumer-related pressure focussed on companies that are compromising quality commitments or contravening their published standards.
- In using or sourcing a product associated with negative social or environmental impacts, companies are potential targets for pressure groups or regulators; however, if companies attempt simply to abandon the problem by switching to other vegetable oils, they risk accusations of irresponsible behaviour from the same groups.
- Due to the nature of commodity markets, it is currently easier for very large users and small niche buyers to source sustainably; however, sustainable sourcing is an option open to all companies, either now or in the near future.

*The world demand for palm oil is expected to increase from its present 22.5 million tonnes a year to 40 million tonnes in 2020, see Oil Palm Plantations and Deforestation in Indonesia, WWF Germany.

- The palm oil issue may be symptomatic of a new focus by civil society on complex supply chain issues, and not simply the direct cause and effect issues which many companies' existing supply chain policies have been set up to address. Activists might increasingly take the view that companies should be responsible for all the links in the chain connecting environmental and social degradation at the point of production to consumers in developed countries.
- Brand-name and consumer-facing companies are the most likely to be vulnerable to increasingly sophisticated scrutiny of supply chains.

2.4 Summary of ISIS recommendations

- All companies that use palm oil should ensure that their practices in relation to palm oil sourcing match their published quality, supply chain or sustainable development policies.
- Companies that use palm oil or palm oil derivatives should undertake an adequate assessment of the volumes that they use and whether these are significant.
- Companies that are significant users, or are in sectors that have a high risk of customer or consumer-related pressure, should ensure that they have adequate supply chain monitoring systems in place.
- Companies that are significant users, or are in sectors which have a high risk of customer or consumer-related pressure, should participate in collaborative sustainable development approaches through their supply chains, for example through participating in the activities of the Round Table on Sustainable Palm Oil.

3 Survey Results: statistical analysis

3.1 Level of response

Of the twenty-seven companies approached, twenty-four (89%) responded to some or all of the four questions posed. The statistical analysis below is based on the respondents only.

Several companies gave more than one response, updating their initial replies in the light of their own subsequent research. The analyses presented here take account of the latest and most up-to-date response from each company.

The responses varied in their level of detail. Nonetheless, when taken together, they gave a consistent picture of patterns across the surveyed companies. The answers to the four questions (1, 2, 3a and 3b) are analysed in turn below.

It should be noted that the palm oil picture is not static. It was clear that several companies are reviewing their practices or closely monitoring the situation. This strategy is clearly appropriate at a time when awareness of the issue is growing rapidly and when initiatives to reduce the impacts of production are gathering momentum.

3.2 Questions and responses

3.2.1 Underlying risk

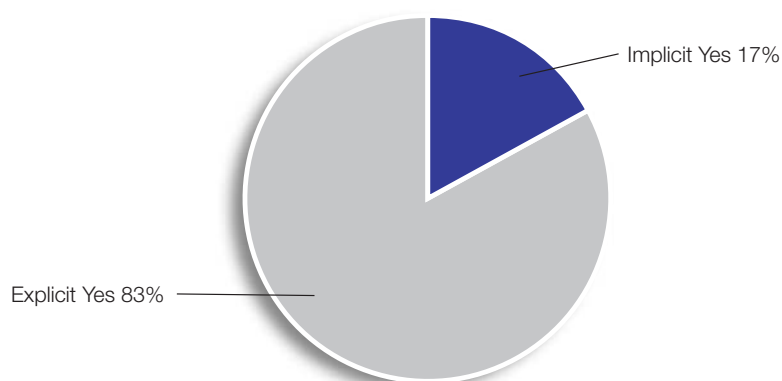
Question 1

“Do you consider that the ecological practices associated with components of your supply chain can pose a significant risk to your business?”

Acknowledging the risk

All twenty-four of the respondents acknowledged the potential risk posed by the lack of ecological sustainability in commodity supply chains in general. This was explicitly stated by twenty respondents (83%) and was implicit in the responses of the remaining four (17%), since they discussed their ongoing efforts to manage the risk. Several companies acknowledged the importance of social issues in addition to ecological concerns.

Chart 1: Is there a risk?



Perceptions of risk

Few of the respondents elaborated on the nature of this risk, but two (8%) specifically mentioned NGO-led campaigns in the media and one of these (4%) also mentioned the related issue of food safety.

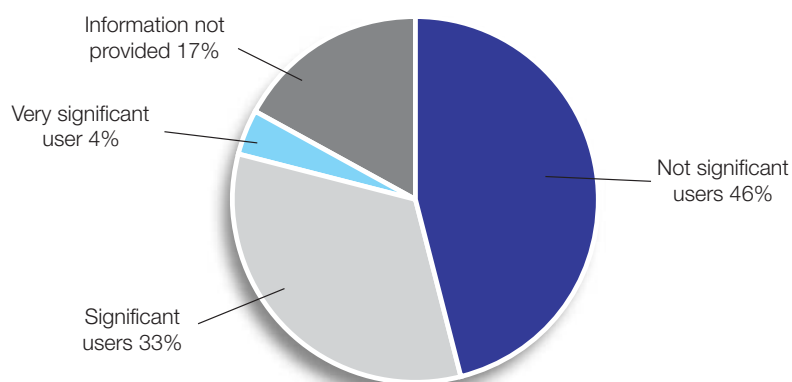
92% of respondents appeared to accept that significant use of palm oil could carry substantial risks. However, one UK retailer mentioned that its risk due to palm oil was negligible since it was not of current concern to consumers and one manufacturer felt that its usage of palm oil was largely invisible to the end-user.

How much does the company use?

The key factor mentioned in relation to the perceived underlying level of risk was the quantity of palm oil handled by a company. Each respondent expressed this in widely varying ways but the following broad classification of the replies could be established.

- Nine companies stated that they considered themselves to be negligibly small users and two others implied the same thing (a total of eleven or 46% of all respondents). Of these
 - six considered that the risk was therefore negligible and no action was required, whilst
 - five still felt some action was necessary to manage the risks.
- Eight companies appeared to consider themselves relatively substantial users with significant risks to manage. However, only one of these eight stated so explicitly and for the remainder this had to be inferred by the respondent's acceptance of the premise of the initial letter of enquiry ('...as a potentially significant consumer of palm-oil-based ingredients...your company...'). The actual levels of usage in this group may overlap with those in the previous group.
- Of the remaining five companies, one is a very large user by any standards, one is still collecting information on its level of use and three gave too little information to indicate their opinion.

Chart 2: Is the company a significant user of palm oil?



Companies seldom stated explicitly what figures they were using to judge their level of usage. Some mentioned only the use of crude palm oil; others clearly included their use of palm oil derivatives and palm kernel products. Few if any assessed their usage of palm-based ingredients in ready-processed products, despite the fact that these may be substantial in some sectors (e.g. for retailers).

3.2.2 Existing generic supply chain management systems

Question 2

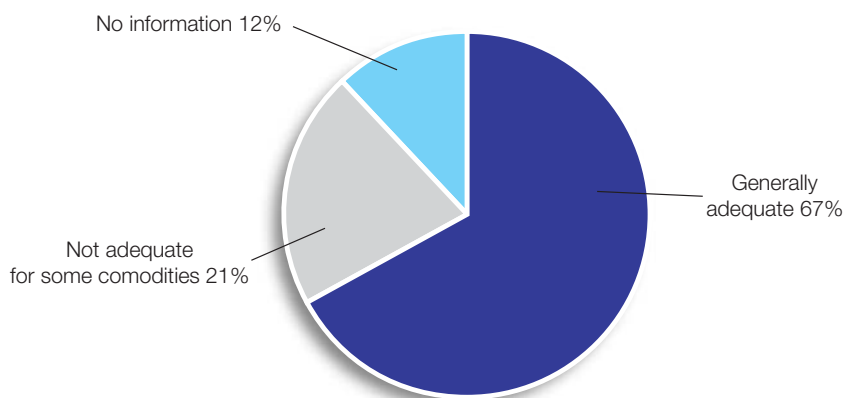
“Is this a matter that is covered by your current environmental and supply chain management systems? In particular, do you have in place a system for tracing the origins of other products through your supply chain (e.g. timber, cocoa/cocoa butter)?”

Adequacy of systems

- Sixteen out of twenty-four companies (67%) stated that they had systems that gave adequate general protection,
- Five (21%) stated (or in one case implied) that their systems were only partially effective for some products and
- Three (12%) gave no information.

The main reason why some companies considered that their systems were inadequate to identify and avoid all sources of risk was that they are not able to trace some commodities (oil palm among them) back to the site of production. This is a result of the way palm oil is bulked up and mixed along most supply chains. (see Appendix 2 Figure 1)

Chart 3: Are the company's current systems adequate?



Differences between significant and insignificant users

Weaknesses in their generic systems were noted by four of the nine companies acknowledging significant usage of palm oil, as opposed to only one of the eleven companies reporting that their usage was insignificant. This may indicate either that companies in the former group have analysed the situation more thoroughly, or that the companies in the latter group consider weaker systems are adequate for managing smaller risks.

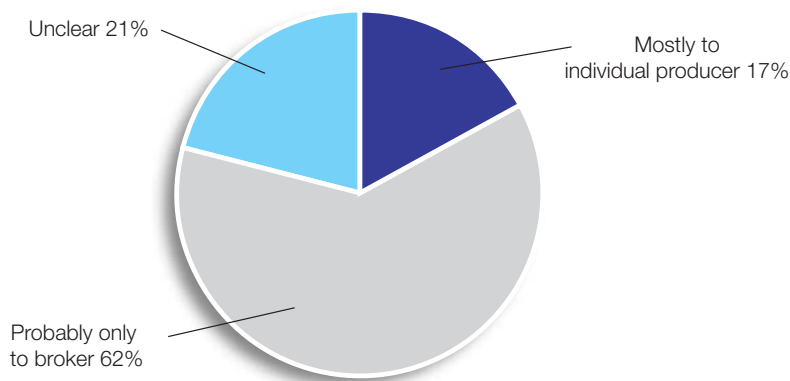
Ability to trace supplies to source

Three companies (13%) reported that they can trace their palm oil supplies to individual producers; we also understand this to be true for some but not all of the supplies used by a fourth respondent (4%).

It appeared from the responses of fifteen other companies (62%) that they were not able to trace their supplies to a named producer, but only as far as a commodity broker, or in one case, a named country with many different producers.

The remaining five respondents (21%) gave too little information to judge, but if we assume that they too probably buy from brokers then a total of 83% of respondents are in this position.

Chart 4: Can the company trace the source of its palm oil supplies?



Traceability was reported by three of the nine companies acknowledging significant usage as opposed to only one of the eleven companies reporting that their usage of palm oil was insignificant.

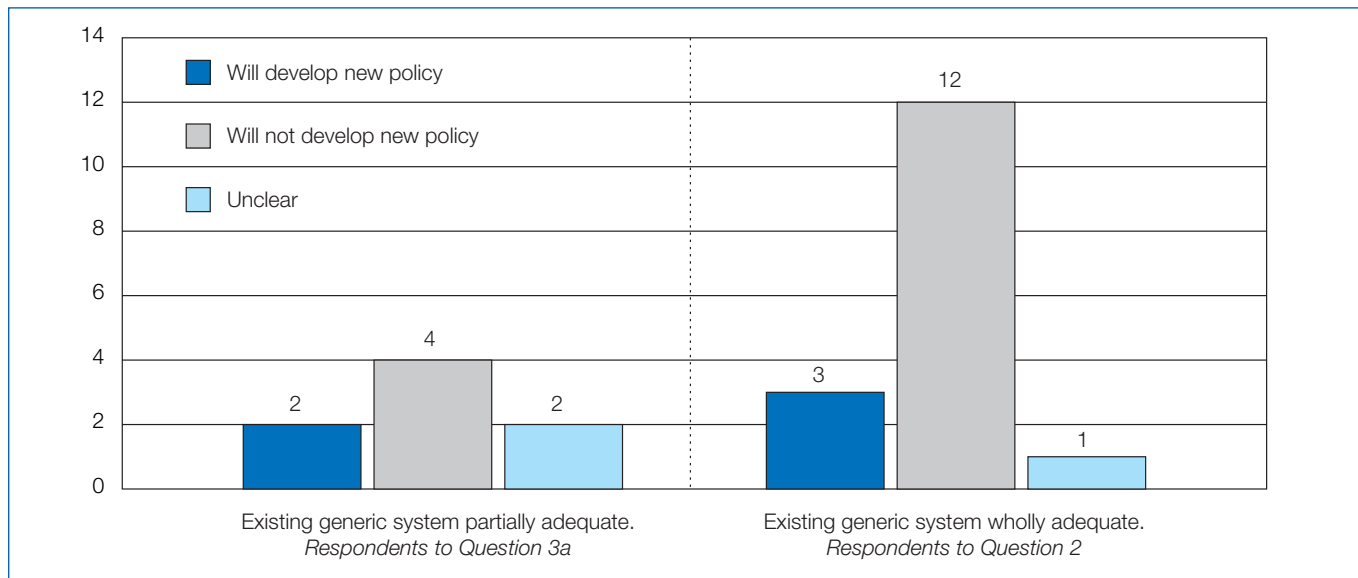
Given these responses, it seems likely that many of the 67% of respondents who consider their current systems effective have not taken full account of this problem. (see Chart 3 on page 9)

3.2.3 Plans to develop a new policy

Question 3a

“If not, is this an area where you are considering developing a new policy?”*

Chart 5: Is the company planning to develop new policies to manage risks due to palm oil?



*i.e. if the company’s existing system is not adequate.

Companies reporting inadequate systems

This question applied to eight (33%) of the respondents, five who reported their systems to be partially ineffective in Question 2 and three who did not answer clearly.

- two of the five with partially ineffective systems went on to state that they were considering developing a new policy
- the other three, plus one of the 'unclears', stated or implied that they were not
- the remaining two who were unclear for Question 2 were also unclear in response to Question 3a.

Companies reporting adequate systems

Sixteen respondents (67%) stated that they did have adequate existing policies to manage supply chain and environmental risks. Of these:

- perhaps surprisingly three either stated (two) or implied (one) that they were nonetheless planning to develop new policies to further manage the risk.
- twelve stated or implied that they were not
- the position of the remaining company could not be judged from the response.

Thus in total five companies (21%) were planning to develop new policies. Three were closely engaged in the recently initiated Round Table on Sustainable Oil Palm, one was taking part in the Sustainable Tree Crops Programme (which will expand to cover oil palm in the near future) and the fifth is planning to switch to a substitute from a different species of palm that is already known to be sustainably produced.

3.2.4 Applying your current system to palm oil

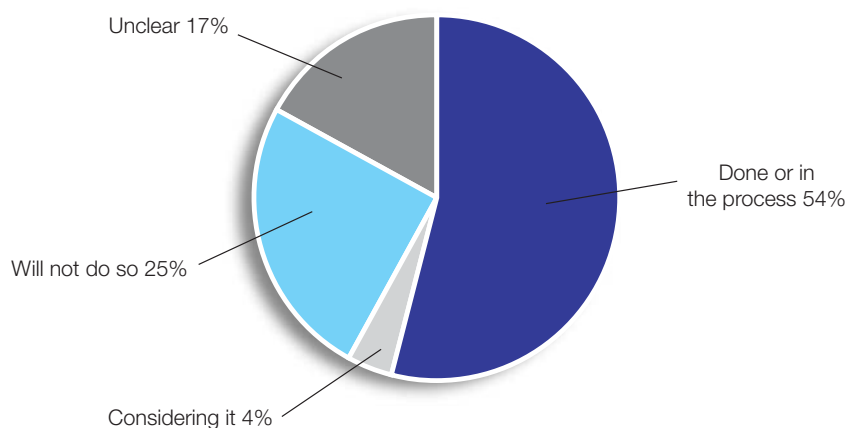
Question 3b

“If you currently have a system that traces the origins of products through your supply chain, will you be extending this to include the procurement of palm oil?”

Overall responses

- Fourteen respondents (58%) have either extended their generic systems to palm oil (seven companies), are in the process of doing so (six) or are considering it (one).
- Six respondents (25%) will not do so: five stated their reasons, and in all cases it was because of the low assessed risk, usually due to the small volumes handled.
- Four (17%) did not give a clear answer.

Chart 6: Does the company intend to extend a generic supply chain risk management system to cover palm oil?



Similar responses from significant and insignificant users

The responses can also be analysed according to whether the generic system was reported to be adequate or not (Question 2). The pattern was similar in both cases.

- **System adequate:** sixteen companies (67%) reported that they had adequate existing generic systems
 - ten are either in the process of extending it to palm oil or have already done so, one is considering doing so, four will not, one gave an unclear reply.
- **System inadequate:** five companies (21%) recognised that their generic systems might be inadequate for palm oil
 - three have already applied these systems to palm oil, one has decided not to, one gave an unclear answer.
- **Unclear:** three companies gave unclear answers to Question 2
 - two also gave unclear answers to Question 4, the third stated that it would not be applying its generic system to palm oil.

3.3 Current unmanaged risks

The survey did not explicitly ask whether companies saw any significant remaining unmanaged risks to them from their use of oil palm, but in most cases (75%) it was possible to judge this from the content of their responses.

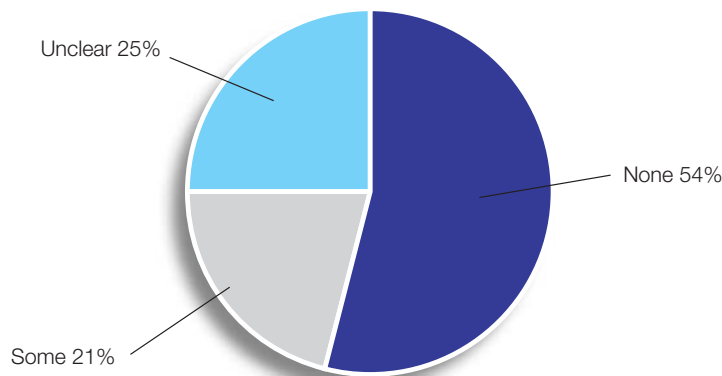
No significant unmanaged risks

- Thirteen companies (54% of respondents, or 72% of those for whom it was possible to judge) appear to consider that they face no significant unmanaged risks.
 - three of these have full traceability to producers they consider to have good 'green' credentials.
 - the remaining ten mainly cited their low level of usage, and in addition:
 - four of these mentioned the additional protection given by their generic supply chain management systems
 - one mentioned involvement in a specific sustainability initiative
 - one mentioned that the company's usage was largely invisible to the public
 - one stated that the palm oil issue was not an issue of concern to its customers.

Significant unmanaged risks

- Five companies (21% of the total, 27% of those for whom it was possible to judge) indicated that they felt they were not yet fully covered against risks due to oil palm.
 - these did not appear to be companies for whom the underlying risks were clearly different in scale or quality from the others, although they do include the largest single purchaser of oil palm products in the survey. What they appeared to share was a concern that in the future, companies purchasing either large or small volumes would be held more directly responsible for the impacts at the production end of their commodity supply chains than is presently the case.
 - it was notable that four of these five (80%) are in the General Retailer or Food and Drug Retailer categories, which together made up only 38% of the respondents; such companies are likely to be most sensitive to reputational risks or pressure from consumers or customers.

Chart 7: Degree of remaining unmanaged risk due to palm oil



4 Survey results: themes

Since the majority of replies to the survey were in the form of letters, supplemented by interviews with certain companies, it was possible to discern themes above and beyond the strict statistical analysis. The themes are presented in this section.

4.1 Levels of knowledge

- Only a limited proportion of companies were able to identify their ultimate suppliers; few could trace their supplies to a given country and fewer still to a particular plantation. This is typical of bulk-traded commodities and is especially true for companies handling large volumes.
- While companies seemed to have little knowledge of crude palm oil per se, the surveyed companies have even poorer knowledge of the origins of palm oil derivatives, or of palm oil as an ingredient in ready-processed goods that they handle.

4.2 What is a 'significant' user

- It was unclear how large usage would have to be before a company considered itself to be a 'significant user'. This reflects an ambiguity in the concept of being a 'significant user' - which could mean either that the use forms a significant part of the company's trade or that the company's use is a considerable portion of regional or global usage. The former meaning is more likely to be relevant to the financial risks faced by the company. However, several respondents argued that, since they were globally insignificant, they had insufficient leverage to influence the commodity supply chains of which they were a part, and so they could not be held responsible for problems existing in those chains.
- One useful measure for judging risk would be the percentage of company turnover devoted to palm oil but only one respondent discussed this explicitly, stating that palm oil accounted for about 0.25% of its products by weight. Several others noted that palm oil was only present in a limited number of their product lines (e.g. in one case only a single line, in another three and in another six).
- Other companies measured their company usage as a proportion of world or EU consumption. World production of crude palm oil in 2001/2002 was 23.8 million tonnes, world trade was 18.0 million tonnes and EU imports in that year were 3.1 million tonnes (comparable figures for palm kernel oil were 2.9, 1.5 and 0.5 million tonnes). Only two respondents explicitly stated their total usage - one handled 700 kg per year of crude palm oil and another 70,000 tonnes per year of all palm and palm kernel products together. It is notable that even the latter company considered themselves to be relatively small users in comparison to the whole European market. For comparison, Unilever is perhaps the world's largest single purchaser of palm oil and derivatives - published data state that they buy over one million tonnes per annum.

4.3 Effectiveness of generic supply chain policies for commodities

- Over 70% of respondents considered that they had adequate systems in place for managing any risks that did exist.
- This usually involved generic codes of conduct for suppliers, with various systems of monitoring and verification. However, given the nature of the potential risks and the general lack of knowledge, there seemed to be an apparent contradiction between these reassurances and the low traceability of palm oil back to source (i.e. to a specific producer).
- Many companies stated that due to its commodity nature, they were only able to trace their palm oil as far as the last bulk supplier, who mixes oil from many different mills in different countries. Several of the largest volume users in the sample reported that it was essentially impossible for them to identify the sources of palm oil bought in large quantities. However others, including the largest single user, did seem able to trace to source.

4.4 Verification

- Assurances about sustainability were extremely general and presented little or no independent verification of the claims; several were so generic (i.e. naming a specific country from which palm oil is sourced and claiming, incorrectly, that all the oil from that country is sustainably produced) as to be of little or no use.

4.5 Food safety/product quality

- A point made strongly by one company was that of equal significance to the social and environmental implications of palm oil was the issue of food quality and safety. The company felt that if it could not trace back its palm oil to source – i.e. to a specific plantation that could be assessed and monitored – then it could not guarantee quality. This is particularly significant as the company concerned is an extensive supplier to major retailers of processed goods that use palm oil.

4.6 Perceptions of risk

Overall, companies accepted the premise that risks are inherent in supply chains. The following three risks were mentioned or implied fairly consistently:

- Accusations of acting irresponsibly with regard to the social or environmental impacts of their sourcing policies
- Contravention of publicly-stated commitments to sustainable development, sustainable sourcing or effective supply chain management
- Inability to respond adequately to concerns raised by consumers or pressure groups.

Companies felt that the key factors in demonstrating that risks were managed are:

- Existence of a supply chain policy, sometimes irrespective of its ability to deliver results
- Lack of visibility of palm oil to consumers
- Ability to shelter behind the ‘commodity broker’ argument
- Confidence that as an insignificant user they would not be targeted by pressure-groups.

In addition, a theme that emerged in discussions, although not in the written responses, was that companies felt a comfort zone in the ability to switch to other oils if palm oil becomes a ‘problem’ commodity.

4.7 Current action

- The survey itself served to highlight the issue: several companies noted that the ISIS survey had stimulated further internal action on this issue.
- A number of these provided follow-up responses as more information became available, indicating that they are already taking action
- More than a quarter of companies are taking part in new oil-palm specific initiatives, including the Round Table on Sustainable Oil Palm and the Sustainable Agriculture Initiative. These steps may eventually provide fuller protection against risk.

4.8 Key survey findings

Based on the above themes, the following conclusions may be drawn:

- In supply chains, ignorance is vulnerability: despite commitments to responsible sourcing, many companies that use palm oil do not know how much they use or where it comes from.
- With poor verification and a reliance on generic policies, companies may find that they do not have an adequate response to concerns raised by consumers or pressure groups.
- Certain companies may be more exposed to risks in this area than they have anticipated, due to the use of palm oil derivatives and its presence in ready-processed goods.
- Continued invisibility to consumers cannot be taken for granted, since NGOs are making increasing efforts to educate the public on this issue.
- Given the prominence of quality and safety issues among European and US consumers, this issue may become more prominent in the context of palm oil.
- Effective action in supply chains is possible, despite objections that the nature of commodity markets impedes it. The incentive for such action depends on how highly a company prioritises palm oil as an issue, which in turn rests on the scale of its use and its overall commitment to Corporate Social Responsibility. However, it should be noted that even when the political will is present, there are barriers to changing suppliers, and it is not an instantaneous process. It appears easier for large bulk purchasers and small niche purchasers to change suppliers, than it is for the medium-sized purchasers that source via commodity markets.
- Overall, companies seem to have codes and systems that are more effective in managing simple supply chains than in managing complex issues such as commodities that pass through several different stages, and may constitute one of several ingredients in a series of products.

5 Sustainable palm oil sourcing: key considerations for companies

Not all palm oil is grown or planted unsustainably. Indeed, many palm oil growers feel that their plantations are well-managed in environmental and social terms. Is this sufficient to persuade the reader that these plantations really are? The industry considers that it has contributed greatly to rural and national developments, and it also has a relatively good record of developing and applying sustainable practices covering soil fertility, pest control, waste management and other issues.

An overview of NGO opinion is that although there are pockets of good practice, this is by no means uniform; that good practice often relates to well-established plantations and not those that are being created to feed current demand; and that the picture is better in Malaysia than Indonesia.

One of the problems faced in Asia, as has been found with timber sourcing, is the absence of credible verification or certification processes. However, it is also notable that leading companies have found ways to circumvent this problem. The Round Table on Sustainable Palm Oil has been created as a mechanism to seek solutions to this problem [see box below for this and other initiatives].

Box 1: Selected current initiatives on oil palm sustainability¹

Round Table on Sustainable Palm Oil - a new joint industry -WWF initiative - aims to develop an environmental charter and plan of action. The website contains links to most key studies and actors. **www.sustainable-palmoil.org**

Malaysian Palm Oil Association - has proposed a draft Environmental Charter for members and has begun a process to define Best Management Practice Guidelines. **www.mpoa.org.my**

Sustainable Agriculture Initiative Platform – an industry partnership developing guidelines for participant companies and suppliers. Unilever is the lead organisation for palm oil. **www.saiplatform.org**

Migros supermarket chain - has developed a set of sustainability criteria for 2nd party auditing of all its palm oil suppliers. **www.engagement.ch/f/trackingstorys/forest_index.php3**

WWF-International - currently addressing deforestation due to oil palm and soy through their Forest Conversion Initiative. **www.panda.org**

Banks – two Dutch banks have drawn up environmental criteria for screening investments in the oil palm sector: ABN-AMRO **www.abnamro.com/com** and Rabobank **www.rabobank.com**

UK Department of the Environment, Food and Rural Affairs (DEFRA) - is exploring policy options for encouraging sustainable commodity production through ACCPE (the Advisory Committee on Consumer Products and the Environment). **www.defra.gov.uk/environment/consumerprod/accpe**

¹ See links at www.sustainable-palmoil.org

The specific questions companies need to address relating to sustainable development raised in connection with palm oil are:

- Sustainable agricultural practices: once a plantation is in place, does cultivation have a detrimental effect on the surrounding environment or the local community?
- Creation of new plantations: does the creation of new plantations cause degradation of biodiversity or the ecosystem; are there other negative environmental impacts; has the land been obtained in accordance with due process; and does the creation of a new plantation have a negative impact on the local community or those who have previously benefited from the land?

Such problems are exacerbated when companies are operating in a difficult and unpredictable political environment (see box number 3), which characterises several of the countries from which palm oil is sourced.

In addition, there is the potential for plantations to have a positive impact, in which case the broad question relating to sustainable development becomes:

- Is the plantation managed in such a way that it brings positive benefits to the environment and local community?

Box 2: Concerns about palm oil²

Environmental concerns ³	Social concerns ⁴
important forests are cleared for some new plantations, harming biodiversity	traditional lands given to plantation companies without due process / compensation
land clearance fires cause air pollution and release large quantities of CO ₂	socio-economic impacts on some local communities
runoff and effluent pollute rivers	welfare and workers' rights sometimes poor

Box 3: Difficult business environments

General problem	Examples
Corruption	Some producer countries are perceived to have high levels of corruption throughout the government ⁵ . Weak and corrupt legal systems are especially problematic for plantation companies dealing with tenure disputes.
Political instability	Regional separatist movements, peace and order problems and political instability at national level.
Economic instability	Relatively frequent and substantial changes in export regulations, taxation and exchange rates.

² For an overview of the issues in this box, see 'Palm oil, forests and sustainability; a discussion paper for the Round Table on Sustainable Palm Oil', www.proforest.net

³ For environmental concerns see www.panda.org and follow links to Forest Conversion.

⁴ For social concerns see in particular 'The Bitter Fruit of the Oil Palm', www.wrm.org.uy

⁵ Transparency International Corruption Perceptions Index 2002, www.transparency.org

The issue of substitutability

There is relatively high substitutability between edible oils, which gives many end-users the option to switch to an affordable alternative oil if the risks associated with palm oil were judged to be too high to manage.

However, there are two important caveats, even though the technical ease of switching to alternative oils provides some insulation from risks within the palm oil sector:

- There may be reputational implications in withdrawing an important market from developing world producers. This is important to note, as all NGOs that have raised concerns about palm oil emphasise that they do not wish companies to cease buying palm oil. Their call is for companies to use their influence as customers to ensure that sustainable practices are employed in the cultivation of palm oil and in the creation of new plantations. This may create a dilemma for companies, as they could become a target for accusations of irresponsible behaviour both by continuing to source unsustainable palm oil or by deciding to switch to alternative oils.
- Some alternative oils also have significant risks attached to them, notably soy⁶.

⁶ See www.panda.org and follow links to Forest Conversion.

6 Conclusion: Should investors be concerned?

Overall, the risks to companies from palm oil will depend on whether it becomes an issue of greater prominence among the public, the media, consumers, regulators or pressure groups. Key determinants of the business risk for an individual company are:

- how much palm oil a company uses and
- whether this constitutes a significant amount
- where the palm oil comes from (i.e. sustainable or non-sustainable sources)
- whether the company has exposure to consumer or customer pressure
- whether the company has published policies on quality or sustainable development.

Although companies selected to participate in the survey were chosen on the basis that they are known or likely to be large users of palm oil, few companies seemed to know how much they use or were able to identify their ultimate suppliers - or even the country of origin.

Surveyed companies had even poorer knowledge of the origins of palm oil derivatives, or of palm oil as an ingredient in the ready-processed goods they handle.

The basis on which companies judged their use to be 'significant' varied considerably, and appeared to highlight very large discrepancies in assessing the business risks they faced and their a company's responsibility for the social and environmental impacts of their supply chains.

Current practice in the palm oil industry suggest that much palm oil is grown in an unsustainable fashion, while the volumes from all sources, including non-sustainable sources, are projected to increase. Many companies are therefore likely to be sourcing palm oil from non-sustainable plantations, both now and in the future. This is in direct contradiction to the sustainability and supply chain policies of many well-known brand names. The key risks for investors are therefore:

- Companies are at risk of contravening their own published food quality, supply chain or sustainable development policies.
- Palm oil cultivation is often associated with negative social and environmental impacts, yet companies that use palm oil seem to have little knowledge or understanding of the risks related to palm oil in their supply chain.
- There is a particular risk of customer and consumer-related pressure being focussed on companies that are compromising quality commitments or contravening their published standards.
- In using or sourcing a product associated with negative social or environmental impacts, companies are potential targets for pressure groups or regulators; however, companies that simply abandon the problem by switching to other vegetable oils risk accusations of irresponsible behaviour.
- The palm oil issue may be symptomatic of a new focus by pressure groups and civil society on complex supply chain issues, whereas company policies were developed to address simpler ones. Activists might increasingly take the view that companies should be responsible for all the links in the chain connecting environmental and social degradation in the producer countries to consumers in developed countries.
- Brand-name and consumer-facing companies are the most likely to be vulnerable to increasingly sophisticated scrutiny of supply chains.
- Due to the nature of commodity markets, it is currently easier for very large users and small niche buyers to source sustainably; however, sustainable sourcing is an option open to all companies, either now or in the near future.

7 ISIS recommendations

1. All companies that use palm oil should ensure that their practices in relation to palm oil sourcing match their published quality, supply chain or sustainable development policies.
2. Companies that use palm oil or palm oil derivatives should undertake an adequate assessment of the volumes that they use and whether these are significant.
3. Companies that are significant users, or are in sectors that have a high risk of customer or consumer-related pressure, should ensure that they have adequate supply chain monitoring systems in place.
4. Companies that are significant users, or are in sectors which have a high risk of customer or consumer-related pressure, should participate in collaborative sustainable development approaches through their supply chains, for example through participating in the activities of the Round Table on Sustainable Palm Oil.

Appendix I - List of survey participants

Food Producers & Processors

1. Cadbury Schweppes (UK)
2. Hershey (US)
3. Nestlé (CH)
4. Unilever (UK/NL)

Food & Drug Retailers

1. Ahold (NL)
2. Carrefour (FR)
3. Sainsbury (UK)
4. Tesco (UK)
5. Wal-mart Stores (US)

Beverages

1. Diageo (note: the company had recently disposed of Burger King in the course of the survey, and therefore palm oil sourcing was no longer relevant to the company)
2. PepsiCo (US)

Personal Care and Household Products

1. Colgate-Palmolive (US)
2. Estée Lauder (US)
3. Johnson & Johnson (US)
4. L'Oréal (FR)
5. Procter & Gamble (US)

General Retailers

1. Body Shop International (UK)
2. Boots (UK)
3. Marks and Spencer (UK)
4. Pinault Printemps Redoute (FR)

Leisure, Entertainment and Hotels

1. Compass Group (UK)
2. Intercontinental Hotels Group (formerly Six Continents) (UK)
3. Starbucks Coffee (US)
4. Whitbread Group (UK)

Chemicals

1. ICI (UK)

Non-respondents

1. Danone (FR)
2. Hilton Group (UK)

Appendix II - An introduction to oil palm⁷

Features of oil palm as a crop

The oil palm is a native of tropical West Africa that is now cultivated throughout the tropics. It grows best in rich lowland soils in areas near the equator with a plentiful, year-round rainfall, but seasonally dry areas are also suitable, especially if irrigated.

Mature trees resemble stout coconut palms and eventually grow to over 30 m in height. In their native range oil palms have many traditional uses but in plantations the large, dark orangey-brown fruits form the main commercial product. Trees begin to yield fruit after 3-5 years and then do so annually, the quantities increasing with age. After around 25 years they are so tall that harvesting becomes difficult and at this stage replanting should occur.

Production systems

The traditional West African production system, based on semi-natural palm groves, has been superseded by more intensive plantation methods in most areas, and it is the sole approach in Latin America and South-East Asia.

Plantations vary in scale from a few hectares to tens of thousands of hectares in size. Large plantations can stand-alone but smaller plantations are usually grouped together and may often be planted as satellites, managed by smallholders, around a large central plantation owned by a private or parastatal company. This arrangement is dictated by the rapid perishability of the fruit; primary processing must take place within 24-48 hours of harvest so production areas must be close to a large mill, which in turn requires a large, steady fruit supply to ensure economies of scale.

Production area and trends

Oil palm is widely cultivated in tropical Asia, Africa and South America but Malaysia and Indonesia produce around 90% of the palm oil that enters world trade. The recent global expansion of plantation area has been extensive, from about 1.7 million ha of mature area in 1980 to 7.3 million ha in 2002. Most of this expansion has come in Malaysia and Indonesia where ideal planting conditions are coupled with strong government support. Plantations are currently concentrated in Peninsular Malaysia and Sumatra. Continued rapid increases are expected in most producer countries, with the planted area in Indonesia alone predicted to double in the next 20 years and major planting also in Sarawak and other areas.

Oil palm plantations can be highly productive, with the Malaysian national average at about 3-4 tonnes of crude palm oil and 1 tonne of palm kernels per hectare. Much higher yields have been achieved experimentally and major efforts are being made to achieve these commercially, especially in areas where further expansion of area is not feasible. However realised yields have stagnated for many years and increasing use of marginal areas may lower average yields in the short term.

⁷ Main sources: The Oil Palm, Corley and Tinker, 2003, Blackwell Publishing and Oil World Annual 2002, Oil World, 2002, Mielke, Hamburg.

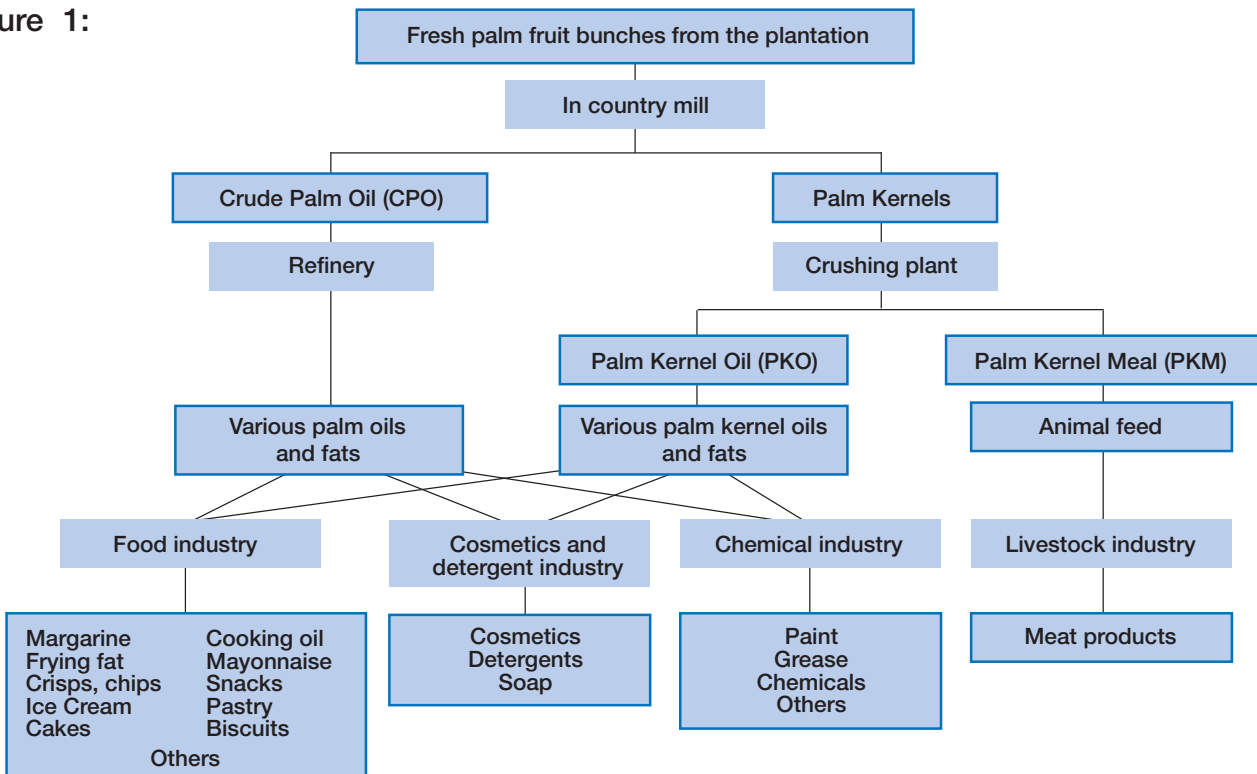
End uses

Both the oily flesh and the hard kernel are fully utilised, each producing a different set of products (see Figure 1). The three key products are crude palm oil (CPO), palm kernel oil (PKO), and palm kernel meal (PKM). PKO is the most valuable by weight but the more plentiful CPO provides the bulk of the value.

After further refinement the various fractions of CPO and PKO have a wide range of end uses. The liquid fraction of CPO ('palm olein') is a popular oil for frying and baking. In some cultures the scent and rich orange colour are valued, but in others (e.g. Western Europe) the oil is purified before use. The solid fraction ('palm stearin') is typically used in margarines. PKO has many industrial uses, including soaps, detergents and lubricants. Palm kernel meal is used in protein-rich animal feeds.

Processing chains and main end uses for oil palm products

Figure 1:



There is a very wide range of products that contains CPO, PKO and derivatives. However, this is rarely recognised by the average consumer, partly because these are rarely the dominant ingredients and partly because product labels may list them under names such as 'vegetable oil', 'stearin' or 'olein'.

Supply chains

Oil extraction is carried out in mills close to the plantations. These often mix oil from one or more large plantations and also large numbers of smallholders. The CPO and palm kernels are then transported to refineries for further processing, either in-country or overseas. The CPO and other main products are handled in bulk wherever possible, mixing material from many sources, since this achieves the economies of scale that are important in commodity markets with low profit margins. Companies buying large quantities on the spot markets in places such as Rotterdam or Singapore consequently find it difficult to trace their purchase to its source countries or locations.

Markets

There are major domestic markets in Nigeria, Indonesia and some other producer countries. The principal importers are Western Europe (currently taking 17% of world trade in crude and refined palm oil), India (18%) and China (12%). Authoritative projections suggest world consumption of CPO growing from 22.5 million tonnes per annum in 2000 to 40 million tonnes by 2020⁸, with most of the extra demand predicted to occur in China and India, where rising populations are coupled with increasing affluence.

Palm oil currently forms about 26% of the 95 million tonne global production of edible vegetable oil, second only to soy. However, it forms 51% of the 36 million tonne global trade, with soy forming only 27%.

Palm oil currently competes well on price with other vegetable oils, especially soy but also rapeseed (canola), sunflower seed and others. However, this is a highly competitive market since (although each is preferred for some end uses) there is a high degree of end-use substitutability⁹ coupled with relatively low plant conversion costs. This means that downstream users enjoy relative invulnerability to interruptions in supply of the preferred oil, but are also exposed to knock-on price fluctuations caused by over- or under-supply of the alternatives. A negative result of this substitutability is that producers are vulnerable to rapidly falling demand if the price of alternatives drops.

Health issues

Almost half of palm oil content is made up of saturated fats and palm kernel oil contains even higher levels, approximately 89%¹⁰.

⁸ Oil World Annual 2002, Oil World, 2002, Mielke, Hamburg.

⁹ e.g. substitutability is very high in most edible end-uses, which form 90% of demand.

¹⁰ Fat of the land, Sustain - the alliance for better food and farming - 2000.

Appendix III - Selective list of products in which palm oil and derivatives are commonly used

Food and beverages

Frying oil in processed foods (e.g. for chips, doughnuts and crisps)
Table margarine
Shortening for baked goods (cakes, biscuits, pastries etc.)
Ice cream
Salad dressing
Peanut butter
Vanaspati (vegetable ghee)
Coffee whitener

Cosmetics and pharmaceuticals

Lipstick
Skin lotion
Sunblock
Shaving cream
Bath oil
Perfume (as solvent)

Cleaning products

Soaps
Detergents
Surfactants

Industrial chemical intermediates

Fatty acids
Fatty amides
Fatty alcohol
Glycerine
Methyl esters
Metallic soap
Epoxy plasticizers

Other

Paint
Candles
Biodiesel

Appendix IV - Current NGO initiatives concerning oil palm

Some of the higher profile initiatives concerning the oil palm sector are listed here to indicate the range of organisations and issues involved. Many other regional or local initiatives also exist, especially in the producer countries.

WWF International Forest Conversion Initiative (part of the Forests for Life Programme)

Focuses on soy and palm oil, the two most important and most rapidly expanding edible oil crops. The goal of the Initiative is, by 2005, to ensure that High Conservation Value Forests, freshwater ecosystems and habitats of key species in focal ecosystems are no longer threatened by the expansion of oil palm and soy.

The Check Your Oils Campaign concerns constructive engagement with industry and governments, together with education of the public in some consumer countries (Switzerland, Germany and may be forthcoming in Sweden).

WWF also lobbies for the protection of individual sites - the Tesso Nilo site in Sumatra is a current high profile example where oil palm is one of the key threats to wildlife.

www.panda.org/about_wwf/what_we_do/forests/problems/conversion.cfm

www.panda.org/about_wwf/what_we_do/forests/problems/tesso_nilo.cfm

www.panda.org/downloads/forests/elephantforestsonsale.pdf

World Rainforest Movement Plantations Campaign

Focuses on large-scale industrial tree crops (for pulp, timber, edible oil etc) in the South/Developing World. Aims to influence donors, companies, governments and consumers so that this development model is replaced with others which are seen as more beneficial.

www.wrm.org.uy/

Global Response 'Stop Financing Destruction in Indonesia'

Targets American audiences, urging them to lobby a major US investment bank about its role in supporting the Indonesian oil palm company Lon Sum.

www.globalresponse.org/gra_index/gra0402.html

Environmental Investigation Agency Campaign to Save Orang Utans and Indonesian Forests

Urges consumers to contact senior government figures and the World Bank to express their concerns, and in addition to make written enquiries about palm oil sourcing to their local supermarkets.

www.eia-international.org/

Rainforest Action Network

US NGO highlighted a major US investment bank for its role in financing unsustainable activities, one of the case studies being the company's support for the oil palm developments of an Indonesian palm oil producer.

www.ran.org/news/index.php?area=finance

Friends of the Earth Netherlands/Greenpeace Netherlands

During 2000-2001, lobbied major Dutch banks investing in unsustainable oil palm projects. Resulted in banks making new policy declarations aiming at improved sustainability. Conducted in cooperation with Sawit Watch, Walhi Indonesia and Telapak.

www.focusonfinance.org

Birdlife International's 'Saving Sumatra's Rainforests'

Site-specific action underway, with a major initiative about to start, which focuses on the policies of international donors and investors who support the oil palm sector.

www.birdlife.net/action/campaigns/saving_sumatras_rainforests/index.html

Sawit Watch Indonesia

Umbrella organisation of Indonesian NGOs and local community representatives set up to monitor problems in the oil palm sector, especially relating to social impacts, and to assist rural communities in obtaining fair treatment.

www.sawitwatch.or.id

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