

CHAPTER 1

INTRODUCTION

1. Introduction

1.1 Research Background

The contribution of palm oil plantation related business has been an essential part in developing the Indonesian economy for decades. With its contribution to Indonesia's Gross Domestic Product (GDP) surmounting to more than 15 billion USD in terms of export on the year 2020 (GAPKI, 2020), and with more than 40 billion USD in terms of foreign exchange revenue to Indonesia on the year 2021 (Astra, 2021), it is no doubt the importance of Crude Palm Oil (CPO) which is the by-product of palm oil tree (*Elaeis guineensis*) has the utmost significant contribution to the Indonesian economy. The palm oil plantation has also significant contribution to the livelihood of the Indonesian citizen by providing jobs for more than 16 million people (CNN, 2021) especially when the pandemic Covid-19 era is happening throughout the world, and the industry also increases the social welfare of its farmers by programs that enrich the farmers with its nucleus-plasma program which fosters a partnership between the palm oil plantation companies and its local communities in a profit sharing mechanism that contributes to a minimum of 20% of total land cultivated for palm oil plantation (Zen, Barlow and Gondowarsito, 2005).

CPO is a highly versatile commodities that can be used in many in many products ranging from biodiesel, toiletries, cooking oil, pharmaceutical usage, food products, and many other important products, and due to its significance, it is also the most widely traded vegetable oil compared to other sources which accounts for almost 60% of all global oil seed (Carter *et al.*, 2007). In regards to its competitiveness in terms of pricing in comparison with other

vegetable oil products like rapeseed, soyabean, sunflower or ground nut, CPO prices are always the lowest one, this is due to the fact that the productivity of this particular vegetable oil per hectare area is significantly higher than its competitor, and therefore this particular commodity is being used right now as an alternative to conventional fuel (Beyer *et al.*, 2020).

The production of CPO has grown exponentially in past 30 years, and by the year 2006 Indonesia has dominated the production of CPO surpassing Malaysia as the largest producer of CPO in the world. Currently the world's CPO production is dominated by Indonesia which accounts for more than 60% of the world's production at around 47-50 million tonnes per year at the end of 2021, and followed by Malaysia around 19-20 million tonnes per year at the year of 2021 (CPOC, 2022). According to the CPOC (2022), the demands of CPO for next year globally would increase significantly because of new openings in hotels, restaurant, and café (HORECA) sectors amid nationwide large-scale COVID-19 vaccinations, which will also boost demands in food and non-food (biofuels, oleochemicals, stearin) industries.

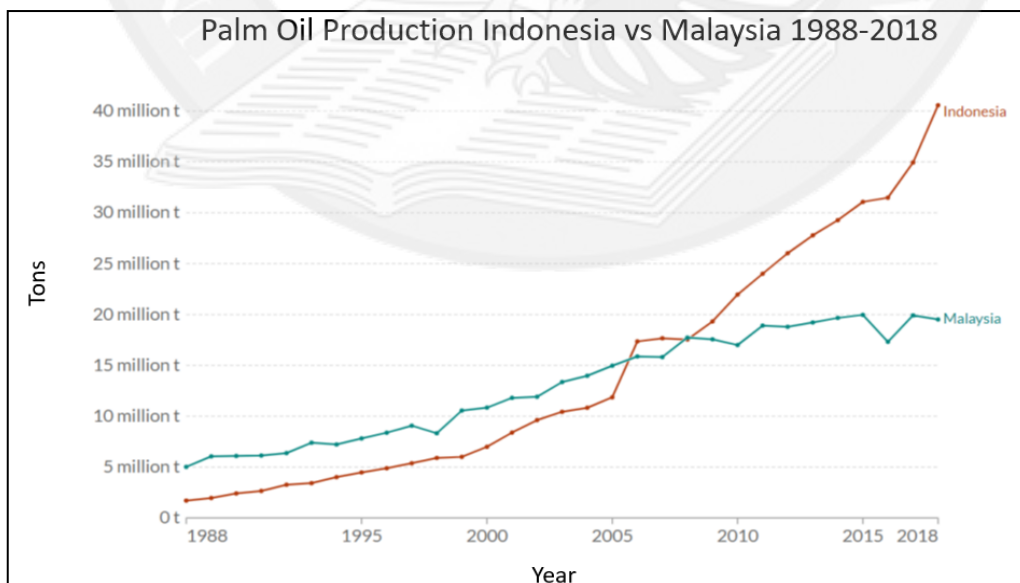


Figure 1.1 Palm Oil Production of Indonesia Vs Malaysia
Source: (Ritchie and Rosser, 2021)

Along with the growth of the industry there are also new challenges that comes with it. Environment has become a very clear and adamant issue in today's business environment, palm oil plantation included. The deforestation rate of Indonesia has grown alarmingly from 2001-2019 to 16.24 million hectares (Gaveau *et al.*, 2022), and by 2013 alone, the palm oil plantation in Indonesia was planted on deforestation areas by more than 53% of its forest area compared to 1989 which has a dire impact on the loss of biodiversity as well (Vijay *et al.*, 2016).

However, in the same sense that the world especially the European Union sees palm oil as a controversial object from the usage of biodiesel and food source as one of the major deforestation agent (Oostever, 2020), other research has also shown that in comparison with other vegetables oils such as soybean, rapeseed, sunflower and groundnut, Beyer *et al.*, (2020) has come to the conclusion that the palm oil has the least carbon loss and biodiversity loss compared to these other vegetable oils. Nevertheless, the undeniable facts are Indonesia experienced an average annual increase of deforestation of 47,600 ha of primary forest loss from 2010 to 2012 alone which hits the record compared to other countries including Brazil and the total primary forest loss has totalled to 0.84 million ha in 2012 (Margono *et al.*, 2014). With now more than 14.6 million hectares of land being cultivated as palm oil plantation by the year 2020 (Statista, 2021) surely the challenges concerning environmental sustainability is inevitable.

It is then because of this environmental issue; the palm oil industry is under scrutiny and new challenges are rising concerning the image that it has been presented as a deforestation agent. Many of the palm oil companies in Indonesia has committed to certain sustainability standards like the Roundtable Sustainable Palm Oil (RSPO) which is a voluntary certification body from Europe created by World Wildlife Fund (WWF) and Unilever in 2004 to ensure the

sustainability factors of palm oil plantation companies (Ernah and Waibel, 2016), and also the Indonesian Sustainable Palm Oil (ISPO) which is mandated by the government under the Minister of Agriculture Regulation Number 11/Permentan/OT.140/3/2015 to ensure the sustainability factors and also the legalities for palm oil plantation companies in Indonesia (Christiawan & Limaho, 2020; Hutabarat, 2017).

However, regardless of the sustainability certifications that the palm oil plantation companies hold, and also the immense economic growth that the industry has provided to Indonesia, and also the many industries that desperately need this particular commodity to produce other goods for the entire world, the industry is still under immense attack from Non-Governmental Organizations (NGO) and many European nations under the guise of sustainability. In 2018 strong advocates from Greenpeace has protested many palm oil plantation companies such as Wilmar, GAMA, Fangiono Plantation, Djarum Group by climbing on board the gigantic palm oil tanker Stolt Tenacity en-route to supply palm oil for a global major player in the snack food industry Mondelez, which has produced many famous worldwide snack brands such as Oreo, Cadbury, Ritz, and among others (Greenpeace, 2018).

On that same year, Greenpeace has also orchestrated a demonstration by occupying Wilmar's palm oil refinery in Bitung, North Sulawesi by using the help of various international citizens and also a famous Indonesian rock band called 'Boomerang' to put banners on the palm oil silo which depicts the words 'dirty palm oil' (Tehusijarana, 2018). Not long after this incident, Iceland Food's (a supermarket retail chain) Christmas advert which clearly depicts the destruction of rainforest made by Greenpeace came to air. Even though it was banned by the local United Kingdom broadcast committee, the ad itself has made over 65 million views.

There has been many instances of these similar acts happening around the world instigated by the NGOs in varieties of ways such as , but the facts are, because of these

aggressive campaign launch by the NGOs many business interruptions has happened from; the withdrawal of one of the biggest financial institution HSBC in funding palm oil related operations due to the negative image that they have gotten from the aggressive marketing campaign by Greenpeace (Kapoor, 2017), the momentarily halt of purchasing CPO conducted by one of the biggest fast moving consumer group and food group like Nestle and Unilever from Indonesian palm oil companies (Chaudari, 2011), and the negative image that is blatantly given to palm oil companies and the companies that buys the palm oil from them (Sron, 2018).

The negative image that is portrayed by the NGOs does not only target the palm oil companies, or the EU, but the government of Indonesia has also fallen under immense pressure amidst these allegations. One of the defining moments is the decree of *Presidential Instruction No.8 of 2018* agreeing to a moratorium of palm oil licenses which halt progress and growth and creates a big uncertainty factor for new investments and also previous holder of concessions to expand and grow (Christiawan, 2019; Limaho et al., 2022). Especially with the National Determined Contribution (NDC) commitment by Indonesia to decrease carbon output by 2030 to 29%, and the Sustainable Development Goals (SDG) that Indonesia has signed on 2015 with 192 other countries (Limaho et al., 2022), the eyes of the world are at Indonesia to see how the government will tackle these issues concerning palm oil plantation companies allegedly accused of agents of deforestation.

However, the final blow would be the effort of European Union (EU) under the newly revised Renewable Energy Directive (RED) called RED2 which will phase out the use of palm oil from 2023 to completely stop using the commodity by 2030 (Andrianto, 2020). Even with the reality that the EU desperately need the CPO which was shown clearly that from the year 2011-2016 the Indonesia average CPO export were around 60% of the total consumption for the EU, by using environmental as a weapon fuelled from the statement from Report on Palm Oil and Deforestation on Rainforests presented to the EU, the resolution that is taken by the

EU is to ban palm oil on the basis that the industry is responsible for deforestation and habitat destruction (Andrianto, 2020; Rifin et al., 2020). The utter discrimination continues when the EU published a draft regulation called 'Proposal for a regulation on deforestation-free products' which is hailed by NGOs such as ClientEarth but are deemed discriminatory and hypocritical from producers' countries such as Indonesia and Malaysia who promised to lodge this issue at the World Trade Organization (WTO) on the basis of protectionism and the fact that it burdens the poorer farmers (Barahamin, 2022).

As we can see, throughout the decade, the palm oil industries have flourished because of its Resource Based competitiveness mindset and their sustained competitive advantage in terms of pricing, productivity, and resources. However, with the new threat that is arising, which is environmental sustainability issues, the industry has been crippled and the consumers are waning away. Even with the sustainability certifications that these palm oil companies has achieved, the attacks keep on coming and even more dire than ever. Many research has predicted that the challenges will keep on coming and the palm oil industry cannot be complacent in order to survive and grow in this new world (Limaho et al., 2022; Sron, 2018). As we can see here, there is a gap, if sustainability is the main issue, why does all the effort from the certification bodies and the effort for these palm oil companies to be certified is not enough? The knowledge gap that exists here is the business expansion strategy amidst the environmental issues arising and there is a need for more research pertaining the actions of these companies and to discover the underlying issue of more than just sustainability certificates, but to a deeper understanding of an evolving business strategy that has garnered competitive advantage for decades for this particular industry.

The discrimination against palm oil does not only come against Indonesia but also to the neighbouring country, Malaysia. Even though the industry in Malaysia is more mature in terms of production and experience compared to Indonesia, the attacks from the EU and the

NGOs are still using the same environmental concerns ranging from, environmental degradation, deforestation, loss of biodiversity, carbon footprint, and peatland conversion (Austin *et al.*, 2017;Meijaard *et al.*, 2020)

In the Renewable Energy Directive (RED) II which the EU parliament has agreed to phase out palm oil for biodiesel use from 2021 and outright banned by 2030 because of deforestation factors, the Malaysian government has also filed its complaint to the WTO because of this unfair practices, and the government has realized that this can jeopardize the market share of Malaysian palm oil in the European oils and fats sector (Kannan *et al.*, 2021; Oosterveer, 2020).

The attacks from the EU against Indonesia and Malaysia does not stop on the policy sectors but also to the buyers that has purchased palm oil products to include certification labels, detailed product labels, or the pressure for other companies to use palm oil free labels, even until campaigns to educate the market about the difference between vegetable oils and palm oils in a bias note (Hinkes, 2019)

The strange thing is that the Malaysian palm oil producers has mostly followed the RSPO principles and criteria, and in the year 2015 the Malaysian Government has also develop a mandatory national standard like the Indonesian ISPO which is called the Malaysian Sustainable Palm Oil (MSPO) that also focuses on responsible practices from environmental, social, safety, and legal basis with many involvement from multi-stakeholder agencies to help with the sustainability issues until policy formulation (Majid *et al.*, 2021).

Similar to the Indonesian government, the Malaysian government has also gives initiatives to the local palm oil players to form Palm Oil Mill Effluent (POME) capture that can reduce GHG emission by 30% through methane capture and achieving zero-waste standard (Harsono, Grundmann and Soebronto, 2014).

The Malaysian Palm Oil industry is also very regulated even with more than 15 laws in place that the industry must adhere ranging from Land Conservation Act 1960; Environmental Quality Act 1974, Protection of Wildlife Act 1972, Hazards and Critical Control Points (HACCP), Environmental Impact Assessment (EIA), until MSPO code of practices to ensure sustainability throughout the whole chain process of the palm oil supply chain (Naidu and Moorthy, 2021).

The real incentives from the Malaysian Government that really distinguishes itself from Indonesia concerning environmental sustainability is perhaps the establishment of Malaysian Palm Oil Wildlife Conservation Fund (MPOWCF) that specifically funds wildlife conservation through many activities including studies, marketing, that includes academicians, NGOs, and other government officials.

However, despite having all these efforts that has been done by the Malaysian Government, the reality is palm oil, especially coming in from the two largest producing countries, in the eyes of EU is still deemed unsustainable even with many countersuits are being complained by Indonesia and Malaysia in the WTO under the guise of trade protectionism.

This has proven that the conventional ways of doing things is no longer working, and the impact this will have affect both the market share of Indonesia and Malaysia in the world which inevitably will create an economic ripple until the farmers. Issues on palm oil sustainability has been addressed through comprehensive strategies and policies and it is still argued not enough, even until Indonesian government has declared moratorium on palm oil plantation expansion on 2018 and yet the discrimination still happens on 2020 from EU.

1.2 Research Problem

Against this background, this research will try to discover new strategies or perhaps to identify whether these palm oil companies in question do have an ‘environmental sustainability’, or perhaps what should be the best strategy in terms of growth amidst these challenges. A number of research questions are devised to assist this research such as:

1. How does the company implement their environmental strategy plans in the case of palm oil plantation expansion?
2. How are the implementation of green marketing as a process of companies’ strategies in their efforts to communicate and achieve sustainability strategies especially in the case of business expansion?
3. What does the company think about co-opetition strategy and what are the possible strategies that can be included in the co-opetition coalition target to achieve sustainability and expansion as an industry, specifically in the green marketing section to avoid sustainability issues?

1.3 Research Objectives

This dissertation will try to identify the necessary steps and strategies that is needed to be implemented by palm oil plantation companies in Indonesia from the CEO/Owner’s or Sustainability Directors’ perspectives. The target of this dissertation is to be able to present a formula or guidelines from the grand strategy that can be immersed into different direct implementation, and to understand the point of view from the CEOs or owners or Sustainability Directors of several palm oil plantation companies on what are the real challenges in the coming years and what should be done as a company to persevere through by any means, directly, indirectly, philosophically, strategically, conventional and or unconventional, deliberately, or reactively.

The hope is that this research will be able to the development of business strategy theories and implementation by providing new addition to existing models or perhaps creating a new theory specific to the implementation part of the environmental strategy. Therefore, the industry can grow further and decrease the risk of business interruption.

1.4 Scope of Study

The research will focus on big multinational palm oil companies (more than 50,000 ha) based in Indonesia who has ISPO or RSPO certifications. The research will also focus on the CEO and or owner's perspectives because they are the ones that run the companies on a daily basis and has the capacity to do significant company transformation from within and also build alliances with other stakeholders. For the purpose of this study, the respected companies or groups, or holdings that are in the research has significant international exposure in terms of exports of its palm oil products.

The scope will be limited to the business strategy side and not on the agricultural side or the operational side such as land production intensification, or increase efficiency in palm oil mill. The expansion strategy has to also focus on specifically in the palm oil plantation sector and not on unrelated diversification business expansion strategy.

1.5 Contributions of the Study

The benefits of the research can be categorized into a few segments:

1. For palm oil plantation owners or decision makers such as CEO, Commissioner, Board of Directors:
 - a. This research will hope that it can create a platform or a business decision mapping to identify each challenge from the perspective of owners and to see how do business owners view these new 'terms of engagements' arising from the world and how

does it affect and alter the way of doing business. Specific considerations will be put into place on:

- i. Pros and Cons
 - ii. Stakeholder relations
 - iii. Competitive Advantage
 - iv. Lobbying
 - v. Strategy building
- b. To have an understanding of what is the conventional strategy that has been used before in the past to gain competitive advantage, and to understand what will be the new model.
2. For NGOs and environmental activist:
 - a. To understand the perspective of palm oil players and the business' challenges that goes beyond just environmental factors.
 - b. To have an understanding or a common ground for future collaboration and understand the knowledge or perspective gaps that is apparent.
 3. For Governmental, sectoral policy makers, and academics:
 - a. To understand and mitigate the risk and benefits of each perspective and potential consequences that may arise by implementing new laws and or regulations.
 - b. To have an understanding of how does the globalization era of climate policies from around the world will have a deterrent impact from the country's economy in all levels.

It is truly the hope of this author that the research can have a significant contribution to emphasize the importance and the real possibility of collaboration between different stakeholders with different point of views.

1.6 Limitations of the Study

The limitations of this particular research would be these few factors:

1. Limited sources of experts in the palm oil plantation field and those who understand environmental issues

Researchers and practitioners in the political environmental issues ranging from consultants, government officials, lecturers and researchers are also very limited due to the new field that it is. The decision of expansion, intensification, diversification, mergers, and acquisitions are the owners and or the board's decision. Even though Indonesia is the biggest producer of CPO by volume in the world, it is still highly controlled by a few conglomerates who owns the land, mills, distribution channels, from upstream to downstream. The whole concept of carbon credit has been around for quite some time, but the real implication and planning execution has just been conceptualized and going to be implemented soon.

2. The geographical location of this research will be located in Indonesia.

Different palm oil producing countries such as Columbia, Malaysia, Thailand, and other African nations will and may have different rules and regulations concerning operation, lease, ownership, environmental aspects, expansion boundaries, foreign investments, and etc. In order for this research to be thorough and precise, the limitation of this research is specifically related to the geographical country factor, in this case Indonesia, which will contribute specifically to the business strategy of palm oil plantation expansion in the country and to the players in the field.

Indonesia is also a good geographical setting since it is the third largest country in the world after Brazil and Congo to possess rainforest coverage in hectarage of almost 500,000 square miles, but also as a country it is the third largest emitter of greenhouse gas, and has one of the highest deforestation rate in the world (Kiprop, 2017).

3. Sample size

The palm oil world is a very small one indeed in Indonesia even though as a country it is the largest producer but the total private owned company in palm oil plantation owns more than 54% of the total productive land in palm oil plantation (Jayani DH, 2019) and with only less than ten conglomerates in the whole industry controlling the production and supply (Science Agriculture, 2020) the challenges in getting a decent data collection in an interview setting will certainly be a contest.

