Overcoming the challenges of certification for independent smallholders in the palm oil industry

By

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Submitted to the MIT Sloan School of Management in partial fulfillment of the requirements for the degree of

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Abstract

Independent smallholders’ certification in the palm oil industry has been recognized as a significant challenge both in the academic literature and in the interviews conducted with experts prior to writing this thesis. According to both sources, a massive certification of independent smallholders seems very unlikely in the medium-run. At the same time, smallholders are a critical component of the palm oil value chain, both in terms of production and land use. This thesis focuses on the challenges palm oil independent smallholders in South East Asia are faced with when it comes to certification. The paper is structured around four chapters. Chapter I opens the paper with an analysis of the current context in the palm oil industry and of the rising concerns related to sustainability. The main bottlenecks preventing smallholders to become certified are then developed in Chapter II. In Chapter III, certification of smallholders is presented through the lens of the collective action problem framework. Two case studies then illustrate the fact that certification can be achieved. Based on these case studies, as well as on interviews with experts and on academic papers, we formulate the necessary conditions to create a favorable environment for independent smallholders to achieve certification before suggesting ways to implement them (Chapter IV).
Introduction

Palm oil is the second most traded vegetable oil in the world today, after soybean oil¹, and has experienced an extremely fast growth in the past 40 years. As demand increased, concerns emerged regarding the social and environmental impact of production: palm oil was pointed at as being responsible for deforestation, biodiversity loss, as well as various social conflicts. The Roundtable for Sustainable Palm Oil (RSPO) emerged when multinational corporations and civil society organizations decided to unite forces to tackle these issues. The focus of this multi-stakeholder organization is to work towards making palm oil production more sustainable.

Soon after it was created, the RSPO defined Principles & Criteria (P&Cs) that would guide palm oil growers to produce Certified Palm Oil (CPO). The RSPO recognized that these principles were not adapted to the situation of smallholder farmers and adopted specific P&Cs for smallholders in 2009 and 2010.

The profile of palm oil growers varies widely and goes from very large estates to smallholders. The RSPO currently defines palm oil smallholders as: “Farmers growing oil palm, sometimes along with subsistence production of other crops, where the family provides the majority of labor and the farm provides the principal source of income and where the planted area of oil palm is usually below 50 hectares in size”².


However, certification for smallholders has remained extremely difficult to achieve. In particular, certification of independent smallholders (those who are not contractually bound to a mill) is the most challenging, because they cannot benefit from the financial and technical support of a mill. After several months of research and seven interviews I conducted with experts from the industry, I was left with the impression that independent smallholders certification in the palm oil industry was a very challenging issue and that a massive certification of independent smallholders seemed very unlikely in the medium-run.

In this paper, we will try to answer the following questions: What are the barriers to certification for smallholders? Are these barriers a threat to smallholders’ competitiveness? What are the actions undertaken today to make certification accessible to independent smallholders? What are the necessary conditions for smallholder certification to become achievable?

We will see that these necessary conditions for smallholders to achieve certification are (1) to invest in capacity building of smallholders, (2) to provide market incentives for certification and (3) to make the certification process more accessible from a financial and operational point of view.

For practical reasons, the thesis will focus on examples in South East Asian countries, unless stated differently.
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Chapter I: What has been the impact of RSPO standards on the supply chain of Palm Oil?

In this introductory chapter, we will analyze the impact of RSPO’s standards on the supply chain of Palm Oil. We will start by providing a brief background on palm oil (Part A). We will then identify which factors led to the emergence of the RSPO, whose objective is to make ‘certified sustainable palm oil’ (CSPO) the norm in the global Palm Oil industry (part B). We will then look at the impact the RSPO Principles & Criteria have had on the top and the bottom of the supply chain (part C). We will end this chapter by taking a step back and looking at the situation of advancement of Certification in the Palm Oil industry. We will see that the progress has been significant in terms of Certification but that more needs to be done to make it the norm (part D).

I.A The palm oil industry today: balancing expansion and sustainability

I. A. 1) The impact of palm oil expansion on deforestation and biodiversity

Palm oil production has been pointed at as being responsible for deforestation and important biodiversity loss. These concerns are justified by two important facts:

- The expansion of palm oil crops: Agricultural expansion and intensification has been pointed out as the biggest current threat to biodiversity\(^3\) in the academic literature. Vegetable oils are the most rapidly expanding agricultural sectors\(^4\) and, among those, palm oil is the one experiencing the highest growth.

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The threat palm oil represents for biodiversity-rich ecosystems: Palm oil is grown in areas that are particularly rich in terms of biodiversity, like rainforests and tropical areas. In 2008, oil palm was grown across more than "13.5 million ha of tropical, high-rainfall, low-lying areas, a zone naturally occupied by moist tropical forest, the most biologically diverse terrestrial ecosystem on Earth". In parallel, fewer plant and animal species survive on palm oil plantations, compared with other agricultural options.

If nothing is done to prevent palm oil expanding on this type of lands in the future, many experts recognize that the expansion of palm oil plantations would cause high losses in terms of biodiversity and forested areas: "Although the extent to which oil palm has been a direct cause of past deforestation is difficult to quantify, its potential as a future agent of deforestation is enormous. Demand for palm oil is predicted to continue increasing, and globally, most of the remaining areas suitable for planting are forested." Therefore, the increase in palm oil production that is expected could have dramatic consequences in terms of deforestation and biodiversity loss.

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I. A. 2) Elements of context on palm oil expansion: understanding the historic and predicted growth

Today, palm oil is the second most widely traded vegetable oil in the global oil and fats industry. It is the most important vegetable oil both in terms of production and has become so in the last four decades.

a) Historic growth:

The planting of palm oil for commercial purposes started in the beginning of the 20th century in Congo, Malaysia and Indonesia. However, large scale expansion of palm oil plantation only started in the 1960s. Growth from the 1980s to nowadays has been extensive the total cultivated area for palm oil has increased eight-fold between 1980 and 2009, while the total production of palm oil grew nine-fold in the same period. In comparison, the overall production of vegetable oil increased by 335 percent in the same time period.

Figure 1 below shows the exponential growth of palm oil from 1970 to 2007. It highlights that growth in world production was primarily driven by Malaysia and Indonesia during this period.

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8 PriceWaterhouseCoopers, “Palm Oil Plantation, Industry landscape, regulatory and financial overview”, PwC Indonesia reports (2012)
9 Teoh, Cheng Hai, “Key sustainability issues in the Palm Oil sector”, The World Bank, IFC report (2010), page 4
b) Palm oil production today

Palm oil production is highly concentrated in South East Asia but other regions represent a high potential in terms of future expansion.

Figure 2 shows the countries where palm oil is produced as well as an idea of the area covered by palm oil plantations. We observe that production is concentrated around the Equator line, as palm trees requires a tropical climate and environment to grow.

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In 2009, Malaysia and Indonesia accounted for 85% of the global production while Thailand, Ecuador, Colombia and Papua New Guinea have experienced a steady growth in the past decades and accounted together for 6.6% of the global production in 2009. "At present, relatively little oil palm is grown outside Southeast Asia, but 410-570 million ha of currently forested land across Southeast Asia, Latin America and Central Africa are potentially suitable for oil palm cultivation and might be increasingly utilized as demand rises and agronomic advances are made."

Figure 3 illustrates the current weight of palm oil in terms of area covered in 2008. This figure also shows that there is a lot of potential for countries in other regions than South East Asia. Indeed, since 2009, palm oil cultivation has expanded extremely fast in these latter regions and is predicted to

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continue increasing. This expansion represents a significant economic opportunity for the countries as well as a threat for the environment and biodiversity.

![Oil palm area percentage](image)


**Figure 3: Oil palm cultivation areas as a percentage of country territory in 2008**

c) **Expected growth in palm oil industry**

WWF predicts that palm oil consumption will have doubled by 2030 and tripled by 2050, compared to our current consumption. Annex 1 offers an explanation to why palm oil is becoming so demanded on the global market.

Given this huge increase, it is legitimate to ask where this additional production will come from and how will it impact the environment and ecosystem of regions that are already under pressure. This very same question led to the creation of the Roundtable on Sustainable Palm oil, as we will see in the next paragraphs.

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18 WWF, "Palm Oil", *Web* (2008), last retrieved from the web on 4 May 2013:
<http://wwf.panda.org/what_we_do/how_we_work/businesses/transforming_markets/solutions/methodology/multi_stakeholders/palm_oil/>
I. B. The emergence of the RSPO as an attempt to make palm oil production more sustainable

I. B. 1) The debate on sustainability initiated by civil society organizations

a) How did the debate about palm oil sustainability start?

Environmental NGOs and members of civil society started becoming vocal on issues related to palm oil and deforestation, biodiversity loss, and climate change at the end of the 1990s.

The debate around palm oil and sustainability became particularly predominant after 1997. In that year, large forest fires took place in Africa, Brazil, Colombia and Indonesia. WWF Netherlands further investigated on the causes of these fires and identified that the expansion of palm oil cultivation was one of their underlying cause: in a report released by WWF Netherlands, it was revealed that some of these fires had been started in order to clean the land and prepare it for palm oil cultivation. After understanding the origins of these fires, members of civil society started to consistently point out palm oil production as a main cause of deforestation, biodiversity loss, climate change as well as social conflicts.

b) The Kit Kat ‘powershock’ for multinationals

A good illustration of the “Demonization” of palm oil and how it affected multinationals would be the fake advertisement Greenpeace made to denounce Kit Kat’s use of palm oil. In this advertisement, Greenpeace accused the production of the palm oil Nestlé used for their Kit Kat to

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19 AidEnvironnement, 2007, “Towards effective conservation strategies: the application of strategic principles to increase the impact and sustainability of WWF conservation efforts”

20 This term was used by Darrel Weber, General Secretary of RSPO in a BBC Food Program interview in October 2011
be responsible for the extinction of orangutans and the slogan of the advertisement was ‘Give orangutans a break’.\(^{21}\)

![Image](https://internetetopinion.wordpress.com)

**Figure 4: Greenpeace activist demonstrating against Nestlé and its 'Killer' Kit Kat\(^{22}\)**

Nestlé reacted instantly to Greenpeace’s attack by asking them to remove the ad from the web. However, the video soon became viral. Greenpeace succeeded in its strategy as Nestlé stopped working with some palm oil producers that Greenpeace had pointed out as acting irresponsibly with regard to biodiversity and forest conservation.

This particular advertisement and the criticism generated by the civil society also had effects on other multinationals, as they feared that they might be the next target of criticism if they didn’t commit to sourcing palm oil in a more responsible way.\(^{23}\)

**c) Palm oil’s consistent unpopularity among civil society organizations and Western markets consumers**

\(^{21}\) Referring to Kit Kat’s famous advertising phrase: “Have a break, have a Kit Kat”

\(^{22}\) Retrieved from the internet on March 20th:2013: internetetopinions.wordpress.com

\(^{23}\) Based on an interview conducted with an expert working for a large palm oil producer and manufacturer
Today still, palm oil is very unpopular among some of the most influential global NGOs. The Rainforest Action Network (RAN), for example, still asserts the following on its website about palm oil: “palm oil destroys rainforests”, “palm oil threatens forest people” and “palm oil causes climate change”.

Civil society organizations have popularized the debate on palm oil and the negative environmental and social impacts among consumers in the Western markets. Since the early 2000s, consumers from Europe mainly but also from the United States, Japan and Australia have become more sensitive to the topic of deforestation and loss of natural habitat for endangered species.

An iconic example in the United States is related to the girl’s scout cookies. Two 11 year-old scouts discovered in 2007 that the cookies they sold used palm oil that caused “the destruction of irreplaceable rainforests and threaten(ed) the survival of humankind’s closest relative, orangutans”24. After several years of campaigning and with the support of the Rainforest Action Network’s (RAN), these two girl scouts received a lot of attention from the media in the U.S25.

From the early 2000s, the actors of the palm oil industry were exposed to a lot of pressure coming from social and environmental NGOs. It is in this context of ongoing criticism from the civil society organizations and the consumers that Roundtable for Sustainable Palm Oil (RSPO) was created.

I. B. 2) The emergence of the RSPO

In 2001, the World Wildlife Fund was exploring the idea of creating a Roundtable where the actors of the palm oil supply chain would be able to interact and discuss about pressing issues specific to their industry. And sustainability, as we have seen, was indeed a pressing issue for the industry.

25 This is an example several of my American-citizen classmates have mentioned to me when I told them I was writing my thesis on palm oil.
Unilever, Aarhus United UK Ltd, Migros, Malaysian Palm Oil Association joined the effort of WWF in 2002 and formed the Organizing Committee that would work towards the preparation of an inaugural meeting. This inaugural event took place in Kuala Lumpur in 2003 and the 200 participants from 16 countries signed a Statement of Intent for the creation of the RSPO26.

The RSPO was formally established a year later, in 2004 as an association governed under the rule of Article 60 of the Swiss Civil Code. It was decided that its seat would be located in Zurich, Switzerland, its Secretariat based in Kuala Lumpur, Malaysia and its Liaison Office is based in Jakarta, Indonesia.

I. B. 3) A multi stakeholder organization working towards making ‘sustainable palm oil the norm’

a) What is the RSPO’s mission?

RSPO was defined by its founding members as “a not-for-profit association that unites stakeholders from seven sectors of the palm oil industry - oil palm producers, palm oil processors or traders, consumer goods manufacturers, retailers, banks and investors, environmental or nature conservation NGOs and social or developmental NGOs - to develop and implement global standards for sustainable palm oil27”. The RSPO is therefore a multi-stakeholder organization that serves as a platform uniting all the stakeholders in the palm oil industry.

b) Who are the RSPO’s members?

The RSPO has grown significantly since 2003 and had a total membership of 1088, in November 2012. The distribution of its members (Figure 5) shows that growers represent 15% of the membership of the RSPO.

26 Information retrieved from the official website of the RSPO, January 2012 (http://www.rspo.org)
27 Information retrieved from the official website of the RSPO, January 2012 (http://www.rspo.org)
RSPO membership by stakeholder group

- Processors and traders
- Growers
- Environmental NGOs
- Social NGOs
- Consumer Goods Manufacturers
- Retailers
- Banks and investors

source: sustainablepalmoil.org (2012)

Figure 5: breakdown of RSPO members by category

Becoming a member of RSPO is voluntary but has become an implicit requirement for many growers who want to supply to multinational corporations, according to PwC Indonesia\textsuperscript{28}.

c) The annual roundtables as a forum for all the palm oil stakeholders

Each year, the Round Table event (RT) is held and is a forum where the RSPO members can present their work, exchange and take decisions. “Positioned as the world’s largest sustainable palm oil conference and held since 2003, the annual roundtable or RT is a platform to exchange views and

experiences among various stakeholders in developed and developing countries; to strengthen their co-operation and support in promoting sustainable palm oil. The annual roundtable is positioned as an industry event organized to seek participation from players within the palm oil sector from all around the world.

These annual roundtables have become very important along the years for the palm oil stakeholders as they are an opportunity for members to present their progress, exchange best practices and express their concerns.

d) RSPO’s vision

RSPO ambitions to ‘transform markets to make sustainable palm oil the norm’

To date, the ‘certified sustainable palm oil market’ (CSPO) accounts for 14% of the total market. In the following sub-chapter, we will analyze what RSPO has put in place so far to make its vision reality.

I. B. 4) The creation of new standards and their expansion

In order to transform markets to make sustainable palm oil the norm, the RSPO has:

- Defined Principles and Criteria for sustainable palm oil production
- Defined indicators and processes to achieve certification (and discriminated between large producers and small ones)
- Created various supply chain systems to diffuse the Certified Palm Oil

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29 Source: rspo.org
30 Many interesting discussions can be seen on the YouTube Channel of the RSPO: http://www.youtube.com/channel/UCJqlr0E0atJpa0U-YQF4bWQ?feature=
a) Definition of Principles and Criteria for sustainable palm oil production,

The RSPO has set up Principles & Criteria (P&Cs) for sustainable palm oil in 2007 for palm oil producers (that include smallholders). There are 8 P&Cs:

1. Commitment to transparency
2. Compliance with applicable laws and regulations
3. Commitment to long-term economic and financial viability
4. Use of appropriate best practices by growers and millers
5. Environmental responsibility and conservation of natural resources and biodiversity
6. Responsible consideration of employees and of individuals and communities affected by growers and mills
7. Responsible development of new plantings
8. Commitment to continuous improvement in key areas of activity

b) Definition of indicators and processes for producers to achieve certification

RSPO has defined these general P&Cs while recognizing that there may be a need to adapt to local contexts as well as different types of producers. The organization declares on its website: “The Principles and Criteria have been interpreted to account for local conditions, resulting in national standards that reflect local laws, regulations and best practices. These local interpretations are aligned with the global RSPO standard and are certified as such.”

If the Principles and Criteria are the same for every producer, the way to implement them varies according to the type of producers: plantations, scheme smallholders (smallholders who sell their

32 Source: Rspo.org
fresh fruit bunches to a specific mill) and independent smallholders have different implementation guidance to follow in order to become certified (cf. Chapter II for more details).

c) Creation of various supply chain systems to facilitate the diffusion of Certified Palm Oil

In order to facilitate the sale of 'Certified Sustainable Palm Oil', different supply chain systems have been put in place:

- Identity preserved palm oil (which is fully traceable to an individual level of estate or smallholder preserved from any mixing with other sources of palm oil),

- Segregated palm oil (which is very similar to identity preserved palm oil, the main difference being that segregated palm oil can come from several estates or smallholders and therefore is not traceable at the individual level),

- Mass Balance palm oil (which consists of a mix of CSPO and conventional palm oil),

- Book and Claim (the sale of CSPO certificates is separate from the sale of palm oil)33.

These systems all have specific implications on the supply chain:

- Producing and distributing Identity Preserved and Segregated Palm Oil require a high level of supply chain integration. Both are based on a traceable and segregated system. Identity Preserved implies to have palm oil from one origin (estate or smallholder) only processed in one mill, transported in one tank and stored in one tank before being sold. Segregated Palm oil is similar, except the certified oil can come from various sources. The production of this type of certified palm oil poses supply chain challenges and represents significant additional costs.

-The Mass Balance Palm oil also involves the coordination of the entire supply chain and poses challenges.

- The Book and Claim system is the only system that does not require the coordination of the entire supply chain. Indeed, it relies on the sale of Greenpalm certificates by the producers of fresh fruit bunches (FFBs) in exchange of a price premium. Since the implementation of the Greenpalm certificates in 2008, the price premium has fluctuated significantly. For example, Greenpalm certificate price per ton of CPO (Certified Palm Oil) collapsed from USD 10 in 2010 to less than one dollar in 2011\(^\text{34}\), which significantly weakened the Book and Claim system.

For more details on these systems, please refer to Annex 2.

I.C Impact of the RSPO standards on the actors of the Palm Oil Supply Chain

I. C. 1) Identifying the actors and influencers in the Palm oil supply chain

We can distinguish two types of players in the Palm Oil debate: the actors and the influencers.

The actors include the traditional palm oil supply chain i.e. palm fruit farmers/ producers, plantations, millers, refiners, processors, manufacturers and retailers.

The influencers include social and environmental organizations, banks and financial institutions, traders, industry associations, media and governments.

The table below gives a brief synthesis about the way these protagonists interact within the palm oil supply chain:

\(^{34}\) New Britain Palm Oil Limited, “New Britain Palm Oil Sustainability Report 2010/11”, NBPOL Sustainability report, (2010), page 46
I. C. 2) Understanding the operational challenges in the palm oil supply chain

At the producer's level

Palm oil fresh fruit bunches (FFBs) must be milled within 24 hours of harvest to preserve the quality and freshness of palm oil. Thus all producers who do not own a mill (including smallholders) must deliver their harvest rapidly to a nearby mill. In practice this often necessitates a close relationship, sometimes contractual, with the company or government agency that owns the only mill within delivery distance. The nature of these arrangements has a direct bearing on the type and direction of environmental and development impacts associated with palm oil production.

At the miller's level
Processing of fresh fruit bunches requires very high capital investment and scale. In some regions, millers are often faced with the risk of operating below capacity.

Traceability of fresh fruit bunches is the biggest challenge for millers when it comes to certified palm oil because in many cases, millers don't buy directly from producers. It is very common to have traders as intermediaries in South East Asian countries. These traders make traceability of FFBs very difficult for the millers (and the auditors).

Shipper/Processor

Traceability is also a great challenge for these actors when it comes to certified palm oil. It is actually very rare to find processors and shippers who are able to work exclusively with these types of oil.

Among the exceptions, New Britain palm Oil is a company who has managed to achieve 100% certification by integrating its full value chain (New Britain Palm Oil Limited Sustainability report 2010/11) and achieve full traceability.

I. C. 3) What has been the impact of RSPO standards on the top and the bottom of the supply chain?

Not all the actors of the supply chain have been impacted evenly after the emergence of the RSPO: those at the bottom and at the top of the supply chain are the ones who have been most exposed to the emergence of the concept of sustainable palm oil.

Those who have significantly been impacted by the emergence of RSPO standards are the following:

1) Manufacturers and retailers

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Because the sell directly to end-customers, retailers and manufacturers have been impacted by the emergence of the RSPO. This direct relationship with the end-customer has made them the perfect targets for civil society organizations who have put a lot of pressure on them since the beginning of the year 2000s.

WWF published the 2011 Palm Oil Buyer's Scorecard\(^\text{36}\) where the organization assesses 132 multinationals operating in Europe, Japan and Australia "against four areas which show whether or not these companies are acting responsibly" with regards to Palm Oil consumption:

- Being an active member of the RSPO;
- Making a public commitment to RSPO-‘certified sustainable palm oil’;
- Disclosing how much palm oil they use;
- Showing how much of the palm oil they source is RSPO-certified."

This scorecard is a clear way to ensure multinationals commit to sustainable palm oil and respect this commitment.

In 2013, several global companies have committed or renewed their commitment to source palm oil from sustainable sources only. Dunkin Donuts is one of the most recent examples and has committed to use 100% RSPO-certified palm oil by the end of 2015.

These public announcements further increase the pressure on retailers and manufacturers who have not yet committed to source RSPO-certified palm oil and who sell on these markets.

2) Millers

\(^{36}\) WWF. "2011 Palm Oil Buyers' Scorecard," Web (2011), last retrieved from the web on April 3rd:
http://wwf.panda.org/what_we_do/footprint/agriculture/palm_oil/solutions/responsible_purchasing/scorecard2011/
The millers who sell palm oil to customers (retailers and manufacturers) demanding certified sustainable palm oil have experienced great changes since the emergence of RSPO standards. Because they are the ones who produce the certified palm oil, they have to ensure that the fresh fruit bunches they process have been produced according to the RSPO Principles and Criteria. This means that it is the responsibility of the mill to ‘prove’ that the oil they produce can be certified. Traceability poses the biggest challenge for them: they might not always know where the fruits they process come from because traders will act as intermediaries between the farmers they source from and the mill.

Mills who want to produce certified palm oil while buying fresh fruit bunches from outgrowers are faced with the following choice: whether to help the outgrowers they buy from to produce fruit according to RSPO standards or to stop buying from sources they cannot guarantee as certified.

In the recent years, many millers have been impacted by the RSPO standards because of the increase in demand in RSPO-certified palm oil in various regions of the world.

3) Producers of fresh fruit bunches – Along with the mills, they are the actors that have been directly impacted by the emergence of RSPO certification.

The Producers include plantations and smallholders.

Plantations

Most plantations in South-East Asia also possess a mill, as it is critical to process the fruit shortly after it has been harvested (cf. Figure 6 above on the supply chain). We can distinguish two types of plantations: those who only process the fresh fruit bunches produced on their lands and those who also source from external producers, i.e. outgrower smallholders or small producers who do not own
a mill. The plantations have been impacted in a similar way as the millers (given the fact that most plantations own their own mills).

Several reports have shown that the impact of certification has resulted in net benefits for plantations. For example, a report from WWF outlines that the benefits related to certification largely outweighed the costs for big plantations. Teoh Cheng Hai, Former Secretary-General of RSPO confirms the statement: “A survey that I conducted in May 2011 among nine plantation companies that collectively accounted for about 45% of total production of CSPO globally showed that implementation of the RSPO principles had resulted in considerable improvements in their triple-bottom line performance (economic, social and environmental). At the plantation level, effective implementation of best practices required by the RSPO standard had resulted in improvements in operational efficiencies and reductions in costs. At the corporate level, the respondents reported that certification had enhanced their corporate image and reputation and provided better access to international markets.”

The impact of the RSPO standards has been positive on plantations, as the resulting improvements in economic, social and environmental performance have outweighed the initial costs of achieving certification.

**Smallholders**

In analyzing the impact of RSPO standards on smallholders, we need to distinguish scheme smallholders from the rest of the smallholders (independent and associated):

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37 The research found that although potential market premiums served as the initial attraction to certification, each major category of benefits was, in and of itself, potentially capable of outweighing RSPO implementation costs. In summary, business benefits gained from adopting the RSPO Principles and Criteria typically outweigh the costs of implementation—in many cases significantly—yet often through unexpected and indirect channels”, in Profitability and Sustainability in the palm oil sector (WWF report)

- For smallholders who have a contract with mills (called scheme smallholders), certification depends on whether or not the mill is willing to support the certification process, as we will see in Chapter II. The emergence of the RSPO standards has only impacted the smallholders working with mills interested in producing Certified Palm Oil. These smallholders may have achieved certification with the help of their mill.

- For the independent and associated smallholders, the emergence of the RSPO standards has had very different impacts, according to the type of mill they sell to:

For smallholders selling to mills that were not interested in producing certified palm oil, the impact has been negligible for them. On the other hand; the impact has been significant for smallholders selling to mills willing to produce Certified Palm Oil. In some rare instances, like in the case of New Britain Palm Oil, the mill might have helped the smallholders achieve certification. In other cases, mills might have required the smallholders to become certified with limited help. For these smallholders, certification is a very big challenge, as we will see in Chapter II, and it is very likely that they did not pursue certification. They therefore had to seek for other mills to sell to because they couldn’t comply with the mill’s demand.

I. D Progress and limitations of the RSPO in 2013

Since it was created in 2004, the RSPO has made tremendous progress in terms of market share. 14% of the global Palm Oil production is RSPO certified to date. It also claimed, back in 2008, that

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its members managed more than one third of the global oil palm area. These figures are very significant and show how rapidly RSPO has been able to expand within the palm oil industry.

However, the RSPO is still limited by various factors that they need to come around before reaching their goal of “making sustainable palm oil the norm” in the global market.

The most significant limitations for Sustainable Palm Oil to become the norm so far are:

- The limited market demand for ‘certified sustainable palm oil’

- The size of the market for non-certified products

- The unsustainable financial burden of certification on independent smallholder’s shoulders

- The tension between the expansion of the standard and its integrity

I. D. 1) The limited market demand for ‘certified sustainable palm oil’

Western markets are increasingly asking for sustainable palm oil. However, these markets represent less than 20% of the consumption of palm oil and only a fraction of the actual consumption is sourced from sustainable sources. In 2010, supply of sustainable palm oil exceeded demand: a significant fraction of the sustainable palm oil produced could not find a buyer. A BBC Food Program research in 2011 showed that even the paper certificates for Sustainable Palm Oil were not finding buyers. An extract from this program can be found in Annex 3.

Given the patterns of the market, a question that is often raised by the experts and the media is the following: ‘Is there actually a demand for certified sustainable palm oil?’ This question is provocative.

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(because there is a demand) but it can be interpreted as: ‘Is the demand sufficient to generate the necessary changes in the industry?’.

Although many experts argue that multinationals like Unilever might accelerate the uptake of Certified Palm Oil in huge markets like China and India, as they drive their requirements through their supply chain, the future size of market for Certified Palm Oil is very uncertain. There is therefore a high perception of risk on the smallholder’s point of view when it comes to deciding whether or not they should become certified.

I. D. 2) The size of the market for non-certified products

Because most of the palm oil produced is used in markets where sustainable palm oil is not a requirement, most producers of palm oil do not feel concerned with certification.

They do not have direct incentives to achieve certification, because it is not likely that they will find a mill willing to pay a price premium for it. These producers might be interested in implementing the best agricultural practices that the RSPO promotes in order to increase their yield or the quality of their fresh fruit bunch but the certification in itself has no direct benefit for them. Until the market demand shifts, Certified Palm Oil will remain the exception and incentives for producers will remain scarce.

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“How long can we keep growers committed to evolving the sustainability agenda if demand [for certified sustainable palm oil] does not increase?” declared Darrel Webber, secretary general of the RSPO on March 17th, 2013 in a British newspaper.

I. D. 3) The unsustainable financial burden of certification on independent smallholders’ shoulders

It is questionable whether or not the emergence of global standards in the palm oil supply chain will affect the smallholders’ competitiveness in the palm oil industry. This will be further discussed in Chapter II.

Nonetheless, because the RSPO ambitions to ‘make certified sustainable palm oil the norm’, the certification of smallholders should be made achievable. However, certification of independent smallholders has been pointed out as not being sustainable as they have to bear a cost and a responsibility that is often judged as too important and with little guarantee of paybacks.

The following statement summarizes this point very effectively: “Private standards like RSPO effectively hand over the responsibility for sustainability (including environmental protection and human rights issue) to the private sector where it is passed upstream along the value chain. This discharges governments, lead firms and the international community from their liability regarding sustainable development and puts the burden on the producers themselves as they are the ones who have to comply with the standard (...) When smallholders have to take over this responsibility and

44 TheGrocer.co.uk, “Sustainable palm oil needs stronger market signals”, (2013), last retrieved from the web on April 15th, 2013: http://www.thegrocer.co.uk/opinion/letters/sustainable-palm-oil-needs-stronger-market-signals/237936
the related duties, (...) it is questionable whether this development is in the spirit of a sustainability initiative.

By putting this burden on smallholders’ shoulders, the palm oil stakeholders are releasing a lot of pressure on the most vulnerable actors of the value chain. This contributes to making the RSPO certification unsustainable and perceived as risky for many producers.

I. D. 4) The tension between the expansion of the standard and its integrity

The RSPO aims at being an inclusive organization and at changing the market in order to make “certified sustainable palm oil” the norm. This diffusion strategy, as well as the total absence of discrimination when it comes to membership, has made the RSPO the target of severe criticism in the past:

For example, the Rainforest Action Network, one of the RSPO’s main critics, often blames the RSPO of not taking corrective actions when it is obvious that its members are not fulfilling their obligations. Other sources have also criticized the RSPO for being slow in responding to violations of production standards (mainly peatlands clearance that emit a lot of CO2 emissions).

However, the RSPO has been more reactive to these critics in the past few years, as the recent example of illegal peatlands clearance in 2011 near Sampit in Indonesia’s Central Kalimantan province illustrates. In this case, the RSPO reacted rapidly to a situation where one of its members

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45 Dallinger, J., “Oil palm Expansion in South East Asia: trends and implications for local communities and indigenous people - Chapter 1: Oil Palm Development in Thailand: economic, social and environmental considerations”, Forest Peoples Programme and SawitWatch report series (n°6), (2011), page 46


had openly violated one of the RSPO Principles. The company in question had violated the second principle of the RSPO (Compliance with applicable laws and regulations) by clearing peat forests without securing the licenses required by the Indonesian government.

Managing the tension between sustainability and diffusion is a challenge the RSPO has to face, like many certification agencies have already been confronted to.

In this first chapter, we introduced the context that led to the emergence of the RSPO, identified the impact of the RSPO standards on the main actors of the palm oil industry and presented the current limitations of the RSPO. This will serve as a basis for the previous chapter which will focus on the challenges certification implies for smallholders.

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48 The Marine Stewardship Council or the FairTrade Committee have also been exposed to severe criticisms for the same matter.
Chapter II: Understanding the challenges posed by certification from the smallholder's point of view

The certification of smallholders is a challenge RSPO has been faced with since its foundation in 2004 and the Roundtable is still working on the improvement of the process to date. Indeed, if the RSPO seems to have found a satisfying certification scheme for smallholders who are contractually bonded to mills (schemed smallholders), the Roundtable is still struggling on implementing certification among smallholders who are not bonded to mills contractually.

Various factors such as a limited access to financial resources and little awareness about new technologies and best practices make it difficult for the smallholders to meet the RSPO requirements. This puts them at a disadvantage compared to larger producers. In this chapter, we will first introduce the distinctions that exist among the smallholders and provide a thorough definition for each type that are: the scheme smallholders, the associated smallholders and the independent smallholders (Part A). We will then review the Standards & Principles that have been put in place for the scheme smallholders and for the independent smallholders (Part B). Having done this, we will analyze the main bottlenecks that exist today for the certification of smallholders, in particular associated and independent smallholders (Part C). We will eventually ask the following question: do smallholders really risk becoming excluded from the supply chain if they cannot access certification (Part D)?
II. A What are the different categories of smallholders and how can we apprehend the diversity of their situation and challenges?

II. A. 1) Understanding the diversity of smallholders

Regarding smallholders, the RSPO has developed a clear distinction between scheme and independent smallholders. Another intermediary type of smallholders is the ‘associated’ smallholder.

Here are the characteristics of the three types of smallholders:

**Independent smallholders**: “In the context of RSPO systems, independent smallholders while very varied in their situations are characterized by their: freedom to choose how to use their lands, which crops to plant and how to manage them; being self-organized, self-managed and self-financed; and by not being contractually bound to any particular mill or any particular association. They may, however, receive support or extension services from government agencies.”

If independent smallholders are, in theory, free to sell to any mill and thus able to negotiate higher prices, reality is usually less appealing: they do not have guaranteed market access and they might not have an important buyer base (and thus an important bargaining power) in the case mills are scattered.

**Scheme smallholders**: “Scheme smallholders, while also very diverse, are characterised as smallholders who are structurally bound by contract, by a credit agreement or by planning to a particular mill. Scheme smallholders are often not free to choose which crop they develop, are supervised in their

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51 The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010), page 7
planting and crop management techniques, and are often organized, supervised or directly managed by the managers of the mill, estate or scheme to which they are structurally linked\textsuperscript{52}.

Scheme smallholders are often referred to as ‘plasma’ smallholders in Indonesia. This shows how incorporated to the mill scheme smallholders can be.

Figure 8 synthesizes the relative advantages and disadvantages for scheme and independent smallholders.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Scheme smallholders</th>
<th>Independent smallholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guaranteed market access</td>
<td>Free to seek highest prices for fresh fruit bunches</td>
<td></td>
</tr>
<tr>
<td>Access to inputs such as planting materials and credit</td>
<td>Able to shift labour and other inputs between palm oil and other crops depending on prices</td>
<td></td>
</tr>
<tr>
<td>Rapid access to new technologies enabling high-end productivity</td>
<td>Low costs of inputs</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disadvantages</td>
<td>Can suffer over-dependence on a single crop with price volatility</td>
<td>Risk that mill will not buy Fresh Fruit Bunches</td>
</tr>
<tr>
<td></td>
<td>Less flexibility in land use and labour allocation</td>
<td>Reduced access (and risk aversion) to credit and technology</td>
</tr>
<tr>
<td>Hierarchical and rigid arrangements often limit farmer decision-making</td>
<td>Often viewed as unreliable by mills that purchase fresh fruit bunches</td>
<td></td>
</tr>
</tbody>
</table>


Figure 8: Advantages and Disadvantages for independent and scheme smallholders\textsuperscript{53}

**Associated smallholders:** Associated smallholders are the intermediate type of smallholders who do not have any contractual obligations with the mill, have ownership on their land and decide what to produce on it but who depend on a specific mill because it is the only mill they can sell their fresh fruit bunches to.

This type of smallholders can be found in most countries in South-East Asia but are very common in Papua New Guinea, because the situation of smallholders there is they often have one unique mill to sell to. The definition of associated smallholders given by the RSPO was actually created by the **RSPO Papua New Guinea Interpretation Working Group**.

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54 The Papua New Guinea National Interpretation Working Group has developed the following interim definition of smallholders in the country. "Associated smallholders retain legal authority over their land and farming systems choice without any mandatory or contractual obligations to the mill. In most cases, the milling company represents the only available FFB market. The milling company and the statutory extension service have a significant level of responsibility for supporting and encouraging the smallholders in being able to meet RSPO requirements. Credit from financial institutions and milling companies is unsecured and land cannot be forfeited for default on repayment or other non-compliance" (rspo.org)
II. A. 2) The weight of palm oil smallholders in the major producing countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage of Area under Smallholders</th>
<th>Percentage of Production under Smallholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>44%</td>
<td>33%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>41%</td>
<td>-</td>
</tr>
<tr>
<td>Nigeria</td>
<td>-</td>
<td>80%</td>
</tr>
<tr>
<td>PNG - Papua New Guinea</td>
<td>42%</td>
<td>35%</td>
</tr>
<tr>
<td>Thailand</td>
<td>76%</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Improving the livelihood of Palm oil smallholder (The World Bank, IFC report) based on Teoh 2010 and Veneulen and Goad 2006

Figure 9: Weight of palm oil smallholders in the major producing countries

The weight of palm oil smallholders (including scheme, associated and independent smallholders) in production and land occupation is very high in the major producing countries. The smallholders are an essential component of the supply chain and need to be included in the RSPO certification process if the RSPO wants its vision to become a reality.

II. B Implementation of Principles and Criteria for the Certification of Smallholders

II. B. 1) The importance of having specific Principles and Criteria for Smallholders

Since its creation, the RSPO has identified certification of smallholders as a challenging issue, as Rikke Netterstrom mentioned during the interview I conducted with her. Because of the weight of smallholders in terms of total production and of area cultivated, it is critical for the RSPO to tackle the smallholder certification issue if they want to make Sustainable Palm Oil the norm.

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55 The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010), page 7
The RSPO recognizes that smallholders are a particular case and cannot be assimilated with the bigger plantations. For this very reason, the RSPO developed specific guidance and indicators to help smallholders become certified “to provide a workable and equitable means by which smallholders can get their produce certified so they are not unfairly excluded from the emerging market in RSPO-certified palm oil”.

In order to develop this special guidance and indicators, the RSPO's General Assembly created the Task Force on Smallholders in 2005. The mandate of the Task Force was to “ascertain the suitability of the RSPO Principles & Criteria for smallholders and make proposals on how best these can be adjusted, nationally and/or generically, to ensure favorable smallholder involvement in SPO production”. In other terms, the Task Force was responsible for developing adjusted RSPO standards for smallholders as well as for ensuring smallholders would be represented in the RSPO process. The Task Force approved specific indicators and guidance for scheme smallholders and independent smallholders respectively in July 2009 and June 2010.

II. B. 2) The Principles and Criterias for smallholders: how are they different than the ones for plantations?

After the Principles & Criterias implementation guidance for plantations were approved in 2007, it took the RSPO two more years to develop the same for scheme Smallholders and an extra year to develop those for independent smallholders, which are still in the phase of work in progress.

The principles and criteria developed for smallholders were made in the spirit of “simplification without compromise”, in Daniel May's words. This means that, in essence, the Criterias are the same


as for estates but that the indicators and guidance were developed in order to facilitate their implementation. This simplification has reduced the complexity of the procedures and decreased the audit costs that the smallholder would have to bear.

The experts I have interviewed listed the following examples of differences regarding independent smallholder certification and estate certification: audit of High Conservation Value (requiring a professional auditor for estates and not for smallholders\(^8\)) different rules for the use of pesticides or fertilizers, and child labor. For the latter, one expert\(^9\) declared “You cannot tell independent smallholders not to have their children help them out in the field. But we have some guidance about what the children can do, safely. However, at the estate level, you’ll have a total ban on child labor”.

It seems that significant trade-offs have been made in order to make certification achievable to independent smallholders. The example of allowing child labor is quite interesting, since it conflicts with the common vision we have of sustainable and ethical practices. As many experts have pointed out, banning child labor would not be realistic, given the existing practices. But we can ask ourselves: isn’t it the role of the RSPO to set high standards, or at least to provide a step by step guidance towards better practices.

**II. B. 3) The future of smallholder certification: linking certification with livelihood and daily life?**

After the Criteria and Principles for scheme and independent smallholders were approved, the Task Force for Smallholders was replaced in the middle of 2012 by the Smallholder Working Group. The mandate of the Smallholder Working Group is “to ensure that smallholders improve their livelihoods

\(^8\) Based on the interview I conducted with Daniel May
\(^9\) Based on the interview I conducted with Rikke Netterstrom
by benefiting from RSPO standards and best practices. Petra Meekers is currently the Co-Chair of the Smallholder working group and explained to me that the mandate of this newly created group was extension of the work the Taskforce started: “Our mandate is to look at the reality smallholders are facing regarding certification and to work on making the standard to reflect and integrate with the daily challenges of the smallholders. It has been recognized that the current criteria are workable but that there needs to be a form of organized guidance for a successful certification. And we see that if we want to increase the number of certified smallholders, we do have to look at how best we can link the standard to the smallholder reality (...), create frameworks whereby it is easier for smallholders to handle the initial steps of certification”.

This change of mandate gives a signal that the RSPO is now addressing the issue in a more holistic way: it is no longer smallholder certification only that is discussed but the impact certification can have on their livelihood and daily lives. We will see in chapter III that this is crucial to the success of certification for smallholders.

However, a lot of progress needs to be done before making the business case that certification increases livelihood. We will now look at the certification modalities for smallholders and identify the main bottlenecks.

II. C Certification of smallholders: understanding the situations

II. C. 1) Certification of scheme smallholders

For scheme smallholders: the certification fully depends on the mill they are contractually linked to.

There are two distinct situations:

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62 Based on the interview I conducted with Petra Meekers
a) First option: The mill or plantation they are linked to wants to be RSPO certified.

If the mill is interested in becoming certified, it is their responsibility to ensure that the scheme smallholders they are working with abide by the certification standards at most three years after the mill has received the certification.

The RSPO decided that scheme smallholders should be assisted (technically and financially) by the scheme manager: “As it is the mills which are seeking certification for the production from their supply base and as the mills and associated estates have direct structural relations with the smallholders on the schemes that supply them, the main responsibility for ensuring compliance with this standard falls on ‘scheme managers’. Such scheme managers will range from mill owners, through nucleus estate managers to government agencies or even traders 63".

The support provided by the mills or plantations to scheme smallholders is substantial.

We will study the case more in details in Chapter III but this is the kind of support New Britain Palm Oil provided to 8000 smallholders they helped become certified in Papua New Guinea: “credit, training, support and supervision in agricultural management techniques and sustainability 64".

This gives us an idea of the type of investments, both in time and money, required to become certified.

b) Second option: The mill or plantation they are linked to is not interested in RSPO certification

If the mill is not interested in becoming certified, the certification process challenges are similar to those encountered by independent smallholders. As we will develop in part II. D, abiding by the standards without the support of external sources implies overcoming several bottlenecks.

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II. C. 2) Certification of independent smallholders

For independent smallholders, certification falls within their responsibility. “Independent smallholders, who may sell their fresh fruit bunches either directly or through intermediaries to a number of mills, are to be certified on their own”.

The smallholders need to bear all the costs associated to the certification process. That is the reason why the RSPO imposes that smallholders form groups in order to share the audit costs. “The smallholders need to bear the cost of certification without benefiting from the guarantee that they will access the markets that are ready to pay a premium for their fresh fruit bunches.

This is a very challenging situation where we see that:

-The bottlenecks to achieve certification are too imposing to be overcome by the smallholders on their own (II. D)

-Smallholders risk being excluded from the value chain (II. E)

II. D What are the main bottlenecks preventing the certification of independent smallholders?

The main bottlenecks I have identified for independent smallholder certification are (by order of importance):

1) The lack of financial incentives

2) The high audit costs

3) The challenges related to the creation of Certification Groups

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4) The difficulty to meet the requirements of the Principles & Criterias

5) The challenge related to traceability of their fresh fruit bunches

II. D 1) The lack of financial incentives

Today, the Palmgreen certificates are traded at a very low price that doesn't even cover for the audit costs. It is therefore difficult for independent smallholders to see a direct financial benefit from certification although, as we will see later, there are some significant indirect benefits that would merit to be put more in emphasis.

Simon Siburat of Wilmar summarizes the challenges related to the incentives quite well:

“Certification is a new thing for them, so there’s a variable reception. Some are very conducive and see the benefit. Others don’t. They’ll see these costs eating into their profits, and ask, at the end of the day, what will this do for me? We’re hoping they’ll get a premium out of this, but we can’t answer how much – because the market can’t assure us.”

Because of the state of the market, it is very difficult for independent smallholders to believe that certification will bring them interesting financial benefits. During the interviews I conducted with several palm oil experts, my belief was confirmed: there is no direct financial incentive to date deriving directly from RSPO certification and it is very hard to predict if there will be any in the near future.

II. D. 2) The high audit costs

The audit costs to become certified can be a deterrent for independent smallholders.

The Taskforce on Smallholders has tackled this issue by designing the certification scheme for independent smallholders as a group scheme: “As the costs of audits are likely to be too high for any
one smallholder to afford, the Task Force on Smallholders and the Certification Working Group have recommended that a Group Certification Protocol should be developed to allow independent smallholders to share these costs. This recommendation is actually an obligation as the certification scheme only allows for groups of smallholders to achieve certification, not independent smallholders.

II. D 3) The challenges related to the creation of certification groups
According to the RSPO rules, independent smallholders can only be certified if they are part of a group. From a financial point of view, the group system is the best system to follow. In Indonesia, it has also been demonstrated that the formation of farmer cooperatives plays a significant role in the increase of livelihood of farmers. However, this poses significant cultural challenges to independent smallholders. For instance, some farmers have always been independent and do not see the interest in becoming part of a group, as well as other challenges including “effective administration, communication and ensuring fair representation of all members.”

II. D. 4) The difficulty to meet the requirements of the Principles & Criterias
While plantations are already using agricultural and management best practices the RSPO Principles require, smallholders are not readily able to meet those requirements. Therefore, smallholders need to invest much more effort and time than plantations do in order to meet the criterias and prepare for an audit.

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72 Quote from an interview I conducted with Daniel May: “The difficulty [about group certification in Thailand] was to convince the farmers who had been independent for 30 or 40 years to become part of a group of the interest of forming a club and losing their independence.”
While scheme smallholders can benefit from the financial and technical support of the estate or mill they work with, independent smallholders can only rely on themselves (and, in some contexts, the government, as we will see in Chapter III): “With independent smallholders, they’re nobody’s child; they’re basically on their own”, declares Simon Siburat of Wilmar, a Singaporean based agribusiness company.

“Independent smallholders are often less productive [than scheme smallholders and plantations]; studies have identified elements of inefficiency that include maintaining old oil palms too long, using smallholders’ own (low-quality) seedlings, applying insufficient amounts of fertilizer, harvesting unripe fresh fruit bunches, and not having strong data management systems.

Implementing Sustainable Management Practices required for the RSPO certification is harder for independent smallholders than for scheme smallholders because the level they are currently at is lower. If we add the fact that they do not receive support from the mills or estates in most cases, we understand how unfavorable their situation is with regards to achieving certification.

II. D. 5) The difficulty to trace the products
Another important characteristic of smallholders in the context of the overall palm oil industry is the role of smallholders in certification. Several companies have become RSPO certified in recent years: either achieving certification on a specific (segregated) portion of their supply, or by producing a given amount of sustainable palm oil and receiving corresponding certificates (“book and claim”). Achieving full certification that includes all smallholders, however, poses significant challenges for companies in terms of ongoing compliance – especially with independent smallholders. These
challenges include the cost of monitoring compliance and the difficulty of ensuring traceability in a shifting supply base.

II. E Is the risk of independent smallholders’ isolation from the value chain a valid concern?

The concern of independent smallholders being excluded from the value chain is often addressed and, before looking at how we can make certification possible, it is important to understand what the arguments in this debate are. There are usually two major uncertainties put forward in this debate and we will bring some points of comparison with other certification process to try and enrich the analysis.

II. E. 1) Risk n°1: certification could become a market requirement in the medium run

**Argument against**: ‘As long as there is a significant demand for non-certified palm oil, independent smallholders will find mills that are ready to buy their fresh fruit bunches’. This argument has been made by various experts in interviews conducted for this thesis. They didn’t believe in the threat of independent smallholders being excluded from the market, at least in the medium run.

**Argument in favor**: other experts have made the point that, as CSPO’s market share increases, independent smallholders will find it harder to find buyers and might eventually have to sell their fresh fruit bunches at a discount. This could result in a significant loss in terms of revenue opportunity and bargaining power.

What can we learn from other standards?

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77 The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010), page 9
78 “As global demand for ‘certified sustainable palm oil’ (CSPO) increases, these small farmers could find themselves excluded from the global CSPO supply chain”, in: Wild Asia (Malaysia), A review of Smallholder Oil Palm Production, Challenges and Opportunities for Enhancing Sustainability. A Malaysian perspective, White Paper, 2012, page 5
In 'Local Enterprises in the Global Economy', the authors argue that, although the standard is initially voluntary, compliance becomes necessary in certain markets, "either for competitive reasons or as a consequence of regulatory demands". The standard therefore becomes a market requirement. The paper focuses on the implementation of the ISO 9000 standards in Pakistan and demonstrates that the of small firms chosen was able to successfully adopt these standards, thanks to the support of external actors (institutions, external buyers) but also because they risked losing their biggest market in the short-run, if they didn’t. For palm oil smallholders, there is no immediate threat to lose markets (or at least, smallholders will still be able to find a buyer that is within their perimeter). This could be a risk because smallholders don’t feel the urgency to act and when they realize they should have taken the leap because certification will have become a market requirement, it could be too late.

In ‘Global Value Chains’, Gereffi points out the inherent challenges to having a gap between the requirements for the domestic market and for the export market. Without coordination from the buyers requiring high standards in production, it becomes a challenge for the supplier to satisfy the buyer. This parallel is interesting because the demand for certified palm oil is negligible in palm oil producing countries and the smallholders need to understand what is required from them in terms of standards, without experiencing the need for it in their daily lives.

Risk n°1 could become a threat in the medium run for smallholders

It is this sense of urgency that the palm oil industry is lacking; for now, there are no tangible risks (the demand for non-certified palm oil still dominates marginally) in the short-run but I argue that,

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slowly, in certain markets, certification will become a requirement and that some smallholders serving these markets will have to become certified or find other buyers. These other buyers might be harder to reach and might use their bargaining power to negotiate the price of the FFB at a discount.

II. E. 2) Risk n°2: certification could entail losses in competitiveness for independent smallholders

Arguments against: the RSPO is working on making the implementation of Principles & Criteria more accessible to the smallholders and announced that it would create a fund to help smallholders finance the audit. This argument has been put forward by the RSPO and some interviewees.

Arguments in favor: certification of smallholders incurs operational and audit costs that smallholders are not likely to recover if their revenue does not increase once they sell certified FFBs.

What can we learn from other standards?

An interesting parallel can be made with the example of small firms in the leather industry in India. A paper by Tewari and Pillai states that these firms were able to comply with new stringent standards without compromising their cost competitiveness. A major factor that enabled them to remain competitive was the role of the Indian government who helped diffuse the standard and who created a "negotiated collective action" towards collaboration between the public and private actors.

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In the case of the Pakistani implementation of ISO 9000 written by Nadvi (cf. paragraphs above), buyers were still more aggressive in seeking lower prices\(^3\) and certification did not provide any improvements in their revenue. This is an interesting parallel for palm oil, given that the buyers are very price sensitive and unwilling to pay a price premium for a commodity. It might well be the case that buyers continue seeking the lowest price possible for palm oil, whether it be certified or not.

**Risk n°2 could become a threat to the success of certification**

Obtaining a price premium for ‘certified sustainable palm oil’ has proven difficult in the past years, because buyers want a commodity like palm oil to remain cheap. On the other hand, large buyers (such as Unilever) are committing to 100% CSPO by 2015 or 2020. Smallholders who decide to take the leap of certification will very likely experience no increase in the price they receive for their FFB. Because of the initial investment that certification represents for them, they will be worse off than if they hadn’t gone through the certification process and sold it to a buyer that didn’t require the FFB to meet the standards.

**II. E. 3) The importance of smallholder certification after assessing the risks**

Although some argue that these risks are negligible, they should be taken seriously. In the medium run, access to certification should be made more accessible to smallholders because:

- Smallholders represent a significant percentage of the production in most producing countries
- The ‘weakest’ actors risk losing competitiveness and market access, while the ‘strongest’ will be able to thrive.

This is not compatible with the vision of the RSPO that consists in making the production more ‘sustainable’ (Cf. part I. D. 3). We will see how this can be done in Chapter III and IV.

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Chapter III: Solving the collective action problem related to smallholder certification

Now that we have highlighted the importance of smallholders’ certification in the medium-run, we will investigate on the reasons explaining why so little initiatives have been started so far.

In this Chapter, we will introduce the concept of collective action problem and see how it can apply to independent smallholder certification (Part A). We will then look at initiatives that some actors of the supply chain have undertaken in order to go beyond the status quo. This will take the form of two case studies from which we will extract the best practices and analyze the reasons of success (Part B). We will then summarize the main take away in the form of a table (Part C).

III. A) How does the collective action problem concept apply to certification of palm oil smallholders?

“We no longer live in a society where responsibility for the way that agricultural commodities are produced begins and ends with the grower”. It is unrealistic to assume that the burden of certification should only be carried by independent smallholders. As we will see in this part, all the actors of the value chain have a role to play and they could actually all benefit (directly or indirectly) from smallholder certification.

III. A. 1) Introducing the concept of collective action problem

The certification of smallholders can be seen, to some extent, as a collective action problem: many actors from the value chain would benefit from certification and the improvements they imply in

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87 Interesting definitions of collective action problem can be found in these two papers:
smallholders’ performance, among which yield increase and quality improvement would be the most obvious. However, the efforts and costs associated to the certification process are too high for a single actor to undertake it alone. With little or no cooperation, nothing ends up being done, although the opportunity costs are high (the opportunities associated to the certification of smallholders).

The article summarized in Appendix 4 is about the Thai palm oil industry is very helpful in understanding the collective action problem concept.

III. A. 2) The collective action problem developed in the context of independent smallholder certification

Who are the actors in this collective action problem?

In this collective action problem, I have identified that the four main protagonists were:

(a) Retailers and Manufacturers who have publicly committed to source their palm oil from ‘certified Sustainable’ sources,

(b) Millers who wish to have quality fresh fruit bunches, with a high OER (Oil Extraction Rate), and produced in a way that respects the RSPO Standards & Principles (optional),

(c) Independent or Associated smallholders who want to increase their livelihood, and

(d) The government who is willing to increase production of palm oil in order to meet the global demand and create more wealth inside the country, as well as to encourage the sustainable development of the industry

The collective action problem "describes a scenario in which a given problem can be solved only by collective, coordinated and directed actions by a multitude of stakeholders simultaneously and in which the concerted action will initially be detrimental to the participating individuals' short-term gain. The result is that collective interests are not realized"
Why is it a collective action problem?

None of these actors has an incentive to invest alone in the certification of independent and associated smallholders because it is too costly and their Return On Investment (ROI) is too low or uncertain. However, we can argue that all of these actors would benefit directly or indirectly from the certification of the independent and associated smallholders.

What is the situation for each stakeholder and what is the benefit they could get from smallholder certification?

(a) Retailers and Manufacturers

A growing number of Retailers and Manufacturers have committed to source part or all of their palm oil supplies from ‘certified Sustainable’ sources, as we have seen in chapter I. However, the wide majority is not ready to integrate their supply chain, which would enable them to ensure that the palm oil sources are being produced according to the RSPO Standards. Instead of integrating their supply chain, they rely on mills for the certification of the palm oil. Therefore, mills have to ensure that all the fresh fruit bunches they process has been produced according to the RSPO Standards. Unilever, who is the Consumer Good Manufacturer that has shown the greatest commitment towards sourcing its palm oil from sustainable sources, has simultaneously divested from all the palm oil plantations it owned. Unilever had plantations in Ghana, Ivory Coast, Democratic Republic of Congo, Malaysia and Thailand and therefore transferred the responsibility of certification to the palm oil plantations.\[88\] The press declaration of Patrick Cescau, then CEO of

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Unilever, is quite eloquent: "Suppliers need to move to meet the criteria, by getting certified both the palm oil from their own plantations and the palm oil they buy from elsewhere".

When asked about the role manufacturers could play in terms of smallholder certification and integration of palm oil in their own supply chain, Rikke Netterstrom, who has worked as a consultant in evaluating the potential of a project with these components, replied:

"I am not saying that is impossible and I believe it can be done on a one-time basis but I am not convinced it can ever be the driving force [in the industry]. I looked into it with a client company and we basically came up to the conclusion that the complexity of the project and the upfront investment for the retailer would be far too big. So I believe it will be done only in a few niche markets. We even had a producer who was willing to support it. So it can be done but I think it’s a step too far in the future. It’s a nice dream”.

The Retailers and Manufacturers would benefit from the inclusion of smallholders from a CSR point of view (direct) and from a higher quality of the palm oil they source. But integrating smallholders in their supply chain would require high investments in capacity building and traceability, which would result in high costs to source palm oil, which they still consider as a commodity, and are not willing to pay a price premium for.

If the responsibility was shared between them and the other three stakeholders identified above (millers and plantations, smallholders and government), it is more likely that manufacturers would be willing to act. But, in the absence of coordination and cooperation, they prefer to leave the responsibility to the plantations and millers to source their palm oil from sustainable sources.

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90 Compared to the benefits derived from controlling its own sustainable palm oil supply chain (mainly brand image and good reputation)
Providing support to the independent smallholders they source their fresh fruit bunches (FFBs) from can be challenging and extremely costly. The challenge comes from the fact that most mills are not always able to trace the independent smallholders they source the FFBs from. This is even more true when traders and middlemen collect the fruits from different smallholders without segregation and then sell it to the mills, like it is common in Indonesia. And even when mills are able to trace the smallholders they source their fruits from, the cost of capacity building required to help smallholders become certified is extremely high.

When asked about the profitability of capacity building to help smallholders become certified, Rikke Netterstrom replied: “The problem is that for the estate, [the return they get from smallholder certification] might not be enough for them to justify the absolutely humongous resource outlay required. I mean it’s fine for companies like NBPOL (cf. case study in III. B. 1) who aims at being fully traceable and sustainable but it’s more problematic when you talk about those that are focused on the ROI, who are probably never going to be 100% certified, leaving out small holders would be a lot easier and a lot cheaper for them”.

Millers and plantations would always benefit from better quality fresh fruit bunches and an increasing number of them are also seek for fruits produced according to the RSPO standards. They would directly benefit from smallholder certification. However, the certification of independent smallholders is not a responsibility they are willing to take on their own, in most cases. The independent smallholder is actually the last producer they will have certified if they choose to be 100% certified.

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91 Based on the conversation I had with Rikke Netterstrom
Another option they have is to stop working with independent smallholders who are not certified, provided they are able to source enough fresh fruit bunches to reach capacity\(^92\).

\((c)\) Independent and Associated smallholders

As we have seen in Chapter II, there are many bottlenecks that prevent independent and associated smallholders from becoming certified. They are not able, and most of the time not willing, to make all the necessary investments to become certified because they cannot afford it or see enough benefits that would justify the investment.

In the interview I conducted with a professional working for a large palm oil producer and manufacturer, that professional explained that smallholders have a short-term approach when assessing the benefits certification can offer. Although good agricultural practices that are associated with certification have the potential for long term benefits to smallholders (such as increase in yields), the short term costs outweigh these benefits in the smallholder's assessment. Indeed, the up-front costs involved for both the certification process, as well as, operational changes\(^93\) are the elements that deter smallholders from achieving certification. The cost-benefit assessment is further compounded by the relatively low price premiums to cover certification costs and uptake in the "certified sustainable palm oil" market currently, which do not provide a significant short term financial incentive for smallholders. "Smallholders are not yet able to afford or justify the short term costs of certification given current market conditions, unlike larger companies that may have longer term objectives related to market positioning and differentiation\(^94\). To date, certification does not offer enough benefits in the short-run for it to be appealing to smallholders. However, using a long-term perspective, certification can offer benefits that would justify the certification cost.

\(^92\) Based on interviews I had with several experts.

\(^93\) Operational changes would include, for example, the construction of new facilities to store chemical pesticides due to environmental, safety or health concerns.

\(^94\) Based on interview conducted with professional working for a large palm oil producer and manufacturer.
In addition to this short-term vision, certification is a concept that is relatively new (and even unknown) for most smallholders: “Certification is a new thing for them, so there’s a variable reception. Some are very conducive and see the benefit. Others don’t. They’ll see these costs eating into their profits and ask, at the end of the day, what will this do for me? We’re hoping they’ll get a premium out of this, but we can’t answer how much – because the market can’t assure us”, declared Simon Siburat from Wilmar. Several reports, like the white paper written by Wild Asia, suggest that certification could benefit smallholders both directly and indirectly in the long run. However, most smallholders are not ready to make the investment (and most of the time, not able) without external support since the investment is too important in comparison to the uncertain benefits in the short run.

(d) Governments

Some might argue that governments have a limited capability in helping independent smallholders to become certified: they do not have the required knowledge to decide what is best for the smallholders (cf. quote from Rikke Netterstørm in the paragraph below) and they cannot impose the RSPO standards, given that they are based on a voluntary basis. However, governments have many ways of influencing the palm oil value chain. For example, the “government can make certification a licensing requirement, subsidize program participation, or promote participation through their procurement policies or by applying program standards to their own practices.”

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When asked about the role the government could play in helping smallholders achieve certification, Rikke Netterstrom believed that it had an important role to play. But she also emphasized the limitations of the government's intervention, if it was not supported by the private actors: "There sure is a massive role to be played by government. However, on their own, without channeling it through the producers, they don't stand a chance (...) they are entirely dependent on implementation by estates. But financial assistance, technical assistance, or outreach assistance from the government would be very helpful". We will see in Chapter IV that these three components are indeed critical to making certification accessible to smallholders.

It appears that governments could benefit from the certification of smallholders: the implementation of best agricultural practices would yield to an increase in palm oil production, which would increase the national production and the revenues they generate from taxes. It would decrease the negative environmental impact of palm oil cultivation as well as potentially increase the smallholder's livelihoods, both outcomes which they most certainly see as a positive.

The government of Indonesia has been the furthest on imposing standards on palm oil production: in 2011, it set up the Indonesian Sustainable Palm Oil (ISPO), which consists in "guidance to increase the global competitiveness of Indonesian palm oil whilst also bringing it under stricter environmental legislation". It is planned that the ISPO will become compulsory for all producers by December 31" 2014. The Indonesian government has set very high standards that all the producers in the country will need to respect. Provided they offer enough guidance and support, the certification gap will be easier to bridge for smallholders.

99 Based on an interview I conducted with Rikke Netterstrom  
100 PriceWaterhouseCoopers, "Palm Oil Plantation, Industry landscape, regulatory and financial overview", PwC Indonesia reports (2012), page 6
III. B. Two successful initiatives of actors from the supply chain that go beyond the status quo

Now that we have explained that our challenge can be seen through the lens of a collective action problem, we will study two cases where the actors have managed to overcome this problem. What we will learn from these initiatives will provide us a first step to build our recommendations on (Chapter IV).

We will study the most interesting initiatives that have been undertaken in order to facilitate the certification of smallholders. The first initiative will focus on the example of a certification of 8,000 associated smallholders (supported by NBPOL). The second one will focus on the first successful certification project involving independent smallholders (led by the GIZ).

III. B. 1) Certification of associated smallholders: New Britain Palm Oil Limited

a) A few elements of introduction

New Britain Palm Oil Limited (NBPOL) is a plantation company that operates in Papua New Guinea and the Solomon Island. Its activities include “all aspects of palm oil plantation management, seed production, mills, manufacturing of intermediate and consumer products”¹⁰¹. The company is very committed to sustainability and is engaged in having 100% of its supply chain of palm oil fully traceable. For this purpose, NBPOL opened a refinery in Liverpool, U.K., in 2010 where it refines certified and fully traceable sustainable palm oil. To date, 89% of the palm oil sales of NBPOL go to Europe.

NBPOL has been “involved with the RSPO since its start”\textsuperscript{102}. It is actually “a leading player in the RSPO and has set ambitious targets regarding achieving full certification”, according to an IFC report\textsuperscript{103}.

Full certification meant working with the several thousand associated smallholders they source from and help them become certified. NBPOL was publicly congratulated by the RSPO in 2010 for the work it did with these smallholders. I had the chance to interview Petra Meekers, Group Sustainability Manager of New Britain Palm Oil.

b) Context of the project

NBPOL processes 82\% of Papua New Guinea’s national production and sources more than 30\% of its fresh fruit bunches from smallholders. Deciding not to work with smallholders anymore (and avoiding the effort it required to have them become certified) was not an option: “We realized that if we were going to achieve certification, we needed to bring our smallholders with us. They’re 30\% of our industry, we couldn’t leave them behind”\textsuperscript{104}, declared Simon Lord, the Head of Sustainability for NBPOL, in 2010.

NBPOL worked with these independent smallholders not only because of their inclusive strategy but also because they needed them from a business point of view: it would have been very difficult for them to make do without them, given that they represent 30\% of their industry.

c) The challenges for NBPOL


\textsuperscript{103} The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010), page 11

\textsuperscript{104} The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010)
**Addressing a large number of associated smallholders.** In total, NBPOL was working with about 13,500 smallholders in 2010: 7,500 smallholders were long-term partners and 8,000 smallholders had just become part of NBPO's supply chain, after the company acquired 3 important plantations from Cargill. These smallholders were mainly associated.

**Motivating smallholders to increase their productivity.** While NBPO's estates produced 26 tons per hectare on average and the long-term smallholders of NBPO produced 19 tons per hectare on average, the newly incoming smallholders (from Cargill's acquisition) had a yield of about 5 tons per hectare. There was a lot of progress to make for them in terms of productivity. According to Petra Meekers, the incoming smallholders were based in a difficult region that had been affected by natural disasters and where smallholders were not interested in harvesting their block. NBPO overcame these resistances and helped these smallholders to significantly increase their yields.

d) **Reasons of success of NBPO**

NBPO deployed a lot of efforts in order to help both its historical and newly incoming smallholders to become certified.

1°* reason of success: understanding the smallholder's situation*

New Britain Palm Oil started by surveying its smallholders to check on some agricultural and social indicators that would tell them what the situation was. Based on the results of the survey, they identified the areas in which their smallholders scored well and those where they scored poorly and were able to define a roadmap for every specific region or group of smallholders. For example, they looked at where improvements were needed, where awareness needed to be created, what trainings were required, etc.

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1°5 The World Bank, FSG Social Impact Advisor, "Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector", IFC reports (2010), page 12
2nd reason of success: creating awareness around certification

NBPOL worked extensively on creating awareness about certification, environmental practices and price premium. The company diffuses weekly radio programs on provincial radio channels in order to create awareness, according to Petra Meekers.

3rd reason of success: investing in capacity building

NBPOL provided technical assistance and extension106 services to the smallholders, after identifying the areas of weakness through surveys.

In its 2010/11 sustainability report describing the capacity building of the incoming smallholders, NBPOL declared: “We developed an innovative and participatory approach, providing credit, training, support and supervision in agricultural management techniques and sustainability. The project will also involve replanting of close to 5,000 hectares107”.

The investments were significant and NBPOL is committed to continue “providing the technical, financial, and material support108” until smallholders reach a satisfying level of yield and profitability, being in line with RSPO’s Principle n°8 which is “Commitment to continuous improvement in key areas of activity”.

4th reason of success: developing partnerships with the smallholders

NBPOL has developed a partnership relationship with their smallholders. This trust relationship has enabled the certification process to go smoothly.

106 “Extension allows for better agricultural practices to be disseminated to smallholders who may not have technical agronomic knowledge or specific experience with palm oil (...) successful extension sets the ground for a certified crop.” (NBPOL Sustainability report 2010/2011)


"None of NBPOL’s smallholders are under contract to supply fruit but instead the company develops partnerships (...) Seeing and treating smallholders as partners and supporting them has allowed a healthy relationship to be established which mitigates potential disruptions from single smallholders\textsuperscript{109}.

5\textsuperscript{th} reason of success: ensuring a minimum price premium to keep smallholders motivated

In 2011, the price premium associated to Greenpalm certificates dropped from USD 10 to less than one dollar per ton. NBPOL decided to set a minimum price premium for the Greenpalm certificates in order to keep its smallholders motivated.

e) Conclusion:

"NBPOL was the first company in the world to certify all of its smallholders. Unlike many companies that have yet to certify 100\% of their fruit base and mix certified and uncertified fruit at the start of their supply chain, all fruit entering our NBPOL mills is certified and segregated\textsuperscript{110}.

This 100\% certification goal was motivated by the will to become fully traceable. This and NBPOL’s commitment to smallholders made the certification of these associated smallholders a success.

III. B. 2) Certification of independent smallholders: the GIZ’s project involving 412 independent smallholders in Thailand

This project led by the GIZ has been the only successful case regarding independent smallholder certification so far. Understanding how the GIZ overcame the difficulties is a great source of learning for my research. In addition to this, the project has proven to yield important benefits for

\textsuperscript{109} Simon Lord interviewed in October 2012, Sustainablepalmoil.org, “New Britain Palm Oil Limited Case study”, Web, last retrieved from the Web on April 11\textsuperscript{th} 2013: http://www.sustainablepalmoil.org/refineries-manufacturers/refineries/case-studies/new-britain-palm-oil-limited

\textsuperscript{110} Simon Lord interviewed in October 2012, Sustainablepalmoil.org, “New Britain Palm Oil Limited Case study”, Web, last retrieved from the Web on April 11\textsuperscript{th} 2013: http://www.sustainablepalmoil.org/refineries-manufacturers/refineries/case-studies/new-britain-palm-oil-limited
the smallholders and provide an encouraging business case. After studying this project, we can then identify best practices that can be transposed to other projects in Thailand and, eventually, other countries in South East Asia.

**a) A few elements of introduction**

The German International Cooperation (GIZ) is a development organization that promotes sustainable development worldwide. The GIZ initiated a program in Thailand where it provided technical and financial support to help 412 independent smallholders become certified. I had the chance to interview Daniel May, who coordinated the project for the GIZ.

**b) Context of the project**

The program was funded by the German government (3.5 million euros), that was looking at sponsoring a project that would help smallholders in the palm oil industry become certified in 2008, when there was a lot of controversy around palm oil and the increase in food prices.

The project lasted almost 4 years and ended in July 2012, when 412 smallholders successfully received the RSPO certification.

**c) The challenges for the GIZ**

Talking about benefits that go beyond certification, Daniel May and his team realized very early in the project that smallholders were not interested in certification or sustainability in itself. For example, they asked questions like: ‘what is the interest I have in becoming certified?'; ‘what is the price premium?'.

The project coordinators soon had to review their argumentation and decided to communicate about the other benefits than certification in itself. "When asked how farmers would benefit most from the
cooperation, they replied that they were interested in learning about farm management, fertilizer management, harvesting management. From then on, GIZ decided to focus on these issues rather than certification and sustainability-related issues that didn’t generate a lot of attention among the smallholders. This shift contributed significantly to their success.

d) Reasons of success of the GIZ

1st reason of success: Providing best agricultural practices knowledge to farmers

The first step GIZ identified was to provide farmers with agriculture knowledge. Fertilizer, water, pesticide, or harvesting management, were topics they were particularly interested in learning more. The objective was to increase the yield of their farms.

2nd reason of success: Establishing a durable and interdependent relationship between the mill and the farmers

Several mills showed a willingness to pay a price premium for higher fresh fruit bunches with higher Oil content (called Oil Extraction Rate, or OER, in the industry). This financial incentive therefore further encouraged farmers to increase the quality of their fresh fruit bunches and to develop partnerships with interested mills.

3rd reason of success: Finding buyers for certified palm oil to incentivize farmers

The mills in the area of intervention were not seeking certification and therefore didn’t care whether or not the FFB respected the RSPO standards. The smallholders mainly sold their FFB for domestic use and felt the Greenpalm certificate scheme would not benefit them either. Therefore, certification in itself was not appealing to the farmers as it would incur audit costs and additional operational costs with no guarantees of increase in revenue.

111 According to Daniel May, who worked directly with these smallholders
The GIZ had to find buyers who would be interested in buying sustainable palm oil. They discussed with Shell Thailand who showed interest in buying sustainable palm oil in the long-run (once mills in Thailand become certified) as well as Johnson & Johnson willing to buy certificates at an above-market price. Finding potential buyers who were willing to pay a price premium for certified FFBs was crucial in the success of the certification project.

4th reason of success: creating a strong business case and a positive group dynamic

According to Daniel May, the 412 smallholders benefited from a 1,1 million euro yearly income increase that can be broken in two: A million euros came from the mill (for the quality of the fruits) and 100,000 euros came from the sale of Greenpalm certificates.

The extra income from the certificates is money that belongs to the community. They have reinvested this money in additional staff that works on the documentation; they are organizing trainings, and have also started to bargain as a group with the fertilizer suppliers. “They are taking collective action to achieve something together”, declared Daniel May.

e) Conclusion:

The benefits for smallholders were significant: they accessed technical advice and support, increased their productivity and the quality of their FFBs, which in turn significantly increased their income. In addition to this, they derived several agro-ecological benefits from the sustainable management practices they put in place\(^\text{112}\).

Figure 9 summarizes the impacts and economic added value for smallholders and mills.

Impact

10-15% reduction in fertilizer costs
Yield increased 3 ton/hectare
0.1 additional Thai Baht per kg of Fresh fruit Bunch

Economic Value Added
Revenue increase 3000 USD/year per smallholder (approximately)
1-2% Oil Extraction Rate increased for mill

Source: RT9 presentation by Dr. Kukawkasem, GIZ Project on Sustainable Palm Oil Production in Thailand (2011)

**Figure 10: Summarized benefits of the GIZ Project**

The results of this certification project are very impressive. The Return on Investment is huge, if we compare the Initial Investment (approximately 3.5 million dollars) to the extra income the 412 smallholders were able to generate collectively (approximately 1.1 million dollars). However, replicating this project requires high initial investments and overcoming the collective action problem\(^\text{113}\) is a key challenge.

### III. C Take away from these case studies and limitations

#### III. C. 1) Take aways from these two case studies

Several key factors explain the success of this program. Figure 11 synthetizes these factors of success and puts them in perspective with the bottlenecks identified in Chapter II.

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\(^{113}\) “In this project everybody benefits, particularly farmers and mills, but downstream industries and the government as well. Solutions for improving the palm oil sector are available, but investments primarily in capacity building are required and must be funded. Due to increased incomes for all stakeholders, such investment will pay off!” (May, D., Nielsen, T., “Tackling the Collective action Problem in palm oil production”, (2011), *The Nation*)
<table>
<thead>
<tr>
<th>Bottleneck addressed (as identified in Chapter II)</th>
<th>GIZ</th>
<th>NBPOL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) The lack of financial incentives</td>
<td>The farmers found other benefits than certification alone. The identification of buyers of certified FFBs was a determinant factor in convincing smallholders to become certified.</td>
<td>NBPOL ensured its smallholders with a fair price for their FFB.</td>
</tr>
<tr>
<td>2) The high audit costs</td>
<td>In both cases, the smallholders didn't have to pay the</td>
<td></td>
</tr>
<tr>
<td>3) The challenges related to the creation of Certification Groups</td>
<td>The GIZ created a favorable dynamic in the group and encouraged solidarity and mutual help.</td>
<td>-</td>
</tr>
<tr>
<td>4) The difficulty to meet the requirements of the Principles &amp; Criterias</td>
<td>Guidance was provided by both actors to the smallholders. The GIZ provided best agricultural practice knowledge to the smallholders. The certification was made possible by important investments in capacity building.</td>
<td>NBPOL worked extensively on creating awareness on certification. Efforts on extension were a determinant factor in achieving certification.</td>
</tr>
<tr>
<td>5) The challenge related to traceability of their fresh fruit bunches</td>
<td>A need for a mutually beneficial partnership between the mills and the smallholders was identified as a necessary condition to success.</td>
<td>Not Applicable (NBPOL has an integrated supply chain already and produces almost 100% certified palm oil).</td>
</tr>
</tbody>
</table>

Figure 11: Factors of success of each project – addressing the bottlenecks identified in Chapter II

III. C. 2) Limitations to the case studies
As some experts have pointed out during two interviews, the example of NBOL might not easy to replicate in countries like Indonesia and Malaysia\(^\text{14}\). However, Petra Meekers pointed out that “the

\(^{14}\) Experts argue that the situation in Papua New Guinea is exceptional and different from that of Malaysia and Indonesia (different type of smallholder, freedom to choose which crop to cultivate vs. obligation by the state, etc)
system can be extended to a lot of countries and we have received recognition from various
governments that our system was interesting for them\textsuperscript{115}.

On a similar note, Daniel May mentioned during our interview that Thailand had been chosen for
the pilot because smallholders represented 80\% of the producers and had interesting characteristics.
It was estimated that it “could be a little bit easier compared to other countries in South East
Asia\textsuperscript{116}”. However, the case of the GIZ is cited extensively as the first large scale certification
program for independent smallholders and as an example to follow.

Both these case studies will give us a good ground basis to start Chapter IV where we will discuss
about the necessary conditions and recommendations to ease the certification process for
independent and associated smallholders.

\textsuperscript{115} Based on the interview I conducted with Petra Meekers, Group Sustainability Manager at NBPOL
\textsuperscript{116} Based on the interview I conducted with Daniel May, project coordinator at the GIZ
Chapter IV: Necessary conditions to make certification accessible to independent smallholders and recommendations

This chapter will be composed of three parts: in the first one (Part A), we will list three necessary conditions that have identified after synthesizing the research and interviews conducted for this thesis.

In the second part, we will identify best practices to meet these necessary conditions. These best practices will be sourced from experts’ advice, innovative projects in the palm oil industry and other certification processes that might have been confronted to similar issues. We will propose 'recommended solutions', keeping in mind that these solutions might require adaptations among contexts and countries (Part B).

At the end of the chapter, we will recognize the limitations of these recommendations and discuss the need for further research (Part C).

IV. A Necessary conditions to make certification beneficial for independent smallholders

In the previous chapters, we have identified the main challenges RSPO was faced with (Chapter I), the bottlenecks for independent and associated smallholders’ certification (Chapter II) and we have
studied two cases of successful certification of independent and associated smallholders (Chapter III).

Following these steps, three necessary conditions have been identified for the creation of benefits in the certification process of smallholders:

- Capacity building of smallholders (1)
- Guarantee of market incentives for certification (2)
- Accessibility of the certification process (audit and maintenance) (3)

These necessary conditions are explained below:

**IV. A. 1) 1st necessary condition: capacity building of smallholders to reach the level of requirements**

To achieve certification, smallholders need to implement the Principles & Criteria, to develop sustainable agricultural practices, and to become part of a group.

These two latter components are often seen as ‘benefits’ of certification but it is more accurate to see them as causes of certification. Indeed, certification is simply a recognition for these good practices that have been achieved through improvement efforts.

In order to achieve those three components and become certified, associated and independent smallholders, and the related stakeholders need to invest a lot in capacity building.

**IV. A. 1) 2nd necessary condition: create incentives for certification**

It is often argued that independent smallholders obtain many benefits from the productivity increase, the adoption of sustainable practices and sometimes the change in organization structure (formation
of groups). As we have just mentioned in the previous paragraphs, achieving these three components
is a cause of certification, not just a consequence. This observation leads to the following question:
once smallholders have succeeded in these three components, what is their incentive to become
certified?

Smallholders need to find incentives to go through the first audit process and maintain their level
over the years. Market access can be a good incentive in itself, provided the only buyers within reach
for smallholders require certified fresh fruit bunches. Certification thus becomes a requirement and
the smallholder is incentivized to achieve it. But if there are alternatives and all other conditions
remain equal, a smallholder, no matter how close he or she is to certification, will have no incentive
to become certified. And that is because the smallholder will always have the option to sell to a mill
that does not require certification. As Daniel May from the GIZ declared during our interview, there
is a need to “create benefits that go beyond sustainability”. Above all, smallholders are sensitive to
the “cost versus benefit” implications of certification.

As long as the demand for ‘certified sustainable palm oil’ remains the exception rather than the
norm, other forms of financial incentives need to be found to motivate smallholders to achieve
certification.

IV. A. 3) 3rd necessary condition: accessibility of the certification process

Once smallholders meet the requirements and find an incentive to become certified, the
implementation and audit costs related to certification should not be deterrents.

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117 Based on the interview I conducted with Daniel May
118 Cashore, B., et al., “Governing through markets: Forest certification and the emergence of Non-State Authority”,
New Haven: Yale University Press (2004), Print
Because independent smallholders (and associated smallholders, to a lesser extent) are “nobody’s child”\textsuperscript{119}, they cannot always rely on the support of greater organizations to become certified. The certification process needs to be made accessible to them along the whole process: initially (by providing access to financial support and to information) as well as on the long-run (by enabling them to maintain the level of requirements over the years).

**IV. B. Solutions to meet the three necessary conditions**

**IV B. 1) Capacity building of smallholders**

The best practices for capacity building I have identified are:

a) To provide smallholders with access to training and information

b) To give smallholders a better access to financial services

c) To empower the certification group to become a business unit

\textit{a) Provide smallholders with access to training and information}

In the beginning of the program, the smallholders who worked with the GIZ requested training on good agricultural practices (fertilizer, pesticide, yield management, etc.) Because independent smallholders have such a low yield compared to plantations, improving their agricultural practices is a priority, as well as a ‘low hanging fruit’.

“The current low yields achieved by independent small farmers provide an exceptional opportunity to significantly increase the production of CSPO from the existing planted area. With appropriate

\textsuperscript{119} The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC \textit{reports} (2010), page 7
technical support, training, extension support and management, smallholder production has the potential to reach similar levels of production as the larger estates. A better dissemination of information is also necessary. Auditors from SAI Global Indonesia recommended during a presentation at the 10th Roundtable (2012) that the RSPO provide “improved dissemination of the requirements” among the actors of the supply chain. The RSPO requirements should be accessible and better explained to producers, so that they can make their management choices in an educated way.

**Possible solution to explore: Create local centers of Excellence**

Daniel May suggested that a way to give smallholders access to training and information would be to create Centers of Excellence. These centers of excellence would be a knowledge and training hub at the local level and could be funded by various stakeholders: the group of smallholders (this is happening in the case of the GIZ Project, although they do not call it officially ‘Center of Excellence’), the millers, the traders, government institutions, etc.

Such Excellence Centers have been developed for other crops, such as cocoa or timber, and include various services ranging from training on agricultural best practices, nurseries, financial literacy, etc. They have proven to be particularly appreciated by farmers, who can refer to it as a knowledge center.

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121 SAI Global, “Challenges and Limitations of RSPO Program Audit: a review based on auditing experiences of SAI Global Indonesia”, SAI Global presentation at at RT10 (2012)

b) Give smallholders a better access to financial services

Access to credit is an ongoing challenge for independent smallholders. Garry Smith, from the FAO declares: “Access to credit is a cross-cutting issue that’s critical. Farmers don’t have registered assets against which they can borrow, and the financial system will only lend against unreasonable collateral requirements, not on cash flow. It hampers smallholder farmers”. Smallholders need access to credit for initial investments (land acquisition, clearing, planting) as well as for ongoing inputs (fertilizer and other inputs over the lifetime of the crop).

The need for credit is even higher when smallholders want to achieve certification: bridging the gap between their practices and those required in order to qualify for certification requires an additional investment. Among many more, investment in fertilizer, pesticide, replanting of trees are the most frequently cited. With little or no access to credit, smallholders are not able to proceed to those changes.

Palm oil smallholders also need specific credit terms: “the delay in the productive lifecycle of oil palm also means that these initial loans must be structured to allow deferred repayment”.

Possible solution to explore: Support access to credit and improve loan terms

Several actors could help smallholders to access credit: plantations, donors, local banks, governments, etc.

A report from the International Finance Corporation, sees opportunities for both the private sector and international donors: Plantations could offer “support to smallholder efforts to obtain credit, via either direct credit or by guaranteeing loans from local banks” while donors could “provide capital to

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promote lending to smallholders, whether through support to plantation companies or by capitalizing banks and microfinance institutions that are providing credit to the sector.\footnote{125}

Regarding the specific credit terms, local banks and governments could provide support in creating flexible loan terms (banks) and in providing cross-sectorial government subsidized scheme. The latter has already been offered by the Indonesian government\footnote{126}, whom we have seen is well in advance in terms of providing support to its producers. In India and Bangladesh, local banks and microfinance institutions have developed a wide array of flexible loan terms and this model could be replicated in other South East Asian countries for palm oil producers.

c) Empower the certification group to become a business unit

Independent smallholders can only become certified if they become part of a group. Therefore, overcoming the reluctance of some members who want to remain independent and creating a good dynamic in a group is critical in order to achieve certification. Smallholders in the GIZ project provide us with an excellent example of best practice:

\footnote{125}{The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, IFC reports (2010)}
Daniel May talking about his experience with group certification of smallholders in Thailand (cf case study in Chapter III):

"The difficulty came from the fact that we had to convince the farmers who had been independent for 30 or 40 years to become part of a group. On the one hand, we forced them a little bit, because we told them that they had to be a group in order to receive any service from GIZ. Only ten farmers left the groups in the process and the remaining 412 members were satisfied in the end when they saw the individual benefits they could receive from it. Getting them together and creating the idea of a club and collaboration took a while but I think, in the end, all of them are quite committed to it.

Actually, they started to do the documentation to track the yield they have, how much they produce per hectare. And after a while, they start identifying who has the highest yield, or the best quality and then they start to build internal trainings. The best farmers were inviting their neighbors to tell them how they do this. Today, everyone sees benefits in collaborating within a group."

The GIZ smallholders have formed a ‘cooperative’ group that is empowered to improve their livelihood through internal trainings and the reinvestment of their profit in capacity building (cf. case study in Chapter III). The GIZ initially ‘forced’ them to do so but they are now independently managing their group as a business. They offer a great example of best practice.

Possible solution to explore: Empower groups and cooperatives to become a business

As Simon Winter from Technoserve declared in an interview, organizing smallholders in groups is key to improving their productivity and sustainability: “The first question is how to give smallholders bargaining power – if you’re independent, you’re not going to get a decent deal with the buyer. But
even if you’re organized, you face general challenges of farmer groups: you need to run the group as a business\textsuperscript{127}.

The system Fedepalma has put in place offers a good example of what has been done in the field of empowering communities. Indeed, the national federation of palm oil growers (Fedepalma) in Colombia has been promoting the formation of smallholder alliances over the last 15 years. The alliances consist of a central mill operator and local smallholders that organize into a productive unit. Fedepalma, along with the mill operator, typically provide technical training to these smallholders. But it also provides trainings to develop organization and management skills: “There’s a lot of training needed on how to run a cooperative, on understanding that getting organized is useful\textsuperscript{128},” declares Jens Mesa-Dishington, President of Fedepalma. These alliances have had, at least, four positive outcomes: (1) The alliance can be used as a platform to deliver training for smallholders efficiently; (2) Economies of scale are made, both for smallholders and for the operating mill; (3) The alliance has helped in promoting social development in the area; (4) The smallholders and mills have developed new attitudes, especially in the case where smallholders have been able to buy stock from mill operators. In the latter case, smallholder’s attitude has been transformed: “they’re ready to put in all the effort to protect the business”, according to Jens Mesa-Dishington.

Empowering farmer groups to start a collaboration and even a business has proven to be very fruitful. One idea could be to link those group to a Center of Excellence where they could organize trainings, inquire information, access to inputs at a negotiated group price, etc.

\textbf{IV. B. 2) Provide market incentives of certification}

\textsuperscript{127} The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, \textit{IFC reports} (2010)
\textsuperscript{128} The World Bank, FSG Social Impact Advisor, “Improving the Livelihoods of Palm Oil Smallholders: the Role of the Private Sector”, \textit{IFC reports} (2010)
Best practices in order to create market incentives are:

a) To create financial incentives for certification

b) To create partnerships with mills

c) To find buyers for the Greenpalm certificates and to agree on a satisfying price for both parties

a) Create financial incentives for certification

Creating benefits that go beyond certification was something that the GIZ did very well: they provided training and capacity building to farmers (cf. necessary condition n°1) and created favorable market terms for farmers to receive positive financial returns out of certification. Farmers have a cost-benefit analysis approach when they weigh whether or not they should become certified. What is said in the following quote about forest certification applies very well to palm oil: “A key lesson that emerges from our story regarding the use of non-state market-driven governance systems is that forest companies and forest owners must perceive a direct or indirect economic benefit. This rather intuitive statement, widely supported by our cases, has enormous consequences. A non-state market-driven system cannot create standards that are so high that the potential benefits in support are outweighed by the costs of implementation”\(^\text{129}\).

Just as it is the case of Forest Certification, it is clear that smallholders need to perceive higher benefits than costs before they decide to become certified.

**Possible solutions to explore:** There are two possible solutions to explore – (1) creating partnerships with mills (point b below) that will guarantee market access for smallholders and –(2) finding buyers of Greenpalm certificate (point c below)

b) Create partnerships with mills

Creating partnerships with mills has been a determinant factor in the GIZ project. Solving the prisoner’s dilemma described below is a key element of success for independent and associated smallholders’ empowerment and success towards certification.

<table>
<thead>
<tr>
<th>The prisoner’s dilemma applied to the relationship between mill and independent smallholders</th>
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<tbody>
<tr>
<td>(Collaborate, Collaborate) would generate the greatest returns for both actors: The Mills invest in smallholders (eg. capacity building, trainings and assistance in becoming certified) and smallholders commit to selling their high quality FFBs to the mills.</td>
</tr>
<tr>
<td>However, the mills fear that the smallholders will defect. Investing in the smallholders requires upfront investments. If the mill helps them and the smallholders sell to competitors, the mill loses its investment and helps its competitors.</td>
</tr>
<tr>
<td>Similarly, the smallholder fears that the mill will defect: If they commit to selling to one mill, they lose the bargaining power they usually have and might not receive a fair price. Their efforts will have been vain.</td>
</tr>
<tr>
<td>Even though collaboration yields the highest payback, the players are more likely to defect, if they is not a strong trust relationship between them.</td>
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</table>

The mill and smallholder are playing a prisoner’s game that only trust and reciprocation can solve. Otherwise, as Elinor Ostrom wrote about solving collective action problems: “If participants fear that others are going to take advantage of them, no one will wish to initiate costly actions only to find that others are not reciprocating.”

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Possible solution to explore: Solve the prisoner’s dilemma by creating partnerships or trust relationships between independent smallholders and mills

Overcoming the prisoner’s dilemma can be done in several ways. I found the following elements particularly helpful in the case of our study:

- **Creating a new incentive structure**: As we have seen in the case of the GIZ, mills have committed to pay a higher price for higher quality FFBs. There is an incentive for smallholders to produce higher quality because they will be rewarded for their effort, while the mill can be reassured the smallholders will sell to them if they offer a premium that is competitive enough.

- **Creating interdependencies between mills and the smallholders**: such interdependencies would lower the probability of defect by each party. For example, mills could provide advantageous loan terms to smallholders who commit to selling their FFBs. Both parties would be incentivized to cooperate because they would be interdependent.

- **Engaging in reciprocal relationship on the long-run**: ongoing repeated games with a prisoner’s dilemma framework can prevent players from defecting if they see value in maintaining a long-term trust relationship. For example, if mills can guarantee smallholders access to markets and solve their transportation challenge (i.e. getting their FFBs to the mill within 24 hours post-harvest) on the long-run, it is more likely that smallholders will collaborate.

Simon Lord, from NBPOL, mentioned the quality of the roads as a sign from mills that “they care and are concerned about forming true partnerships” with their smallholders. These kind of long-term commitments, no matter how trivial they can seem, are critical in building a trust relationship between mills and smallholders.
When possible, mills and smallholders need to define tighter relationships to overcome the prisoner’s dilemma. This is easier to do in the case of associated smallholders, because they have a tacit exclusive relationship with the mills. Therefore, it is critical for the independent smallholders to engage in such trust relationship and to demonstrate goodwill and reciprocity if they want mills to invest in capacity building, buy their fresh fruit bunches and guarantee a higher price for quality fresh fruit bunches, etc.

In this way, smallholders and mills will follow the recommendation of Elinor Ostrom which is “to use broad strategies of reciprocity”\(^ {131} \).

Limitation: I have become aware that, oftentimes, mills do not behave in a responsible way and can decide to stop working with smallholders at any time. In this case, smallholders cannot rely on them as partners. Finding buyers of certified FFB (part c below) is then the only option they might have in the short-run. If the price premium offered is high enough, it might be worth becoming certified. Otherwise, it is very likely that smallholders will not engage in such a process.

c) Finding buyers for the Greenpalm certificates and agreeing on a satisfying price for both parties

The Greenpalm certificates have lost a lot of credibility amongst smallholders in the recent years because the price has varied so dramatically. In addition to this, smallholders need a certain guarantee on price to ‘take the leap of faith’.

This can be achieved by finding buyers of fresh fruit bunches (either mills or retailers) willing to buy the certificates at an ‘off market’ price, guaranteeing a minimum income for the farmers over the medium run. New Britain Palm Oil Limited has set a floor price for the certificates it brought from

all its associated smallholders when the prices plummeted in 2010\textsuperscript{132} and Johnson & Johnson is paying an off-market price to the 412 independent smallholders who were certified with the help of the GIZ.

**Johnson & Johnson buying Greenpalm Certificates at an off-market price: a good ROI in terms of CSR**

Offering an off-market deal to independent smallholders is what Johnson & Johnson decided to do for the project in GIZ. They offered an off market price in 2012 to buy certificates from the 412 independent smallholders certified with the help of the GIZ. Thanks to the off market deal, which covers for the audit costs, the company has been able to communicate on this initiative as part of their CSR policy. The company has gained a lot of visibility through this video they published on YouTube and the LinkedIn page of the RSPO. Such an off market deal has enabled them to differentiate themselves from their competitors and to communicate extensively on it.

Such agreements on a minimum price increase the confidence independent smallholders have in the certificate system and would make them more likely to “take the leap of faith” and work towards becoming certified.

**Possible solution to explore: Set a minimum price for Greenpalm certificates**

In order to provide medium term financial incentives to smallholders, a floor price could be set by the buyers of the GreenPalm certificates, either:

- **At the RSPO level**: A floor price has been set for the whole *FairTrade* coffee industry when the price markets were low. This floor price would have to be set by all the stakeholders concerned, as it was the case for FairTrade coffee: “Floor prices were established after considerable field research and several rounds of negotiation between representatives of the Fair Trade movement, farmers, and the

\[\text{\textsuperscript{132} New Britain Palm Oil Limited, “New Britain Palm Oil Sustainability Report 2010/11”, } \textit{NBPOL Sustainability report}, \text{ (2010)}\]
coffee industry. Farmers, the RSPO and the rest of the palm oil industry should therefore at the same table and agree on a minimum price of certified FFB.

-At the local level: A price smoothing effort has been put in place in Uganda which consists of an agreement between the government and a consortium for private sector oil palm plantations (called OPUL). This agreement lays out a pricing formula at which farmers can sell their fresh fruit bunches and that is calculated in such a way to ensure a fair and relatively stable income over time. This price smoothing method could be extended to the Greenpalm certificates. It has not been done in the Greenpalm system, to my understanding. If it were implemented, it might require the intervention of the government or local authorities.

Setting up a fair price would increase the incentives for smallholders to become certified and give more legitimacy to the Greenpalm certificate scheme, which has been highly criticized. For example, regarding these certificates, Nick Thomson, CEO of NBPOL declared: “Paying fifty US cents per ton to a palm oil producer who does not have access to a segregated supply chain via an offset certificate, whilst the same consumer pays an unsustainable palm oil producer eleven hundred dollars per ton makes no sense to me at all.” The Greenpalm certificates have been traded at prices that are so low that they have lost their credibility. It is very hard to convince the smallholders to ‘trust’ the market when they learn how low such certificates can be traded at. A floor price would help smallholders become more confident that they can extract value from the Greenpalm certificate scheme.

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IV. B. 3) Making the certification process accessible

Best practices for this third necessary condition are to:

a) Limit audit costs smallholders have to bear

b) Make the certification process easier for smallholders

a) Limit audit costs smallholders have to bear
Even if smallholders qualify for certification, audit costs can still be a deterrent. Their cost-benefit analysis approach combined with the fact that they have a shorter-term perspective, in comparison with larger organizations, make the audit costs an additional obstacle towards certification. Various stakeholders have a role to play in this situation. In some cases, mills might want to pay the upfront audit costs, like NBPOL did for all its associated smallholders. In other cases, retailers and manufacturers might cover for the costs. This is what Johnson & Johnson has done, indirectly, by offering an off-market price for FFBs that would cover the audit costs.

Possible solution to explore: Create innovative solutions to support smallholder certification

The RSPO has recently announced\textsuperscript{136} the creation of a Fund for Smallholders. Although little has been said on it officially, it appears that its main mandate will be to subsidize the audit for independent smallholders\textsuperscript{137}. This would be very helpful indeed but it has not yet been officialized. In addition to this, the size of the fund might not be sufficient to support all the smallholders that could benefit from becoming certified.

Engaging a wider range of stakeholders in funding the audit is an interesting idea, too. I have become aware of this option looking at several examples from the Marine Stewardship Council. The MSC

\textsuperscript{136} FoodNavigator.com. "RSPO introduces smallholders support fund." (2013), last retrieved from the web on May 4\textsuperscript{th} 2013: http://www.foodnavigator.com/Financial-Industry/RSPO-introduces-smallholders-support-fund

\textsuperscript{137} Based on the interview I conducted with Daniel May
encourages and facilitates these types of funding initiatives, according to Stéphanie Poey, the Head of Communication for the MSC French branch, whom I interviewed on the topic of small fisheries. One fishery in Gambia obtained certification after a German retailer, Kaufland, and its customers, organized a fundraising campaign and collected enough money to finance the audit.

Of course, palm oil is not as ‘visible’ as fish. However, engaging other stakeholders to finance the audit costs is still relevant. These stakeholders can then decide whether they wish to communicate on it (like J&J did) or not.

b) Make the certification process easier for smallholders

Independent and associated smallholders have successfully managed to become certified. In my conversation with Petra Meekers, Co Chair of the Smallholder Working group, she recognized that this had been achieved thanks to the help stakeholders provided in extension, awareness and guidance. The cases of NBPOL or the GIZ illustrate this statement well. Today, the mandate of the Smallholder’s Working Group is to make certification easier to achieve for smallholders.

Possible solution to explore: Create a stepwise or differential system for certification

This idea emerged from various readings and the interview conducted with Mélanie Poey, from Marine Stewardship Council France.

Today, the RSPO certification is made in such a way that producers either qualify or don’t. Even though the RSPO has made a special effort to adapt the implementation of the Principle & Criterias to the different contexts and countries, there is no in between for smallholders. A way of addressing this issue, and encouraging them to pursue their efforts towards certification could be to create a stepwise process by which they could measure their progress and be encouraged to achieve higher results.
In the case of the MSC, the organization has developed a scoring system by which fisheries can become certified, even if they do not meet the optimal level defined by the MSC. The system is the following: Fisheries receive 0 to 100 points on 31 key indicators. The MSC requires fisheries to score at least 60 on each key indicator and to score 80 on average, in every core category\textsuperscript{138}. They can then pass the assessment if they commit to improving every key indicator up to the 80 level within 5 years:

"The MSC program very consciously allows fisheries to qualify for MSC certification without meeting the 80 level on all indicators. MSC believes the movement of fisheries from the 60 to 80 levels is a positive outcome for the world's fisheries and directly in line with the MSC's vision. This is one of the tenets of MSC's theory of change\textsuperscript{139}."

This type of stepwise system is a factor of motivation for small fisheries and could be explored by members of the RSPO to see if it would be helpful in motivating smallholders to seek certification. However, the RSPO would need to make sure this does not compromise the integrity of its standard. As we have seen in the first chapter of this paper, this is an issue that is particularly sensitive for the RSPO and its critics.

**IV. C. Limitations**

Writing this last chapter, my intention was to create a discussion around the necessary conditions and best practices I had identified. I recognize that further investigation and more trials would be required. However, I kept in mind what I had read in Towards Better Practice in smallholder palm

\textsuperscript{138} "The MSC's standard for sustainable fishing is comprised of three core principles that require: 1) healthy fish stocks; 2) that the fishery does not jeopardise the supporting ecosystem; and, 3) that management systems ensure the long-term future of all resources", Harnessing Market Forces for Positive Environmental Change, MSC report (2011)

\textsuperscript{139} MSC, "Harnessing Market Forces for Positive Environmental Change", MSC report (2011)
oil production\textsuperscript{140} and I hope that the recommendations formulated can serve as a first basis for further research.

\textsuperscript{140}“Smallholders, governments, companies and NGOs are coming up with solutions – partial or complete – to specific constraints in smallholder palm oil production. Solutions are situation-specific, arising out of particular biophysical, tenurial, market and policy conditions. This will limit the transferability of tools and innovations from one successful context to another untried context. (…) But contextual differences do not mean lessons cannot be transferred – practitioners can use their own best judgment to pick up and apply what might work from another context, and discard what is irrelevant”. Vermeulen, S., et al., “Towards Better practice in smallholder palm oil production”, Natural Resource Issues Series No. 5, International Institute for Environment and Development.
Conclusion
After highlighting the main bottlenecks preventing independent and associated smallholders from achieving certification, we analyzed the situation through a collective action problem lens and identified the reasons of success of two successful projects before determining the necessary conditions for smallholders to achieve certification. Possible solutions to facilitate the process were suggested in the last chapter of this paper and further research would be required to determine a potential path towards implementation.

Although certification of palm oil smallholders still appears to be very challenging, this paper has shown that there is hope for improvement:

- Some successful certification projects have started to emerge and the future ‘certification generations’ can learn from them.

- The RSPO is conscious of this challenge and is working towards overcoming it. For example, the Smallholder Working Group should meet early July 2013 to discuss about ways to facilitate the access to certification for smallholders. The issue is slowly but surely progressing.

- Certification processes from other industries have also experienced challenges regarding small farmers or firms and literature has shown us that these could be solved.

There is definitely a positive movement towards addressing smallholders’ certification challenges in the palm oil sector. The changes in the next years should be interesting to observe, and I hope this paper will contribute to making them happen?
Annex 1: Factors explaining the future increase in demand for palm oil

The popularity of palm oil is due to the three following factors:

-Palm oil is very cost-competitive compared to other vegetable oils such as soybean oil, rapeseed oil and sunflower seed oil. For this reason, palm oil has recently expanded in markets that traditionally preferred other forms of oil.

-Palm oil’s crop productivity is very high in comparison to all other types of vegetable oils. For example, the average oil yield of palm oil is 3.8 tonnes per hectare which is 9.3, 7.6 and 5.8 times greater than soybean oil, rapeseed oil and sunflower oil respectively (Oil World, 2008). “Producing approximately 36% of the world’s oils and fats from 6% of the world’s oilseed acreage is a compelling story in terms of land use efficiency”, declared Nick Thomson, CEO of New Britain Palm Oil Limited.

-The usages of palm oil are very diverse: for example, palm oil is a cooking ingredient, as well as an essential ingredient in packaged food and domestic products, and can also be used in biofuels. Today, although 80% of the current palm oil output is consumed for edible uses, the demand for non-edible uses is increasing.

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Annex 2: Different Supply Chain systems for palm oil certification

Annex 3: Interview of Darrel Weber for the BBC Food Program (extract)

The following extract from the BBC Food Program in 2011 is a conversation that reflects the following interrogation: 'Is there a market for certified sustainable palm oil?'

Darrel Weber, RSPO Secretary general at the time of the interview: “We have 5 million tons of certified sustainable palm oil in the market. With that 5 million tons, basically, if all of Europe wanted to purchase sustainable palm oil, they could. Tomorrow. But there is this challenge in the supply chain (...) Because it’s still only 10 or 11%.”

Interviewer: “But campaigns on these issues have been running for more than a decade, the RSPO itself was set up in 2004, and still yet, the available sustainable palm oil is being left out there in the market without finding a buyer. It’s staggering”.

Darrel Weber: “Yes, and we are ourselves trying to understand where are the bottlenecks providing big hurdles for buyers to indeed buy Certified sustainable palm oil. And we understand that at least one of the hurdles is with regards to the derivatives of palm oil for the food industry. They don’t use crude palm oil. They use the derivatives of crude palm oil and it is not always easy to get the right amount at the right place at the right time”.

Interviewer: This does mean that we have UK-members of the RSPO, some of the biggest food manufacturers in the world, who could be buying more and are not buying more. And they are your members.

Darrel Weber: “Yes, and we will be asking them this very same questions in the coming months. We are still trying to understand the challenges within the supply chain. We still don’t quite understand why the uptake for the option of certificates, which are quite cheap at the moment, is not more important at the moment”.
Annex 4: Synthesis of ‘Tackling the Collective action Problem in Palm Oil Production’

“Tackling the collective action problem in palm oil production” is an article that focuses on the idea that quality increase of fresh fruit bunches can be seen as a collective action problem in the Thai palm oil industry.

“Tackling the collective action problem in palm oil production”

This publication deals with the introduction of certification standards in the Thai Palm Oil industry and the collective action problem that prevents this implementation. It was co-authored by Daniel May, the project director at the German International Cooperation (GIZ) who was involved in the certification of 412 Thai independent smallholders in 2012 (cf. example on GIZ certification below) and Thea Nielsen, a PhD candidate at the University of Hohenheim in Germany.

A need for quality control in the fresh fruit bunches production

So far, the Thai government’s strategy to increase certified palm oil production in order to meet the demand has been to expand oil palm production areas. The authors argue that this is the easiest way of tackling the issue of increase in demand but that it leads to other difficulties. “As a consequence, the government should reallocate its efforts to improving the OER through implementing FFB quality control measures, although it is more difficult and requires significant investment in capacity building of smallholders by both the government and the private sector”.

The present sub-optimal OER in Thailand can be explained through the interplay of three processes:

- Mill overcapacity: “Since mills have the same policy of accepting whatever feedstock is offered, suppliers of low quality FFBs can always find a buyer”.

- The structure for harvesting and delivering FFBs: “Almost all producers pay labor services based on the quantity of FFBs harvested and most FFBs have been exposed to excessive handling before being processed at crushing mills”.

- The underdevelopment of FFB quality control systems: “Very few agents along the supply chain have quality control, as it is timely and costly. Only a very few mills use a price differentiation scheme for different FFB qualities; however the premiums offered for high quality FFB with a high OER are rather low”.

The collective action problem identified

This article demonstrates that introducing quality standards is a collective action problem: “it would benefit the sector as a whole, but offers no immediate individual rewards to individual actors”. The different actors will not implement changes on their own and, without cooperation, nothing can be done. Change is handcuffed in the risk aversion of the actors as well as their lack of cooperation with one another.

Overcoming the collective action problem

The German International Cooperation (GIZ) and the Office of Agricultural Economics have developed a project to support smallholders to increase their yield, improve the quality of their fruits and to achieve certification. They have managed to overcome the collective action problem in this situation and the authors wish that this example leads to more investments from the private sector and the government in capacity building of independent smallholders. We will study this specific case in more details in Part B of this chapter.
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