

# Key Takeaways from Engagements with Palm Oil Producers

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Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the long-term financial value creation that our clients depend on to achieve their investing goals. As part of our fiduciary responsibilities as an asset manager to act in our clients' best interests, we assess a range of risks and opportunities that can affect the financial performance of the companies in which we invest on their behalf. We engage companies to understand their approach to the material drivers of risk and value in their business models, provide feedback, as appropriate, and raise any concerns. We may signal continuing concerns through our voting, where clients have authorized us to vote on their behalf. We vote to advance the long-term financial interests of our clients as shareholders.

This spotlight provides a look into our approach to engagement with listed palm oil producers, on behalf of our clients invested in these companies, over the course of the 2021-22 proxy year.<sup>1</sup> Given the complexities inherent in the palm oil industry, clients are seeking transparency on BIS' approach to engagement with listed palm oil producers. Dynamics impacting the industry near term include public scrutiny of and enhanced regulations targeting irresponsible production practices,<sup>2</sup> as well as divergence in customer demand, with increasing demand, particularly in the West, for sustainable palm oil production<sup>3</sup> while the largest buyers seek conventional products. In this spotlight, we have included several case studies to demonstrate how engagement with these companies can help inform long-term investors and other stakeholders on the continuing challenges as well as opportunities across the palm oil value chain, including the production of sustainable palm oil.

## BIS' approach to engagement with companies in the palm oil industry

Palm oil is the world's most widely used oil crop, utilized in products ranging from cooking oil and dairy substitutes to cosmetics and biofuels.<sup>4</sup> However, its production is associated with several potential risks, including those related to deforestation, climate change and biodiversity loss, as well as disputed land use, labor-related issues, bribery and corruption. These risks have the potential to impact companies' ability to deliver strong, long-term performance in light of rising regulatory expectations and growing customer demand, particularly in the West, for sustainably produced palm oil.

The BIS team conducts ongoing, multi-year engagements with palm oil companies, which are based primarily in the Asia ex-Japan region. Palm oil production is heavily concentrated in Southeast Asia – with Indonesia and Malaysia accounting for approximately 84% of global output.<sup>5</sup> We engage to further our understanding of palm oil producing companies' long-term strategies and how they manage the material risks and opportunities in their business models that can impact their ability to create durable, long-term financial value. **In the 2021-22 proxy year, BIS met with more than a dozen palm oil producing companies based in Asia ex-Japan, representing over 75% of BlackRock's clients' total exposure to palm oil companies in the region.**<sup>6, 7</sup>

Several characteristics of the palm oil industry limit the effectiveness of engagement by minority investors like BlackRock. For example, most producers have a single shareholder, or a small group of affiliated shareholders, that control a majority of the shares, which reduces the impact of feedback from unaffiliated or minority investors. Further, because the industry has a fragmented supply chain, transparency remains a challenge as investors seek to assess practices from the perspective of a minority, long-term investor. Finally, the palm oil industry is characterized by the prevalence of smallholders and small-scale farmers, which makes it more difficult for the industry to achieve widespread adoption of high standards of agriculture practice.<sup>8</sup> As a result, we focus our engagement efforts on the larger listed companies, whose practices tend to be leading the industry and may be taken up over time by smaller companies. Our dialogue can help inform companies about our areas of focus and concern as long-term investors on behalf of our clients.

An area of focus with companies in the industry is the production of “sustainable palm oil”. To address and manage the material sustainability-related risks and opportunities associated with palm oil production,<sup>9</sup> particularly as some governments around the world look to only allow imports of sustainably produced palm oil,<sup>10</sup> industry stakeholders, including producers, downstream customers, regulatory bodies, and non-governmental organizations (NGOs), promote and certify sustainably produced palm oil. Sustainable production methods minimize the regulatory, reputational, and financial risks associated with palm oil production that could have a material impact on long-term shareholder value. The Roundtable on Sustainable Palm Oil (RSPO),<sup>11</sup> developed certification criteria that include not clearing primary forests, areas of significant biodiversity or fragile ecosystems, reducing the use of pesticides, protecting the rights and lands of local communities, and the fair treatment of workers, among others.<sup>12</sup> RSPO is perhaps the most well-known organization promoting the growth and use of sustainable palm oil products through global standards and multistakeholder governance.<sup>13</sup> Already, several governments have taken action to introduce mandatory certification standards, such as Indonesia and Malaysia, where the Indonesian Sustainable Palm Oil (ISPO) and Malaysian Sustainable Palm Oil (MSPO) were introduced in 2011 and 2013, respectively.<sup>14</sup>

As part of our assessment of companies in the palm oil industry, BIS considers a company’s management of material sustainability-related risks and opportunities, any remediation and grievance mechanisms, and governance and oversight structures, amongst other things. We look to understand how companies manage and mitigate the risks associated with their environmental impact, land use and community engagement, and supplier and sourcing processes and position themselves to capture related opportunities. The assessment is the basis for ongoing engagements and may inform voting decisions, as appropriate, for those clients who have given us the authority to vote on their behalf. We evaluate the public disclosures and policies of palm oil companies as well as third-party research and data.

As discussed in our [Global Principles](#), BIS believes that well-managed companies will effectively evaluate and manage material sustainability-related risks and opportunities relevant to their businesses. Appropriate risk oversight of business-relevant and material sustainability-related considerations is a component of a sound governance framework. These issues have the potential to significantly impact the economic viability of some palm oil-dependent business models.<sup>15</sup> We encourage companies to provide comprehensive reporting to aid investor understanding of these issues and how they are identified and managed. BlackRock has consistently advocated for enhanced reporting that allows investors to understand risks and opportunities in the business models of the companies they invest in. Better quality information supports better investment decision-making and capital allocation.

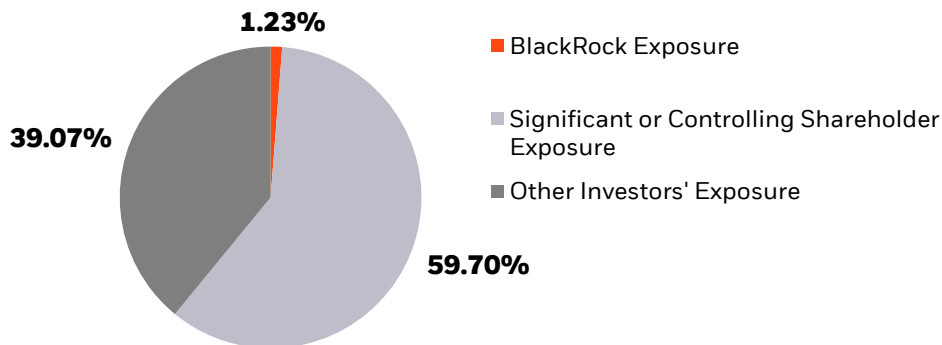
## Key takeaways from our engagement with palm oil producers

BIS has identified four key dynamics impacting the industry in the medium term:

### 1. Despite controlling ownership structures, companies may benefit from understanding the perspectives of minority shareholders

Whilst we acknowledge that companies with controlling shareholder structures, as is widespread in the palm oil industry, have business operations that are largely defined by those shareholders, we believe they benefit from understanding the views of minority shareholders who are unaffiliated with the controlling shareholder or block. This diversity of feedback and perspective has the potential to better inform management and board decision-making, which is why BIS continues to engage extensively with companies in the industry. We offer our perspective as a long-term shareholder on behalf of our clients. We encourage companies to focus on company-specific issues that can have a material impact on their business models and ability to generate long-term financial value.<sup>16</sup>

**Average Exposure Across Select Palm Oil Companies<sup>+</sup>**



Source: BlackRock. Information as of Q1 2023.

For a detailed breakdown of BlackRock’s clients’ average exposure to select palm oil companies, please refer to the appendix on page 5.

## 2. Investor understanding would be enhanced by improved company disclosures

In our engagements, we encourage companies to provide comprehensive disclosures on their long-term strategy, the milestones to delivering it, and the governance and operational processes that underpin their businesses and long-term financial performance. In addition to robust financial disclosures, we find it helpful when companies provide the data and narrative that informs investors as to how material, business-relevant sustainability risks and opportunities are identified and managed.

For the palm oil industry, an important issue is how grievances (i.e., allegations) are managed and disclosed by companies. Through our research and engagements, BIS has come to the view that companies across the industry could improve how they manage, disclose, and remediate grievances lodged against them. Many palm oil companies that we have engaged do not publicly acknowledge grievances or complaints that have been filed against them, while others do produce lists but do not regularly update them. The lack of sufficient disclosure regarding grievances can hamper investors' understanding of the risks facing the company and whether and how appropriately management is responding to the substance of the allegations.

## 3. Key challenges remain for certified sustainable palm oil demand

While most palm oil companies are members of the RSPO or other sustainable palm oil certification schemes, our engagements help further our understanding of the challenges to fully comply with standards and to increased production of certified sustainable palm oil. The most significant of these are consumers' price sensitivities and impediments to demand for sustainable palm oil to grow in key markets.

Many producers have noted the higher costs associated with sustainable palm oil production, as well as the costs incurred to obtain the relevant certifications. These costs are not recoupable as producers are unable to charge a premium for sustainable palm oil in most markets. As some producers explained, the demand for certified sustainable palm oil remains weak in key markets such as China and India, largely given the highly price-sensitive nature of these economies.<sup>17,18</sup> That said, according to the RSPO, possible bright spots for sustainable palm oil demand in China may come from recent developments in palm oil research and recently approved palm oil varieties.<sup>19</sup>

Several palm oil producers were optimistic about the outlook for certified sustainable palm oil demand in these markets and have begun to engage with buyers, regulators, and industry bodies to raise awareness about the benefits of sustainable palm oil production. Producers explained to us the importance of a "shared responsibility" approach across the value chain that can effectively enhance awareness and demand for certified sustainable palm oil. This underscores the important role of buyers of palm oil in encouraging greater production of sustainable palm oil and creating the demand that will shift the cost curve.

Our engagements with palm oil producers reveal that their large multinational buyers tend to purchase mass balance palm oil for a number of reasons.<sup>20</sup> This ranges from customers in certain markets being unwilling to pay a premium for Certified Sustainable Palm Oil (CSPO) to the buyers utilizing palm oil as only a small component of their production process where it is blended with other materials. In such cases, even though 100% of the palm oil producers' production is CSPO, they are forced to sell it as mass balance or conventional palm oil instead. However, in a recent engagement, a Malaysian-based palm oil producer discussed with BIS their observations that there are cases of buyers that demonstrate an understanding of the importance of a "shared responsibility" across the value chain. For example, one buyer co-invested in projects, thereby helping to share costs. Rather than just purchasing more CSPO, we have observed that buyers are increasingly getting involved in the implementation phase by co-investing in planting projects which support the production of CSPO. We are encouraged by this example of a collaborative relationship between the buyers and producers of sustainable palm oil and will continue to engage the entire value chain to learn about further developments.

## 4. Labor and community-related risks are more in focus

Most palm oil companies have publicly committed to principles that aim to address material sustainability-related risks, such as no exploitation of workers, no conversion of High Conservation Value and High Carbon Stock forests, and no planting on peatlands.<sup>21,22</sup> In some countries, including Malaysia and Indonesia, these voluntary corporate principles are reinforced by local regulations on issues such as deforestation.

Nonetheless, companies continue to be implicated in sustainability-related controversies that may have a material impact on their financial performance. While material environmental issues in the industry, such as deforestation, have been recognized for some time, more recently, issues related to social dependencies and impacts, such as labor issues, community relations, and land-grabbing, are increasingly in focus.

For example, Malaysia's palm oil industry has historically depended heavily on migrant workers, with more than 80% of the industry's workforce immigrating from countries such as Bangladesh, India, Indonesia, and Nepal.<sup>23</sup> The impact of the COVID-19 pandemic and the resulting governmental constraints on immigration exacerbated an already tight labor market, which companies are still facing. Some companies are facing workforce shortfalls that may impede operations. In addition, some Malaysian palm oil producers have been accused of worker exploitation, such as discouraging foreign workers from returning home at the end of their contracts,<sup>24</sup> while others have been under investigation for poor labor practices and standards, including forced labor.<sup>25</sup>

## Adverse employment practices block trade

Two Malaysian-based palm oil producers were issued a Withhold Release Order (WRO) from the U.S. Customs and Border Protection (CBP) in 2020 following allegations of forced labor.<sup>26</sup> BIS has held several engagements with both companies to learn more about the issues as well as the companies' responses to the serious allegations. Following engagements with one of the companies, including a meeting with two of their independent directors, as well as an analysis of public disclosures, BIS found that the company has introduced several improvements to the governance structure, processes, and operations to address and oversee these labor-related issues. In April 2022, the company submitted a comprehensive report to the CBP containing a detailed assessment of their operations mapped against the International Labor Organization's (ILO's) forced labor indicators, containing in-depth descriptions of their improved governance structures and management systems, policies, guidelines and standard operating procedures, and providing supporting evidence and independent reports from third-party consultants appointed to audit the company's operations. BIS determined that the company had acted to address shareholder concerns through the implementation of recent initiatives and policy changes made to address these labor-related issues. BIS voted to support the elections of the incumbent directors at the company's 2022 annual general meeting.

The second company had hired an independent auditor to conduct an assessment of their practices compared to the eleven ILO indicators of forced labor. The auditor was hired a year after the WRO was issued, and management relayed that they had wanted to enact some self-identified improvements prior to the audit. In February 2023, the company provided an update that it was in the process of remediating gaps identified by the auditor, which included the upgrading of worker housing facilities and the reimbursement of MYR 111.64 million (approximately USD \$25.96 million according to exchange rates then) to eligible former and current workers who paid recruitment fees to secure jobs over three tranches throughout the year. Through engagement, the company indicated that it will likely submit a final report to the U.S. CBP seeking to modify the WRO after the final tranche of reimbursement slated for September 2023. BIS notes that progress to address the concerns raised in the WRO has been slow and will seek to understand further developments through continued engagement.

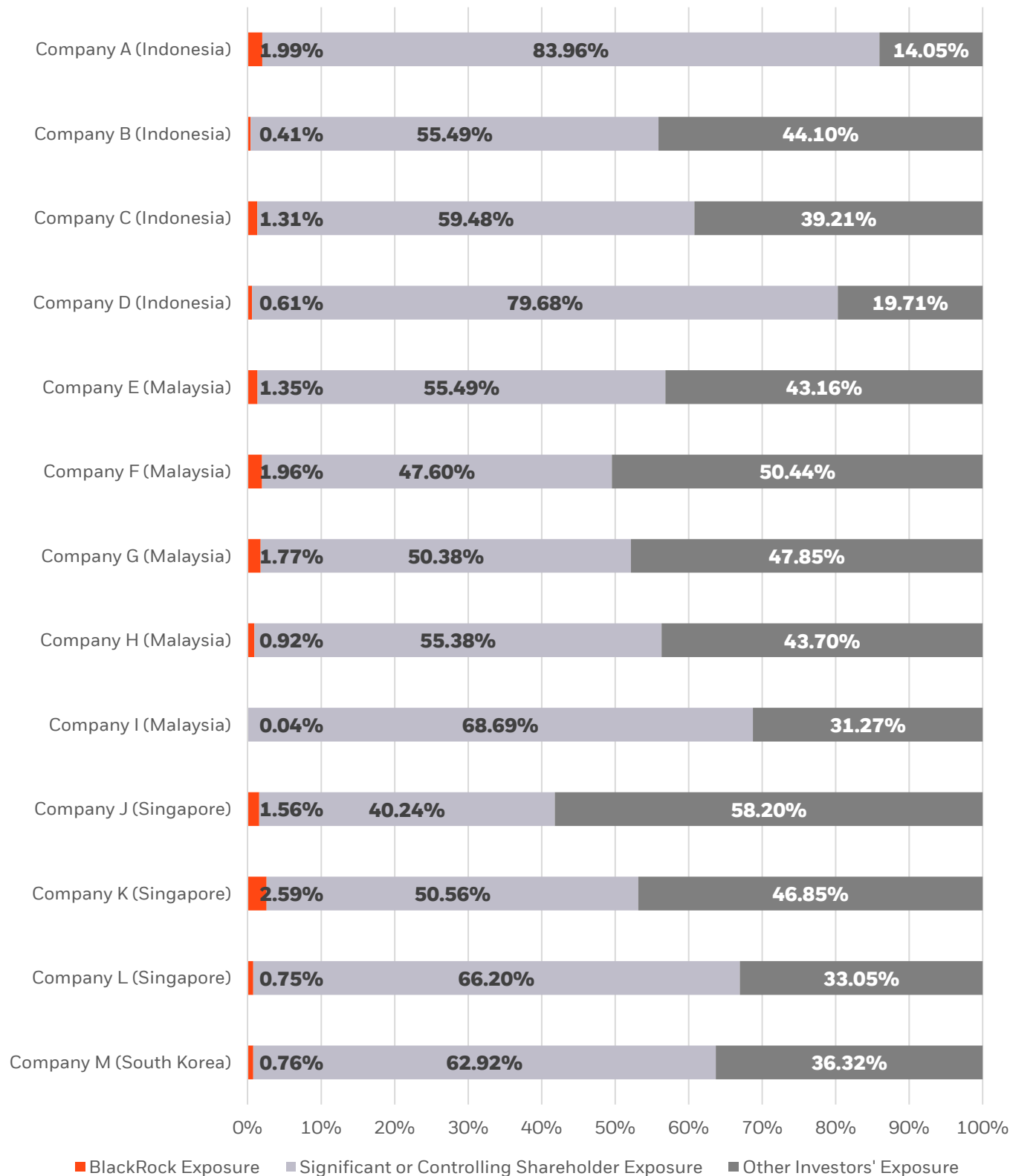
These cases highlight the material risk to companies' ability to deliver durable profitability if their products and operations do not meet the standards of importing countries. This, in turn, has the potential to negatively impact our clients' financial interests as long-term investors in affected companies.

## Looking ahead

BIS will focus on engaging with and encouraging palm oil producing companies to develop strategies that aim to manage the material risks and opportunities in their business models that can impact their ability to create durable, long-term financial value. We will continue to engage to better understand how companies are boosting efforts to export to key developed markets and work with customers to increase demand for sustainably produced palm oil. Within our regular engagements with companies that use palm oil in their products, we will seek to understand their approach to supply chain resilience and supplier partnerships to enhance product quality and meet consumer demand for sustainable products.

# Appendix

## BlackRock Exposure to Select Palm Oil Companies\*



Source: BlackRock. Information as of Q1 2023.

# Endnotes

1. The 2021-22 proxy year covers the period from from July 1, 2021 to June 30, 2022, representing the U.S. Securities and Exchange Commission's (SEC) 12-month reporting period for U.S. mutual funds, including iShares.
2. Reuters, "[Malaysia slams EU deforestation-free law for blocking palm oil market access](#)", December 23, 2022.
3. Roundtable on Sustainable Palm Oil, "[New Report Shows Europe is the Biggest Market for Sustainable Palm Oil](#)", September 25, 2022.
4. Reuters, "[Factbox: Global edible oil markets simmer after shock Indonesia ban](#)", April 2022.
5. U.S. Department of Agriculture, "[Palm Oil Explorer](#)", last updated in April 2023.
6. This refers to equity holdings. Please note that some companies did not respond to our repeated requests for engagements.
7. BIS also engages with companies in developed markets where we discuss the use of palm oil and their palm oil supply chain management. As part of our engagement with companies that use natural resources in their products - including palm oil - we seek to understand how they engage on and hold their suppliers responsible to sustainable and responsible sourcing and production. We also seek to understand the monitoring and mitigation processes, as well as any targets for increasing the proportion of inputs that are sustainably sourced.
8. According to the Roundtable on Sustainable Palm Oil (RSPO), smallholders are usually family-based enterprises producing palm oil from less than 50 hectares of land. In Malaysia and Indonesia, smallholder production represents approximately 40% of the total oil palm plantation area. Moreover, please refer to the Roundtable on Sustainable Palm Oil, "[As a Smallholder, Gaining Certification Changes Everything](#)" for additional information about independent smallholders in the palm oil industry.
9. By material sustainability-related risks and opportunities, we mean the drivers of risk and long-term financial value creation in a company's business model that have an environmental or social dependency or impact. Examples of environmental issues include, but are not limited to, water use, land use, waste management and climate risk. Examples of social issues include, but are not limited to, human capital management, impacts on the communities in which a company operates, customer loyalty and relationships with regulators. It is our view that well-managed companies will effectively evaluate and manage material sustainability-related risks and opportunities relevant to their businesses. Governance is the core means by which boards can oversee the creation of durable, long-term financial value. Appropriate risk oversight of business-relevant and material sustainability-related considerations is a component of a sound governance framework.
10. Reuters, "[Malaysia slams EU deforestation-free law for blocking palm oil market access](#)", December 23, 2022.
11. RSPO was founded in 2004 by a group of producers, downstream consumers, and conservation organizations. Please see the [Roundtable on Sustainable Palm Oil \(RSPO\)](#) for additional information.
12. For additional information, see the [RSPO website](#).
13. However, we do note that these sustainable palm oil certification schemes are not without criticisms. For instance, RSPO have been accused by NGOs and other stakeholders for not adequately auditing member companies, being slow to investigate allegations and penalizing non-compliant members, as well as having inadequate standards for suppliers, amongst others.
14. United Nations Environment Programme, Law and Enforcement Assistance Platform, "[Regulation of the President of the R.I. No. 44 of 2020 on the Certification System for Sustainable Palm Oil Plantation in Indonesia](#)", March 13, 2020. Originally a voluntary scheme, the MSPO was made mandatory for plantations, independent and organized small holdings and palm oil processing facilities in Malaysia in 2019. For additional information, please see "[MSPO Certification Scheme](#)".
15. Our 2022 commentary on [our approach to engagement with the palm oil industry](#) describes our views on these issues for palm oil producers, and details our engagement approach to encourage the efficient management of natural capital which we view as core to a resilient, long-term corporate strategy for companies that rely on natural resources.
16. For example, in December 2022, the European Union reached a preliminary deal on a new law that will limit the sale of commodities tied to deforestation into the EU market (European Parliament, "[Deal on new law to ensure products causing deforestation are not sold in the EU](#)" December 12, 2022). Moreover, breaches of global norms on issues such as human rights abuses can not only harm the people/communities directly affected, but also expose companies to material business risks. These risks can materialize in a variety of ways, from fines and litigation to workforce and supply chain disruptions that may damage a company's standing with business partners, customers, and communities. Furthermore, these risks may call into question a company's ability to maintain operations in a certain location and benefit from the labor, raw material, community support, or regulatory structures in place, particularly if they significantly undermine their corporate reputation and purpose, thereby impacting their ability to deliver long-term financial value for shareholders.
17. Reuters, "[Scorching prices slow palm oil imports by top consumers India, China – trade](#)", March 3, 2022.
18. In 2020, imports of palm oil to China and India totaled a combined \$8.7 billion, more than a quarter of global trade volume that year. Source: Observatory of Economic Complexity (OEC), "[Which countries import Palm Oil? \(2020\)](#)".
19. RSPO, "[China Sees Favourable Prospects for Sustainable Palm Oil Production](#)" April 19, 2021.
20. Mass balance palm oil refers "RSPO Certified Sustainable Palm Oil from certified sources that is mixed with ordinary palm oil throughout the supply chain." Please see, RSPO, "[Supply Chains](#)".
21. Also known as No Deforestation, No Peat, No Exploitation (NDPE).
22. The High Carbon Stock Approach (HCSA) identifies and conserves High Carbon Stock rainforests. For additional information, see the HCSA [website](#). High Conservation Value (HCV) refers to forests and other ecologies of significant biodiversity. For additional information, please see the HCV Network [website](#).
23. Fair Labor Association, "[Assessing Forced Labor Risks in the Palm Oil Sector in Indonesia and Malaysia](#)", November 2018.
24. Reuters, "[Malaysia palm oil workers discouraged from going home, rights groups say](#)", December 2022.
25. AP News, "[US bans second Malaysian palm oil giant over forced labor](#)", December 30, 2020.
26. The U.S. Customs and Border Protection "implements Section 307 of the Tariff Act of 1930 (19 U.S.C. 1307) through issuance of Withhold Release Orders (WRO) and findings to prevent merchandise produced in whole or in part in a foreign country using forced labor from being imported into the United States." For more information, please see, U.S. Customs and Border Protection, "[Forced Labor](#)", last modified on March 24, 2023.

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