

1. INTRODUCTION AND SUMMARY

From palm oil and sugar to dairy and seafood, Asian FMCG companies depend heavily on soft commodities to maintain and grow their business. In fact, FMCG companies are typically the largest users of these commodities. Companies need a reliable, good quality, reasonably priced and reputational risk-free supply of raw materials to allow them to manufacture, brand and sell their goods.

However, environmental degradation, problems with local communities and labour, and mounting issues such as climate change are making it more challenging for producers to provide consistent and growing supplies of commodities. Furthermore, many common soft commodity production practices are exacerbating these environmental and social challenges. This will have a direct impact on FMCG companies' ability to source raw materials.

ASIA FALLING BEHIND GLOBAL FMCG COMPANIES

Global FMCG companies are among the leaders in implementing sourcing policies to remove these risks from their supply chains and take advantage of related opportunities. Global investors and banks have been engaging with global FMCG companies to promote responsible sourcing. This plays a role in mitigating systemic risks, such as climate change, water scarcity and deforestation. It also reduces risks and enhances quality of earnings at portfolio companies.

However, Asian FMCG companies have only started to identify and manage these issues; they remain behind global leaders and may have vulnerabilities in

AWARENESS OF NEGATIVE IMPACTS OF SOFT COMMODITIES IS RISING

- Awareness of the negative environmental and social impacts of soft commodities and how these affect businesses is increasing. Of the 162 Global 500 companies that reported to the CDP Global Forests Report 2014, 74 per cent recognized at least one material business risk associated with the key commodities driving deforestation. In terms of the types of risks recognized, 55 per cent of companies recognized at least one reputational risk across commodities; 51 per cent of companies recognized at least one operational risk and 45 per cent of companies recognized at least one regulatory risk.¹⁶
- In line with the growing awareness of the need to address these concerns, 14 US-based FMCG companies, including General Mills, Mars Inc and PepsiCo, signed a joint letter in November 2015 calling on world leaders to adopt a strong global climate deal at the COP21 climate conference in Paris.¹⁷ In this letter, the companies stated that government, civil society and business need to play their part in tackling climate change and one of the three commitments they disclosed was focused on boosting their efforts to make their supply chains more sustainable.





OF THE 162 GLOBAL **500 COMPANIES** THAT REPORTED TO THE CDP GLOBAL **FORESTS REPORT** 2014, 74 PER CENT RECOGNIZED AT LEAST ONE **MATERIAL BUSINESS RISK ASSOCIATED** WITH THE KEY COMMODITIES DEFORESTATION

Figure 2: Companies' disclosure of their sourcing of certified responsibly produced commodities

*Note that Charoen Pokphand PCL and Thai Union Frozen Products PCL use certification standards that are not considered credible by WWF. Refer to page 38 for attributes of standards that WWF supports.

their supply chains. They urgently need to employ the strongest management approach possible: time-bound, quantified procurement targets based on third party certification standards.

This chapter:

- Reviews finance sector initiatives in commodity supply chains;
- Sets out the major environmental and social issues linked to commodity production;
- Reviews certified responsible commodity production;
- Reviews the uptake of certified responsibly produced commodities, in particular by Asian FMCG companies;
- Highlights the business benefits of sourcing certified responsibly produced commodities;
- Identifies solutions and existing market practices to the hurdles some companies may encounter.

The following table shows which large Asian FMCG companies are disclosing their sourcing of certified responsibly produced commodities.

| Companies disclosing their sourcing of certified commodities | Companies NOT disclosing their sourcing of certified commodities |
|--|--|
| Amorepacific Corp | China Mengniu Dairy Co Ltd |
| Charoen Pokphand Foods PCL* | Emami Ltd |
| Dutch Lady Milk Industries Bhd | Fraser & Neave Holdings Bhd |
| Hindustan Unilever Ltd | Fraser & Neave Ltd |
| Nestlé Malaysia Bhd | Godrej Consumer Products Ltd |
| Petra Foods Ltd | Indofood CBP Sukses Makmur Tbk PT |
| Thai Union Frozen Products PCL* | Masan Consumer Corp |
| Unilever Indonesia Tbk PT | Mayora Indah Tbk PT |
| | Orion Corp/Republic of Korea |
| | San Miguel Corp |
| | Super Group Ltd/Singapore |
| | Tingyi Cayman Islands Holding Corp |
| | Thai Beverage PCL |
| | Tsingtao Brewery Co Ltd |
| | Ultrajaya Milk Industry & Trading Co Tbk PT |
| | Universal Robina Corp |
| | Vietnam Dairy Products Joint Stock Company |
| | Want Want China Holdings Ltd |

SOURCING RESPONSIBLY PRODUCED COMMODITIES: THE BUSINESS BENEFITS

The sourcing of responsibly produced commodities offers a wide range of benefits to FMCG companies.

Operational benefits

Evidence from studies across several commodities is that certification processes result in higher yields and more stable long-term supplies. Through supporting their suppliers to undergo certification, FMCG companies can create more resilient supply chains, with greater transparency, and higher quality control.

Reduced reputational risks

As markets mature, brand value represents an increasingly large percentage of a company's market capitalization. Asian companies that do not make an effort to source responsibly produced commodities run the risk of being seen as laggards by civil society stakeholders, financiers and consumers – with negative consequences for their reputation. Those that move ahead may find new opportunities.



Positive branding opportunities

Evidence from product take-up and marketing surveys finds that products made with responsibly produced commodities can have a marketing advantage over conventional products. Nielsen found that Asia-Pacific is the region with the strongest propensity to buy socially responsible brands.¹⁸

Anticipating tighter retailer sourcing policies

An increasing number of retailers in developed markets have pledged to use responsibly produced commodities in private-label products and also in the products that they stock on shelves. This presents a risk for Asian FMCG companies if they are not able to meet these requirements. It also represents an opportunity to increase their market share by developing a base of sustainable products to serve the demand.

Reduced regulatory risks

There are a number of risks that may result from sourcing commodities not produced in accordance with regulation. Estimates vary but a significant proportion of palm oil is thought not to be in compliance with domestic law. Risks include supplier disruption, direct fines, reputational risks, and restrictions on market access. All certified responsibly produced commodity standards reduce these risks as they require compliance with the law.

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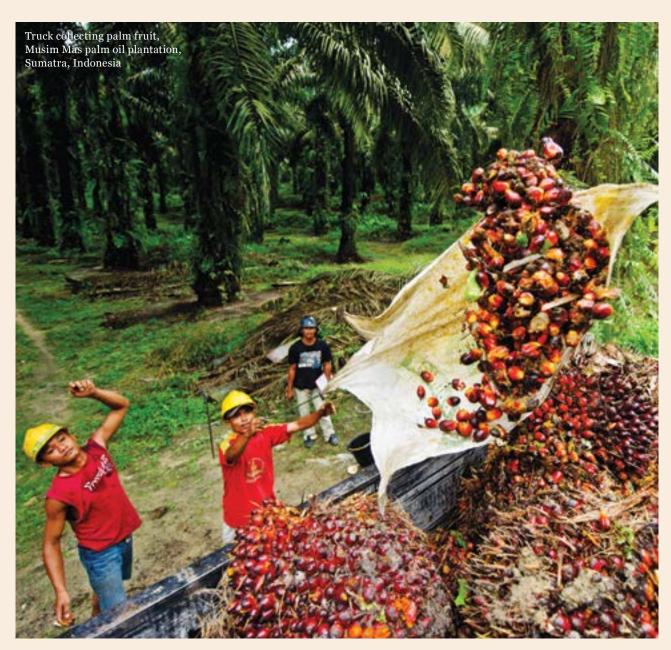
STEPS TO ACHIEVE THESE BENEFITS

Companies are adopting a number of strategies to take advantage of opportunities and create more resilient supply chains. FMCG companies should consider the following steps:

- · Build internal capacity to understand environmental and social issues in the supply chain.
- Map and assess raw materials supply chains to identify where these issues present risks and/or opportunities to the company.
- Consider the resilience of suppliers to environmental and social shocks.
- Establish the cost of various certification schemes.
 - o Consider suppliers' needs for capacity building, training and financing.
 - o Consider synergies to be achieved through partnering with suppliers and other buyers.
- Establish the potential marketing benefits of products with sustainable attributes.
- Assess which customer markets have the highest potential for sustainable products and potential impact of sustainability leadership on brand value and customer loyalty.
- Develop a sustainable sourcing policy and formulate plans to implement the policy. The best policies include:
 - o Quantified and time-bound key performance indicators;
 - o Sourcing based on certification standards that are international, credible, independent and have input from multiple stakeholders;
 - o Complementing certification by participating in platforms such as the Palm Oil Innovation Group (POIG) to innovate and stretch the certification schemes and make commitments to achieve higher levels of performance, for example the Roundtable on Sustainable Palm Oil (RSPO) NEXT criteria;
 - o Clear protocols regarding supplier codes of conduct.
- Set out an internal governance structure with clear responsibilities for reviewing the policy and monitoring and reporting on its implementation.

ENGAGEMENT QUESTIONS FOR INVESTORS

- What are the most significant environmental and social risks and opportunities in the company's supply chain, production and marketing processes?
- How is the company identifying and addressing these risks with its policies? How is it capturing opportunities?
- What are barriers to implementation?
- How does the company decide what to disclose about its supply chain-related policies?



2. EXISTING FOCUS ON RESPONSIBLE SOFT COMMODITY PRODUCTION AND PROCUREMENT BY THE FINANCIAL SECTOR

The finance sector is working to address the concerns related to soft commodity production (and procurement) through direct engagement as well as a variety of collaborative forums, including the Banking Environment Initiative (BEI), finance sector membership of the RSPO, initiatives of the UN-backed Principles for Responsible Investment (PRI), CDP's Forests Program, and Ceres.

In addition, the finance sector has produced a number of guides on responsible investment in various soft commodities, such as the International Finance Corporation (IFC)'s Performance Standard 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources. 19

COLLABORATIVE INITIATIVES



The Banking Environment Initiative

The BEI's mission is "to lead the banking industry in collectively directing capital toward environmentally and socially sustainable economic development".

Major work streams include the BEI and the Consumer Goods Forum (CGF)'s Soft Commodities Compact which has been signed by 12 banks including Barclays, Deutsche Bank, UBS, Rabobank, JP Morgan and Standard Chartered.²⁰ The Compact requires the banks to work with and consider financing solutions for their customers so that by 2020 their customers comply with RSPO, Round Table on Responsible Soy (RTRS) and Forest Stewardship Council (FSC) standards21 in the palm oil, soy and forest products sectors respectively. The Compact aligns the banking industry with the CGF's resolution to achieve zero net deforestation in their supply chains by 2020.

The BEI's Sustainable Shipment Letter of Credit is one of the first tangible results of the Compact. This is a financing solution banks can use to incentivize the international trade of sustainably produced commodities. The IFC has confirmed it will offer preferential terms for this type of shipment to its partner banks, piloting the facility for the palm oil sector, where it will offer potential reductions in the cost of capital.²²



Roundtable on Sustainable Palm Oil

The RSPO's primary mission is to advance the production, procurement, finance and use of sustainable palm oil products. The RSPO has 1,700 members representing palm oil producers, processors and traders, consumer goods manufacturers, retailers, banks/investors, and environmental and social NGOs.

Fifteen financial institutions are RSPO members. Of these, 12 are banks/credit institutions and three are investors. Financial members' commitments include abiding by the RSPO Code of Conduct; establishing relevant internal policy; specifying a time-bound plan for providing financial services/products to clients that are RSPO members who provide certified sustainable palm oil or derivative products; reporting progress on an annual basis; and requiring or encouraging clients to be members of the RSPO and promoting the RSPO as the preferred certification standard for their clients.



CDP Forests Program

At the time of its 2015 report, the CDP Forests Program acted on behalf of 298 investor signatories representing US\$19 trillion in assets. Under the programme, companies with forest commodity supply chains complete a survey that helps them better understand and manage related deforestation risks. The commodities covered are palm oil, timber, soy, beef and biofuels.

The survey questions focus on business risk management, covering areas such as risk assessment and analysis, measuring and monitoring of production, traceability, and governance systems. Questions on policy include high-level policy statements, membership of certification bodies/multi-stakeholder initiatives, and level of engagement with suppliers.



Principles for Responsible Investment

PRI has an Investor Working Group on palm oil. This comprises 28 investors with US\$2.8 trillion under management, who directly engage with companies on ESG issues in palm oil supply chains. The group is represented on the RSPO through Generation Investment Management, which chairs the working group. Generation reports on the group's activities through its Annual Communication On Progress. The investor group commenced activities in 2010 engaging mainly with buyers in the EU. Subsequently it has engaged with buyers in India and China, and is now moving upstream to engage with producing companies. PRI also has a working group²⁴ which developed guidance for farmland investment, which was subsequently integrated into PRI in July 2014.



Ceres

Ceres is a US-based non-profit organization that advocates for sustainability leadership. It works with investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices. Ceres' work includes

coordinating the filing of shareholder resolutions. In 2015 there were 10 resolutions relating to deforestation in the supply chain of FMCG companies, of which eight referred specifically to responsible sourcing of palm oil. There were seven such resolutions in 2014 and 10 in 2013. 25

Figure 3: Examples of shareholder resolutions coordinated by Ceres in relation to FMCG companies

| Company (Year) | Resolution | Filer | Result |
|------------------------------------|--|---|---|
| Kraft Foods Group Inc (2015) | Shareholders request the Board to prepare a public report, at reasonable cost and omitting proprietary information, by 1 December 2015, describing how Kraft is assessing the company's supply chain impact on deforestation and associated human rights issues, and its plans to mitigate these risks. | Domini Social Investments LLC | Vote: 30.3 per cent. Information on the Kraft Foods Group website states that the company is working with its suppliers and "Kraft's leading suppliers are making strides in tracing their palm oil supply to identify which mills provide oil and to assess the sustainability risks related to those mills, including the likelihood of deforestation and human rights violations." 26 |
| Avon Products Inc (2015) | Shareholders request the Board prepare an annual public report, at reasonable cost and omitting proprietary information, providing metrics and key performance indicators demonstrating the extent to which Avon is curtailing the impact of its palm oil supply chain on deforestation and human rights. ²⁷ | Domini Social Investments LLC | Withdrawn, company will address. Avon Products Inc updated its Avon Palm Oil Promise in July 2015 with commitments to deforestation-free and conflict-free palm oil. ²⁸ |
| McDonald's Corp (2015) | Shareholders request that the Board prepare an annual public report, by 30 November 2015, at reasonable cost and omitting proprietary information, providing metrics and key performance indicators demonstrating the extent to which the company is curtailing the actual impact of its palm oil supply chain on deforestation and related human rights. | Green Century Capital Management | Withdrawn, company has addressed this. ²⁹ McDonald's has presented its Sustainable Palm Oil Action Plan, including targets and metrics measuring progress, on its website. ³⁰ |
| Target Corp (2015) | Shareholders request that Target report annually, beginning 30 November 2015, at reasonable cost and omitting proprietary information, providing key performance indicators demonstrating the extent to which the company is curtailing the impact on deforestation and human rights of its palm oil supply chain for its private-label products. | New York State Common Retirement Fund | Filed. The company's policy and targets on palm oil are available on its website but no key performance indicators are stated. ³¹ |
| Wendy's Co (2015) | Shareholders request that the Board of directors adopt and implement a comprehensive sustainable agriculture policy that includes, inter alia, a target date for sourcing 100 per cent of key agricultural commodities sustainably and the use of credible and relevant third party standards and metrics. | Calvert Asset Management Company Inc | Withdrawn, company will address. The company's Statement on Responsibly Sourcing Palm Oil is available on its website and indicates Wendy's recently applied for RSPO membership. ³² |
| Tyson Foods Inc (2015) | Shareholders request that the Board prepare an annual public report, initially by 1 May 2015, at reasonable cost and omitting proprietary information, providing metrics and key performance indicators demonstrating the extent to which the company is curtailing the actual impact of its palm oil supply chain on deforestation and human rights. These indicators would include the percentage of palm oil RSPO certified (including percentage GreenPalm, Mass Balance and/or Segregated). | New York State Common Retirement Fund | Vote: 9.7 per cent. No information was found on this topic in Tyson Foods' public information. |

| Company (Year) | Resolution | Filer | Result |
|---|--|---|--|
| Yum! Brands Inc (2015) | Shareholders request the Board prepare an annual public report, at reasonable cost and omitting proprietary information, providing metrics and key performance indicators demonstrating the extent to which Yum! is curtailing the actual impact of its palm oil supply chain on deforestation and human rights. | Trillium Asset Management | Withdrawn, company will address. ³³ The company's policy on palm oil is available on its website but does not state key performance indicators. ³⁴ |
| Energizer Holdings Inc (2015) (makes batteries, shaving, skin care and tanning products) | Shareholders request that Energizer Holdings develop and implement a comprehensive sustainable palm oil sourcing policy. This policy should be communicated publicly within six months of the 2015 annual meeting. | Sisters of the Presentation of the Blessed Virgin Mary | Vote: 29 per cent. No palm oil policy was found on the company's website. |
| Kellogg Co (2014) | Shareholders request that the Board prepare an annual public report, at reasonable cost and omitting proprietary information, by 1 October 2014, providing metrics and key performance indicators demonstrating the extent of progress on the company's stated commitment regarding "minimizing the carbon footprint of our palm oil supply chain and to respecting human rights including no forced or child labour, slavery or human trafficking." | Green Century Capital Management | Withdrawn, company will address. Kellogg updated its Palm Oil Commitment in February 2015 to include information about its progress but this does not mention carbon footprint or human rights. ³⁵ |
| JM Smucker Co (2014) | Shareholders request the Board to prepare a public report, at reasonable cost and omitting proprietary information, by February 2015, describing how Smucker's is assessing the company's supply chain impact on deforestation and associated human rights issues, and the company's plans to mitigate these risks. | Clean Yield Asset Management | Withdrawn, company will address. The company's updated Palm Oil Policy was welcomed by investors and media in July 2014 following this withdrawn resolution. ³⁶ |
| International Flavors & Fragrances Inc (IFF) (2015) | Shareholders request that IFF report annually at reasonable cost and omitting proprietary information, on key performance indicators demonstrating the extent to which the company is curtailing the impact of its palm oil supply chain on deforestation and human rights. | Calvert Asset Management Company Inc | Withdrawn, company will address. The company's website and Policy on Sustainable Palm Oil do not state key performance indicators or progress on this topic. ³⁷ |

SIGNIFICANT ACTIONS BY INDIVIDUAL INVESTORS ON SOFT COMMODITY ENVIRONMENTAL AND SOCIAL ISSUES

Government Pension Fund Global's responsible management

Government Pension Fund Global's (Norwegian sovereign wealth fund with a market value of NOK7,019 billion (US\$805 billion) at the end of Q3, 2015³⁸) investment mandate with Norges Bank Investment Management (NBIM) specifies certain elements of responsible management that the Bank must undertake on behalf of the Fund, including exclusions, development of principles, contribution to and alignment with international standards, and environment-related investments.³⁹

In addition to ethics-based exclusions, the Fund divests from certain companies on the basis of environmental and social risk. There have been 114 such divestments in the past three years. Deforestation risk led to divestment of 27 Malaysian and Indonesian palm oil producers in 2012, 11 Indonesian coal companies in 2013, and five Indian coal companies in 2014. In August 2015, the Fund excluded four Asian companies from its investment universe due to the risk of severe environmental damage through conversion of tropical forest to palm oil plantations in Indonesia. 40 In addition, NBIM's document Climate Change Strategy: Expectations to Companies⁴¹ sets out the steps it believes companies should take to manage relevant climate change-related risks.

Institutional investors and consumer brands call on RSPO to strengthen its standards

In June 2015, institutional investors representing over US\$5 trillion in assets⁴² joined some of the world's largest and most recognizable consumer brands to call on the RSPO to strengthen its standards for certifying the sustainable production of palm oil, in particular the criteria around deforestation and planting on peat. The investors included APG, PGGM, Swedish National Pension Fund, New Zealand Superannuation Fund, Aviva and Allianz Global Investors, while the brands included five of the top 10 corporate purchasers of palm oil globally: Colgate-Palmolive, Kao Corporation, PepsiCo, The Procter & Gamble Company, and The Johnson & Johnson Family of Consumer Companies.

The letter was organized by the office of New York State Comptroller Thomas P DiNapoli and Green Century Capital Management, both members of Ceres' Investor Network on Climate Risk – a group of more than 110 investors focused on addressing the financial risks and seizing the economic opportunities associated with tackling sustainability challenges.

APG approaches Wilmar and its customers to enhance sustainability of palm oil operations

APG Asset Management, the Dutch-based pension fund manager with €428 billion of assets under management as of May 2015, highlights in its 2013 Responsible Investment Report⁴³ its successful engagement with Wilmar International. APG along with other investors convinced Wilmar to enhance the sustainability of its operations after a challenging two-year period of negotiations. In order to maximize its influence, APG approached not just the company itself but also its customers. APG felt that Wilmar had a duty to comply with the requirements agreed by producers, investors and civil society organizations during roundtable discussions on sustainable palm oil.

Under Wilmar's new policy, it intends to cease all further exploitation of peat bogs and contributions to deforestation. It also plans to provide local people with better information and to give them more opportunities to put their views across. The new policy applies not just to Wilmar itself, but also to its palm oil suppliers.

Interfaith Center on Corporate Responsibility works with companies to reduce environmental impacts

The Interfaith Center on Corporate Responsibility (ICCR) frequently engages with companies with the aim of reducing environmental impacts. ICCR has engaged portfolio companies to promote sustainable palm oil sourcing and has seen some success: in 2015 Panera Bread announced it would issue its first palm oil policy after more than a year of dialogue and Yum! Brands committed to sourcing 100 per cent of its palm oil from sustainable sources by 2017. Progress has also been made with International Flavors & Fragrances and Sysco in their sustainable palm oil procurement policies.⁴⁴

RobecoSAM looks at deforestation and water risks across commodity supply chains, and engages with food companies

RobecoSAM uses its Corporate Sustainability Assessment (CSA) for over 2,000 companies to identify how well equipped they are to identify and respond to emerging opportunities and risks resulting from global sustainability trends. The CSA results serve as the basis for the construction of the prestigious Dow Jones Sustainability Indices. RobecoSAM is aware of the ESG issues in agricultural supply chains and states that "companies active in these commodity chains must have sound policies to combat deforestation and limit adverse effects on water availability". It has declared that it will engage with 18 food and agriculture companies, including Carrefour, Wilmar and Nestlé, on the most relevant commodities for their businesses. 45

BNP Paribas's palm oil and wood pulp policies extend beyond lending to cover asset management

BNP Paribas, like several other global banks, has a palm oil sector policy⁴⁶ and a wood pulp sector policy.⁴⁷ However it is one of the few banks that extends such policies to cover its asset management business in addition to lending and other financial services. It states that: "BNP Paribas entities managing third party assets (with the exception of index-linked products) reflect this policy and develop standards adapted to their businesses which will exclude any stock or issuer that does not comply with their standards. External asset managers are actively monitored and strongly encouraged to implement similar standards." These policies list mandatory ESG requirements and recommend certification by the RSPO, FSC and Programme for the Endorsement of Forest Certification (PEFC) as part of the evaluation criteria.

3. ENVIRONMENTAL AND **SOCIAL CHALLENGES RELATED** TO SOFT COMMODITIES

Agricultural, forest and seafood products are very important for generating social and economic development in producing countries. However, their potentially devastating environmental impacts mean they need to be produced according to certain sustainability criteria in order to be socially, environmentally and economically sustainable over time.

Agricultural production (including cattle farming) has one of the largest environmental and social impacts of any economic activity.⁴⁸ Agriculture drives 80 per cent of deforestation worldwide. 49 It also accounts for 70 per cent of freshwater withdrawals globally,⁵⁰ leaving over a third of the world experiencing water shortages.

Seafood also poses issues. More than 3 billion people⁵¹ rely on it as a primary source of protein, but 53 per cent of the world's fisheries are fully exploited, and 32 per cent are overexploited, depleted, or recovering from depletion.⁵²

Demand for natural resources has doubled since 1966, and the global economy is currently using the equivalent of 1.5 planet Earths in natural resources. At the same time, global biodiversity declined by 52 per cent between 1970 and 2010, as measured by WWF's Living Planet Index in its 2014 Living Planet Report. 53 Biodiversity loss is greatest in the tropics, which have seen a 56 per cent decline.

It is vital that soft commodities are produced sustainably - not only to deal with these massive challenges, but to keep companies viable. Soft commodity yields are very sensitive and dependent on a stable and robust ecosystem. Changes in temperature, floods and droughts caused by climate change can have significant impacts on yields.

Producers failing to adopt responsible production methods are damaging their own future viability and FMCG companies not sourcing certified responsibly produced soft commodities are sending the wrong signals to producers and making their own supply chains less resilient.







FMCG COMPANIES NOT SOURCING CERTIFIED RESPONSIBLY PRODUCED SOFT COMMODITIES **ARE SENDING THE WRONG SIGNALS TO PRODUCERS AND** MAKING THEIR OWN **SUPPLY CHAINS LESS RESILIENT**

WHICH COMMODITIES ARE MOST PROBLEMATIC?

WWF has identified 15 globally traded soft commodities that pose some of the greatest threats to biodiversity, carbon sinks and watersheds, particularly in the world's most important places for conservation. Many small producers and people depend on the production of these commodities, while at the same time systems of production may



pose a threat to small businesses and producers. Livelihoods can be impacted positively or negatively depending on the level of sustainability within production systems.

The commodities identified include:

- The high footprint commodities palm oil, pulp and paper, timber, beef, and soy, which are the five largest drivers of tropical deforestation and associated carbon emissions globally;
- 'Thirsty' crops sugarcane and cotton, which are major withdrawers from the world's water table;
- Key wild-caught seafood commodities tuna and whitefish;
- Farmed shrimp and salmon which have an increasing footprint, with aquaculture being the world's fastest-growing source of animal protein and recently overtaking wild-caught fish as the largest volume of seafood globally.

4. ADDRESSING ENVIRONMENTAL AND SOCIAL CHALLENGES IN SOFT **COMMODITIES THROUGH CERTIFICATION**

Fortunately it is possible to produce the commodities FMCG companies and people need while conserving the environment, respecting the rights of indigenous communities and providing decent livelihoods.

This requires a more considered approach to production processes, employing methods such as more efficient use of water, improving seed varieties, setting aside forests, and maintaining and improving soil quality. It also includes considering social issues such as land rights for local communities, legal production, and labour rights for workers.

Within this, deforestation is a central concern. There is much debate and ambiguity over what should qualify as deforestation-free and how it should be verified. However, an overly narrow focus on deforestation risks drawing attention away from other threats (such as forest degradation and the loss of non-forest habitats) and other dimensions of sustainability (such as health and safety, human rights and social welfare). For these reasons WWF sees 'deforestation-free' as a critical aspect of sustainability, but not a proxy for, or superior trait to, full sustainability. Certification against credible, multi-stakeholder standards is one of the best ways to ensure that all major aspects of sustainability are dealt with. See page 62, appendix on deforestation, for more details.

To assist in the transition to more responsible production systems, WWF has worked with various multi-stakeholder initiatives, where stakeholders along the supply chain agree on principles and set standards for better social, ecological and economic management practices that are effective on a large scale. This has resulted in several robust and credible voluntary standards. These require independent, third party certification, and are internationally recognized tools to provide supply chain transparency.

A number of certification standards working to reduce deforestation are shown in the following table.



Figure 4: Certification standards working to reduce deforestation

Standard

Criteria regarding deforestation



Forest Stewardship Council⁵⁴

Timber/pulp and paper

Criteria to maintain high conservation value (HCV) forests and severely limit
the conversion of natural forest to plantation or other uses
 Criteria to maintain
or restore ecosystems, their biodiversity, resources and landscapes
 Criteria to
respect traditional rights and indigenous people and their dependence on forests



Bonsucro⁵⁵
– **Sugar**

• Criteria to prohibit cultivation of sugarcane on areas of critical conservation value (including HCV categories 1-6) and areas legally protected • Key environmental issues (biodiversity, ecosystem services and soil, for example) are covered by an environmental impact and management plan



 Criteria regarding environmental responsibility and conservation of natural resources and biodiversity
 Criteria on responsible development of new plantings (not in HCV areas or primary forest and plans to minimize GHG emissions)
 For RSPO NEXT, additional criteria of no deforestation, no planting on peat or High Carbon Stock areas, no community conflict from land clearance



 Criteria regarding the expansion of land (not in native forests, and HCV area assessments need to be done before expansion in other areas)
 Criteria on safeguarding of on-farm biodiversity

5. PRODUCTION AND UPTAKE OF RESPONSIBLY PRODUCED **COMMODITIES IN ASIA**

As new standards are developed the challenge becomes encouraging consumers, manufacturers and producers to adopt certified commodities so as to mainstream them. Globally there have been production increases in certified materials across a range of commodities. There are no consistent regional production or consumption statistics for certified commodities, however there is enough information to highlight growth in certified production and consumption across Asia.



PRODUCTION

Palm oil

Palm oil production, which is focused largely in Malaysia and Indonesia, has seen dramatic growth in the adoption of responsible practices in recent years, with RSPO certification now accounting for around 20 per cent of global production.⁵⁸



Pulp and paper

Although complete numbers on responsibly produced paper in the region are missing, it is clear that the production of certified responsibly produced pulp and paper is increasing.* In Asia there were already more than 8 million hectares of forests/ plantations which are FSC-certified in 2015, and the number of FSC chain of custody certificates of manufacturing companies and retailers has been growing steadily in China. China currently holds the world record in FSC chain of custody certificates, with over 4,000 companies being certified.



Sugar

Certified sugar has yet to show progress in the region, though more than 40 per cent of sugar worldwide is produced and consumed in Asia. The recently launched Better Sugar Cane Initiative (Bonsucro) is estimated to cover 3.8 per cent of global sugar production as of January 2016. To date, a few sugar mills have been certified in India and a few pre-audits have been done in Thailand. In comparison, Brazil has already certified 10 per cent of its sugarcane plantations according to Bonsucro standards, and both certified ethanol and sugar have been reaching Brazilian markets and international markets.

^{*} Much of this is to standards that WWF does not consider to be credible, such as PEFC.

Figure 5 shows the certification schemes related to FMCG products that have recently entered the market, and the percentage of each soft commodity certified.

Figure 5: Certification schemes



| Voluntary standard system (with launch date) | Commodity | Indicator | Baseline (2009) | Status Jan 2016 |
|--|----------------|--|-----------------------------|--|
| Forest Stewardship Council (1994) | Timber | % hectares of global production forest FSC certified | 8.4% | 15.7% ⁵⁹ |
| | Pulp and paper | % FSC-certified hectares | 4% FSC (virgin fibre) (Ha.) | 7% FSC (virgin fibre) |
| | | | 51.9% recycled | 55.1% recycled ⁶⁰ |
| Round Table on Responsible Soy (2004) | Soy | % RTRS-certified tonnes | 0% | 0.71% ⁶¹ |
| Roundtable on Sustainable Palm Oil (2003) | Palm oil | % RSPO-certified tonnes | 1% | 22.5% ⁶² |
| Bansucro (2004) | Sugar | % Bonsucro- certified tonnes | 0% | 3.83% ⁶³ |
| Global Roundtable for Sustainable Beef (GRSB) (2012) | Livestock | % GRSB-certified tonnes | 0% | 0% |
| CERTIFED LESS STANDAUE STANDAU | Tuna | % MSC-certified tonnes | 0% | 14% ⁶⁴ |
| Marine Stewardship Council (MSC) (1997) | Whitefish | % MSC-certified tonnes | 19% | 67% (priority whitefish) 53% (whitefish) ⁶⁵ |
| Aquaculture Stewardship | Salmon | % ASC-certified tonnes | 0% | 14.71% ⁶⁶ |
| Council (ASC) (2009) | Shrimp | % ASC-certified tonnes | 0% | 2.06% ⁶⁷ |

UPTAKE

Large international FMCG companies have led the uptake of certified commodities, with many of them introducing time-bound commitments for implementing certification across their major commodities. However, much more needs to be done in Asia, where companies' uptake of responsibly produced commodities is limited.

Among companies globally, the level of risk recognition on soft commodity procurement is high. For example, the CDP Global Forests Report 2015⁶⁸ highlighted that of the 171 companies it analyzed, 75 per cent recognized at least one supply chain risk associated with forest risk commodities with the potential to generate a substantive change in business operations, revenue or expenditure.

Steps have been taken toward sustainable procurement too. Seventy per cent of companies in the CDP report said they had a commitment to addressing deforestation and forest degradation and 88 per cent reported opportunities related to the sustainable production or sourcing of forest-risk commodities. Among the manufacturers and retailers which responded to the CDP Program, 77 per cent reported having procurement standards for their sourcing of forest-risk commodities and 85 per cent of those with a procurement standard factor compliance against it into supplier selection.

However, there are gaps in implementation, especially in terms of requiring certification. The CDP report states that standards often lack details and only five respondents explicitly mentioned the training of their procurement teams on what their policies imply for commodity sourcing. On the specific topic of certification for palm oil sourcing, only 18 per cent of respondents require it while 18 per cent prefer it and 64 per cent of respondents encourage it. However the report states that 25 per cent of companies with a commitment to source certified palm oil are yet to get any into their supply chains and this figure reaches 50 per cent for soy.



WWF's Palm Oil Scorecard⁶⁹ confirms a limited participation of Asian companies in buying certified sustainable palm oil. Yet an increasing number of Asian companies are becoming members of the RSPO, such as Kao Corporation, Ajinomoto Co Inc and Charoen Pokphand Foods PCL.

Initiatives encouraging uptake

Consumer Goods Forum

The CGF is leading the industry in terms of encouraging uptake. It is a platform of 400 global FMCG retailers, manufacturers, service providers and other stakeholders across 70 countries whose member companies have combined sales of over €2.5 trillion. In 2013, the CGF Board pledged "to mobilize resources within our respective businesses to help achieve zero net deforestation by 2020". The recommends that its members source certified palm oil,71 pulp, paper and packaging72 and soy.73

On 1 December 2015 the co-chairs of the CGF Sustainability Working Group issued a statement explaining the necessity for individual companies to collaborate with governments on public-private partnerships to reach the common objective to reduce deforestation.74 The statement indicated that CGF members intend to follow what they call a 'produce and protect' approach through which they will prioritize their commodity sourcing from areas where jurisdictional forest and climate initiatives have been designed and are being implemented. Only a few Asian FMCG companies are members of the CGF, mainly Japanese companies.

Palm Oil Innovation Group and national initiatives

The POIG states that it both builds on RSPO standards and commitments and demonstrates innovation in order to support and go further than the RSPO.⁷⁵ The POIG has 16 members, including FMCG companies Danone and Ferrero, alongside palm oil companies such as Musim Mas, and NGOs. The fact that Danone and Ferrero recently joined the POIG shows how FMCG companies can innovate to influence the adoption of voluntary best practices for sourcing commodities.⁷⁶

There are also national initiatives on sourcing sustainable palm oil which impact FMCG companies operating in those countries. These include initiatives in Belgium, France, Germany, Denmark, the Netherlands and the United Kingdom which have made commitments to source sustainable palm oil.⁷⁷

The Global Forest & Trade Network

The Global Forest & Trade Network (GFTN) links over 200 companies, communities, NGOs and entrepreneurs in more than 30 countries around the world. Its goal is to create a new market for environmentally responsible forest products. Since 1991, market-driven demands from GFTN participants have increased the economic incentives for responsible forest management. This is helping to ensure that millions of hectares of forests are independently and credibly certified, guaranteeing that the forests are well managed and that their products come from legal and sustainable timber harvests. This has enhanced the ability of participating FMCG companies to manage deforestation and forest degradation risks by increasing the amount of FSC-certified wood products available and the number of companies on track to become certified.



FMCG COMPANIES' UPTAKE OF RESPONSIBLY PRODUCED COMMODITIES IN ASIA IS STILL LIMITED BUT IS GROWING WWF's GFTN-North America programme has collaborated with Kimberly-Clark on its long-standing commitment to a 100 per cent certified fibre supply, with a preference for FSC-certified fibre supply. In 2014 FSC-certified virgin fibre accounted for 52.4 per cent of the total fibre used in its tissue products globally, with an additional 32.2 per cent made up of recycled fibre.⁷⁸

Uptake in Asia limited but growing

The table opposite shows the steps disclosed by major listed Asian FMCG companies on sourcing of responsibly produced commodities, highlighting that FMCG companies' uptake of responsibly produced commodities in Asia is still limited but is growing.

Figure 6: Companies' disclosure of commitments on certified commodities



| Company name | Disclosure on sourcing of certified commodities |
|--|--|
| Hindustan Unilever Ltd ⁸² | Unilever Group: Committed to sourcing all agricultural raw materials sustainably by 2020 in line with Unilever Group's commitment to achieving zero net deforestation associated with palm oil, soy, paper and board, and beef no later than 2020.* Extended commitment to tea business and supply chains using Rainforest Alliance and Trustea (industry code to embrace sustainability, safety and quality in tea sourcing) certifications with a target of 100 per cent certification of tea bags by 2015. Hindustan Unilever: All the palm derivatives of Hindustan Unilever have RSPO certificates. Nearly 90 per cent of paper and board used for packing products is from certified and sustainably managed forests. The paper and board mills selected are FSC chain of custody certified. All carton supply partners are FSC and PEFC certified. Unilever has joined the Bonsucro roundtable with Hindustan Unilever set to become the first food and beverage company to use sustainable sugar in India. *NOTE: Unilever Group states on its website ⁸³ that because each of its agricultural raw materials has a different growing method it has developed detailed guidelines for its key crops, published in its Unilever Sustainable Agriculture Code, which it requires all its suppliers to follow in the absence of a credible external standard. Examples of how Unilever aims to meet its target to source all agricultural raw materials sustainably by 2020 include: (1) Purchasing all palm oil sustainably from certified, traceable sources (Unilever helped to establish RSPO); (2) Taking 100 per cent of the paper and board for packaging from certified sustainably managed forests or from recycled material (75 per cent by 2015); (3) Sourcing 100 per cent of Unilever's tea, including loose tea, from Rainforest Alliance-certified estates. |
| Nestlé Malaysia Bhd (All information pertains to Nestlé Group) ⁸⁴ | Nestlé Group's Commitment on Deforestation and Forest Stewardship states that Nestlé will use the 'cut off' dates established by the FSC, RSPO and RTRS for conversion of forests and HCV areas, to determine when the company will not source products from plantations/ farms converted from forest land. By September 2013, Nestlé Group met its commitment to source 100 per cent RSPO-certified palm oil, two years ahead of schedule. This includes RSPO Segregated (16 per cent) and GreenPalm certificates (84 per cent), which it has now decided to phase out. Nestlé Group has Responsible Sourcing Guidelines⁸⁵ which reinforce its specific commitments on deforestation and forest stewardship, rural development and water stewardship. It uses FSC certification to demonstrate compliance with its guidelines. For palm oil, its Responsible Sourcing Guidelines go beyond the RSPO standard by making explicit provisions for the protection of peatland and high-carbon forest. Nestlé Group states that by 2014, 28 per cent of the volumes of its 12 priority categories of raw materials were responsibly sourced in accordance with its guideline requirements.⁸⁶ |
| Petra Foods Ltd ⁸⁷ | Subsidiary Delfi Cocoa Brazil is currently producing and distributing Rainforest Alliance-certified cocoa in Brazil. Facility in Hamburg also processes Rainforest Alliance beans. |

| Company name | Disclosure on sourcing of certified commodities |
|--|--|
| Thai Union Frozen Products PCL ⁸⁸ | Set target for 100 per cent of its fishery and aquaculture raw materials to come from internationally certified or responsible sources by 2020. Set target to source 100 per cent Marine Catch Purchasing Document fishmeal raw materials for its shrimp feed products by 2015. At its subsidiary Chicken of the Sea Frozen Foods, Global Aquaculture Alliance Aquaculture Certification Council-certified shrimps accounted for 67.53 per cent of US sales in 2014. The company plans to increase the proportion of certified shrimps to 100 per cent by 2020. NOTE: WWF does not support these certification standards. WWF supports credible standards such as ASC and MSC. |
| Unilever Indonesia Tbk PT ⁸⁹ | Unilever Group: Committed to sourcing all agricultural raw materials sustainably by 2020 in line with Unilever Group's commitment to achieving zero net deforestation associated with palm oil, soy, paper and board, and beef no later than 2020. Extended commitment to tea business and supply chains using Rainforest Alliance and Trustea certifications. Unilever Indonesia: Since 2012 all palm oil sourced by Unilever Indonesia is RSPO-certified and 63.8 per cent of sourced tea is Rainforest Alliance-certified tea blend.⁹⁰ *NOTE: Unilever Group states on its website⁹¹ that because each of its agricultural raw materials has a different growing method it has developed detailed guidelines for its key crops, published in its Unilever Sustainable Agriculture Code, which it requires all its suppliers to follow in the absence of a credible external standard. Examples about how Unilever aims to meet its target to source all agricultural raw materials sustainably by 2020 include: (1) purchasing all palm oil sustainably from certified, traceable sources (Unilever helped to establish RSPO) (2) taking 100 per cent of the paper and board for packaging from certified sustainably managed forests or from recycled material (75 per cent by 2015) (3) sourcing 100 per cent of Unilever's tea, including loose tea, from Rainforest Alliance-certified estates. |

Note that we do not assess the performance of these companies on responsible sourcing but have included their disclosure to facilitate comparison and engagement by financiers on this issue. For example, some companies have made more general commitments to sustainable sourcing without reference to specific certification $% \left(1\right) =\left(1\right) \left(1\right) \left$ standards for all commodities or without time-bound targets.

6. THE BENEFITS OF RESPONSIBLY PRODUCED COMMODITIES FOR FMCG COMPANIES

The sourcing of responsibly produced commodities offers a wide range of benefits to FMCG companies, outlined below.

A. OPERATIONAL BENEFITS

Evidence from studies across several commodities is that certification processes result in higher yields and more stable long-term supplies. Through supporting their suppliers to undergo certification, FMCG companies can create more resilient supply chains, with greater transparency, and higher quality control.

More secure supplies

Many FMCG companies are realizing that certification leads to more secure supplies of several different commodities.



Cocoa

The cocoa economy provides an excellent example of how certification can lead to more robust supplies. Its challenges are well known: low productivity, poor farm management practices, and outdated production systems – all contributing to frequent shortfalls in supply. 92

RobecoSAM states that for "producers that deliver directly to consumers or that have a brand name to protect, having good insight into the production processes is important for managing sustainability in the supply chain. In addition, declining availability of land and water for irrigation can lead to instability in supply and higher prices, posing a direct risk for food producers, as they cannot always pass higher prices onto consumers. Olam International, an important producer of a large number of commodities and trader in cocoa has, revealed that demand for cocoa, for example, is growing by 3 per cent per year whereas supply is steadily decreasing because of the declining number of farmers producing cocoa."⁹³

In order to guarantee quality supply of cocoa, companies including Mondelēz International Inc, Mars Inc, Nestlé SA and Barry Callebaut AG have committed to investing in initiatives around the production and science of responsibly produced cocoa in the coming years.

- **Barry Callebaut AG** works with farmers to increase cocoa productivity by providing training on certification requirements and yield enhancements and other technical support. The company states: "The future of the cocoa sector depends on the improvement of productivity on cocoa farms" and that "average yield of cocoa farms (in West Africa) vs biological potential is 13 per cent".94
- Mars Inc also recognizes the supply challenge and uses certification as a tool, saying: "Demand for cocoa is rising and unless something is done supply will soon not keep pace... we can help farmers produce better crops and make more money for their families. Ultimately, this will create a sustainable supply of quality cocoa as farmers are empowered to reinvest in their businesses and communities. Mars Inc has pledged to certify 100 per cent of its cocoa as sustainably produced by 2020."95
- Similarly, Mondelez International Inc states: "We want to help maintain the long-term stability of the cocoa supply chain and improve the welfare of cocoa farmers and farm communities... One part of our strategy is to support certification. In 2012 we were the world's largest buyer of Fairtrade cocoa and among the largest buyers of Rainforest Alliance-certified cocoa. Buying certified commodities is just one of the ways we promote sustainable farming, support farmers and enable consumers to make informed choices." 96

Mondelēz has also developed a palm oil sourcing policy in consultation with WWF and the United Nations Development Programme. 97 In October 2015, Mondelēz also started a collaboration with Cargill in Indonesia which aims to improve the livelihood of smallholder cocoa farmers in the country as well as to drive their adoption of sustainable farming practices.98



Sugar

Sugar supply faces similar issues. The Coca-Cola Company states on its website: "Through our global suppliers, our system buys millions of tons of fresh fruit, corn, tea, sugar, coffee and other ingredients every year. The future of our business depends on a reliable long-term supply of those ingredients... The challenges facing agriculture, along with increasing global demand for some commodities, can have very real impacts on our business. For example, some crops may decrease in availability and increase in cost as the agricultural productivity of certain regions is constrained by changing weather patterns."99

The Coca-Cola Company, in cooperation with WWF, is making long-term investments into sustainable agriculture in its supply chains, focusing on its most important commodities, including sugarcane and corn in China and elsewhere. The company is not only engaging in pilot projects to improve production and farm practices, but also developing and beginning to implement the Bonsucro standard and certification system, "one of a growing set of agricultural certifications we support". 100



Seafood

Abba Seafood AB – a Sweden-based cannery company – imports longtail tuna from Thailand. The company routinely evaluates the status of every fish stock it sources from, including the fishery methods, status of stocks and how the fishery is managed. The information they received from their suppliers was not enough to guarantee that the fishery was sustainable on these fronts. 101 To address this problem and underpin its supplies, Abba Seafood AB established a fishery improvement project in 2011 with stakeholders in Thailand. 102 Partners included the Sustainable Fisheries Partnership, an NGO that provides technical assistance on sustainable procurement and fisheries improvement, and the Swedish International Development Agency. As Abba Seafood AB's in-house expert on food legislation and declaration Maria Aberg put it: "If there is no fish in the future there is no Abba."

Efficiency gains for suppliers to FMCG companies

A number of studies show that certification brings many benefits to commodity producers, notably through improving efficiency.

Examples of efficiency gains companies have achieved are outlined below.

Palm oil plantations seeing efficiency benefits of certification

Palm oil plantations have seen a number of advantages of certification, according to the RSPO. For example, a report by WWF in collaboration with UK development corporation CDC and the Dutch development bank FMO shows:103

- Certification can reduce the risk of disruptions due to community protests. For a processing facility, this can result in millions of dollars of cost savings.
- Certification can also reduce turnover of workers, in one case by 6 per cent.
- Certification can lead to productivity improvements cooperative leaders believed they achieved improvements of up to 70 per cent, with one smallholder group experiencing a 186 per cent increase.

Positive social impacts of FSC certification

Released in April 2014, the CIFOR-WWF study Social Impacts of the Forest Stewardship Council Certification: An Assessment in the Congo Basin¹⁰⁴ confirmed that:

FSC-certified logging concessions are consistently associated with a range of additional social benefits over and above those provided by non-certified forest management units (FMUs).

• In non-certified FMUs, only constrained by the law, there is a more lax implementation agenda, almost no verification of social standards and more conflict with local populations.

The study concludes that these positive social outcomes materialized because certification pushes companies to maintain a permanent channel of communication with local populations. This avoids unexpected disruptions and social conflicts that might not only interfere with normal operations, but also increase the company's reputational risk.

Certification makes business sense for soy producers

According to a KPMG report 105 in collaboration with WWF, IDH, FMO and IFC, A roadmap to responsible soy: approaches to increase certification and reduce risk, certification makes business sense for soy producers because:

- The investment in certification is on average paid back in as little as three years.
 This can go down to one year for best-prepared large producers, while less-prepared medium-sized producers may achieve return on investment in less than five years.
- Markets are growing for certified soy with an increasing number of end users committing to certified soy. Producers can also obtain access to discounts on agricultural inputs and finance.
- Certified producers can benefit from the implementation of improved agricultural
 practices in fertilizer use and crop rotation, which can result in reduced input use,
 fewer incidents of chemical spills, and productivity improvements.

FMCG companies can support their suppliers

In some cases producers need support from FMCG customers to fund the initial investment. The FMCG companies can recoup related costs through more secure supplies and potentially lower costs as commodity production volumes increase as well as the ability to meet customer demands.

The *Global Forests Report 2014*¹⁰⁶ highlighted that 100 per cent of producers, processors and traders reporting on palm oil claim to be engaging in capacity-building activities in their supply chain to provide or use sustainable materials. However, this number goes down to 68 per cent for manufacturers and retailers, suggesting room for greater action by FMCG companies and retailers.

Smallholder producers of soy and cotton in India have low productivity. A partnership of FMCG companies and NGOs invested in improving their production practices, and smallholders taking part have reported significant productivity increases of up to 54 per cent.¹⁰⁷ Since these farmers make more effective use of inputs and increase outputs, the cost of production per tonne is likely to be lower.



IN SOME CASES
PRODUCERS NEED
SUPPORT FROM
FMCG CUSTOMERS
TO FUND THE INITIAL
INVESTMENT

B. REDUCED REPUTATIONAL RISKS

As markets mature, brand value represents an increasingly large percentage of a company's market capitalization. Asian companies that do not make an effort to source responsibly produced commodities run the risk of being seen as laggards by both their civil society stakeholders and their consumers - with negative consequences for their reputation. This could affect companies' stability of earnings and future growth potential. Conversely, those that move ahead may find new opportunities.

Research shows that in the US, opposition from social movements leads to a negative impact on share price for companies. 108 There may be a similar risk for Asian FMCG companies. Risks relating to food safety are well known; however, there are a growing number of reputational issues relating to sourcing that are relevant for Asian FMCG companies, not just the global brands. Examples include:

- Thai Union Frozen Products PCL was linked to a 2014 Associated Press investigation on the use of slave labour on fishing boats supplying the Thai seafood industry109 and cut ties with the supplier named in the report in early 2015.110 Following a 2015 article in the New York Times on slave labour in its supply chain, Thai Union Frozen Products PCL has implemented a new, more stringent code of conduct and stricter monitoring and compliance protocols. $^{\scriptscriptstyle 112}$ It is partnering with trade associations and NGOs to influence regulators to adopt stronger laws against forced labour and also to raise awareness across the industry on the issue of human rights abuses.
- Charoen Pokphand Foods PCL was implicated in a 2014 Guardian investigation alleging that it bought fishmeal, which it feeds to its farmed prawns, from some suppliers that own, operate or buy from fishing boats manned with slaves. 113
- Tata Tea Ltd, which owns the Tetley brand, was implicated in a 2014 report by Columbia Law School alleging that its tea pickers were living in inhumane conditions. 114 This led the company to commission an independent assessment to determine the facts and recommend necessary actions. 115

Responsibly produced commodities with chain of custody systems and certification are more transparent than conventional commodities. This significantly reduces reputational risks for FMCG companies as well as increasing their ability to offer the consumer insight into the product source. One notable benefit of transparency is providing assurance on food safety issues to the end customer.

C. POSITIVE BRANDING OPPORTUNITIES

Products made with responsibly produced commodities have a potential marketing advantage over conventional products. There are solid examples in more developed markets with lessons that may increasingly apply in Asia.

A 2014 study by Nielsen showed 55 per cent of global online consumers across 60 countries say they are willing to pay more for products and services provided by companies that are committed to positive social and environmental impact. It found that the propensity to buy socially responsible brands is strongest in Asia-Pacific (64 per cent), Latin America (63 per cent) and the Middle East/Africa (63 per cent). The 64 per cent figure for Asia-Pacific in 2014 compares to a 55 per cent figure in 2011, suggesting growing consumer awareness.¹¹⁶

Asian customers perceive green products as higher quality compared to conventional products. A willingness to pay for products with sustainability attributes is confirmed by studies in the Philippines,¹¹⁷ China¹¹⁸ and Japan.¹¹⁹ Market potential varies depending on the type of product and the consumer market segment.

Asian FMCG companies not using responsibly produced commodities in their products risk missing these business opportunities, particularly to international competitors that already have responsible sourcing plans in place.

Specific examples of marketing benefits include:

- Unilever NV reported an increase of market share for Lipton Tea of 1.8 per cent in the UK and 1.6 per cent in Australia after launching a campaign promoting its sustainability efforts. 120 According to Michiel Leijnse, manager of Global Brand Development for Lipton, the company has experienced more than 10 per cent sales growth in Italy and Sweden in the first year since the introduction of certified tea into its brands in Western Europe. 121
- **McDonald's Corp** collaborated with the MSC to advance positive environmental and economic practices in its seafood supply chain. ¹²² The company, which uses MSC-certified wild-caught Alaska pollock for its Filet-O-Fish sandwich, began displaying the MSC ecolabel on product packaging, in-restaurant communications and external marketing beginning in 2011 in Europe and 2013 in the USA.
- Japanese retailer Aeon Co Ltd has increased its range of MSC-certified fish products and expanded its private-label MSC merchandise, demonstrating to customers its commitment to securing the long-term availability of these fish products by promoting the recovery of marine fisheries. ¹²³ The company has stated it recognizes its responsibility to protect marine resources and has committed to communicating in store in partnership with the MSC to help change customers' shopping behaviour. ¹²⁴
- If well managed, the issue of deforestation can strengthen a company's reputation
 and turn a risk into an opportunity. Danone SA has adopted a leadership position
 on palm oil sourcing by joining the Palm Oil Innovation Group in 2015. Danone
 uses its sustainable sourcing policies to differentiate itself with its consumers, and
 communicates these credentials on its customer facing website, Down to Earth. It



also states that it develops a competitive advantage based on a licence to operate and a positive differentiation between itself and its competitors. 125

• In Vietnam's coffee sector, **Nestlé SA**, **Mondelēz International Inc** and others work together with IDH (the Dutch Sustainable Trade Initiative) to offer farmers free training and higher prices for certified beans. Nestlé has trained about 40,000 growers. Adopting more sustainable farming in Vietnam could boost production among individual farmers by 10 per cent and incomes by 30 per cent on average, according to IDH. ¹²⁶ In addition, the companies are able to meet end customer demands for higher quality and more sustainable commodities. "Consumers want to feel good about the coffee they are drinking," said the European director of sustainability at Mondelēz International Inc. "They expect big buyers like us to take action. We also need to secure the right quality."

D. ANTICIPATION OF TIGHTER RETAILER SOURCING POLICIES

An increasing number of retailers in developed markets are pledging to use responsibly produced commodities in private-label products. This presents a risk for Asian FMCG companies if they are not able to meet the new retailer sourcing policies. It also represents an opportunity to increase their market share by developing a base of sustainable products to serve the demand.

Retailers including Carrefour,¹²⁸ Delhaize,¹²⁹ Ahold,¹³⁰ Waitrose,¹³¹ Walmart,¹³² Tesco¹³³ and Marks & Spencer¹³⁴ have committed to using sustainable raw materials in their own-label products. For example, Tesco,¹³⁵ Waitrose¹³⁶ and Marks & Spencer¹³⁷ are already sourcing 100 per cent certified sustainable palm oil for their own-label products (although not yet from Segregated sources).

The annual haze in Southeast Asia has resulted in growing consumer and retailer concerns about selling and consuming products linked to deforestation and open burning. Asia Pulp and Paper's products were removed from three retail chains in Singapore¹³⁸ due to the parent company being investigated for its links to the forest fires. This is a clear example of an FMCG company failing to meet stricter retailer sourcing policies even for non-private label products and this having an impact on revenues.

E. REDUCED REGULATORY RISKS

Without certification, FMCG companies may be sourcing commodities that are not in compliance with domestic laws of producer countries. For example, a 2011 assessment by an Indonesian government task force¹³⁹ found that 81 per cent of palm oil plantations were operating without required Forest Relinquishment Permits from the Ministry of Forestry. According to research by WWF¹⁴⁰ 5 to 50 per cent of globally traded food commodities (the percentage depends on the specific commodities) are not

produced legally in the country of origin. Recent research 141 estimated that food fraud affects 10 per cent of the worldwide commercial food supply and a study by WWF¹⁴² found that between 17 and 31 per cent of global seafood is not produced legally.

Illegality can stem from access to the resource, labour rights, fraud, corruption, or regulations such as compliance with deforestation laws, but in all of these five cases the resulting illegally produced commodities can impact all stakeholders of the food producers. 143 Illegality can indeed encourage corruption and human rights abuses, and drive environmental degradation.

There are a number of risks that may result from sourcing commodities that are not produced in accordance with regulation. These include supplier disruption, direct fines, reputational risks, and restrictions on market access. Given the complexity of globalized supply chains, tackling illegality will take time. Responsible sourcing of commodities through certification is therefore a relatively simple and immediate step for FMCG companies to take so as to manage these risks. All certified responsibly produced commodity standards reduce these risks as they require compliance with the law.

The disruption risk may arise if suppliers are unable to ship products due to stronger enforcement of regulations in producer countries. A supply chain that excludes illegally produced commodities should effectively mitigate this risk.

Usually there are limited direct fines for FMCG companies that have sourced commodities from elsewhere that were illegally produced. The US Lacey Act has such provisions relating to timber. This proved a challenge for Gibson Guitar Corporation, a US-based guitar manufacturer. It was found to have breached the Act by importing ebony from Madagascar. 144 It settled two claims in August 2012 for US\$300,000 in penalties and a US\$50,000 charitable donation, as well as the forfeit of claims to wood items seized in raids by the authorities. The legal fees were reported as more significant.

Moves to limit access to goods made from illegally sourced materials include the following:

Note that the EU Timber Regulation, Lacey Act and Australian Act apply to pulp and paper products, which are part of some FMCG companies' product range.

• In October 2010, the EU adopted the EU Timber Regulation (EUTR) (Regulation 995/2010) to prevent sales of illegal timber and timber products on the EU internal market. Since March 2013, any operator who places timber or timber products on the EU market for the first time has to ensure they are legally produced. Certification provides an efficient way to fulfil parts of the due diligence requirements of the EUTR.145



GIVEN THE COMPLEXITY OF GLOBALIZED SUPPLY CHAINS, TACKLING ILLEGALITY **WILL TAKE TIME.** RESPONSIBLE **SOURCING OF COMMODITIES** THROUGH **CERTIFICATION** IS THEREFORE A **RELATIVELY SIMPLE AND IMMEDIATE** STEP FOR FMCG **COMPANIES TO TAKE SO AS TO MANAGE**

THESE RISKS

- The Australian government passed the Illegal Logging Prohibition Act in 2012. The Act criminalizes the importation into Australia of illegally logged timber and timber products as well as the processing of domestic raw logs that have been illegally logged. The Illegal Logging Prohibition Amendment Regulation, in effect from November 2014, requires importers and domestic processors to have a due diligence system in place to minimize the risk of importing or processing illegally logged timber, 146 similar to the EU.
- The US Lacey Act, in effect since 2008, prohibits imports of illegal wood products. The Act makes it illegal to trade illegally sourced wood products in the US. Importers are required to declare country of harvest, genus and species, product volume and value in a phased-in schedule.
- In October 2012, the UK government and UK organizations signed an
 agreement to work to sourcing 100 per cent certified palm oil by 2015. In 2012, it
 was estimated that 52-60 per cent of the palm oil in the UK was certified.¹⁴⁷ In the
 Netherlands, France, Belgium, Norway, Sweden, Denmark and Germany there are
 (private sector-initiated) national commitments toward sustainably certified palm
 oil as well.¹⁴⁸
- In March 2015 the **UK government** adopted the Modern Slavery Act 2015, which aims to ensure that products sold in the UK are slavery-free. The Act "require[s] businesses over a certain size threshold to disclose each year what action they have taken to ensure there is no modern slavery in their business or supply chains". 149

In Europe a survey commissioned by WWF in August 2015¹⁵⁰ across nine countries identified high support for better laws that ensure the legality of wood-based products on the market. Three-quarters of the respondents did not know products made from illegal timber could still be bought in the EU and 85 per cent said it was important to them that measures be put in place to make sure people could not buy products made from illegal wood.



7. OVERCOMING HURDLES TO RESPONSIBLE COMMODITY SOURCING

Below we outline a number of common hurdles to sourcing responsible commodities for FMCG companies – and how they can be overcome.



HURDLE: CONCERN OVER THE COST OF SOURCING CERTIFIED RESPONSIBLY PRODUCED COMMODITIES

There are costs for both FMCG companies and producers. The producers typically recoup the certification costs via productivity gains, avoided stoppage costs, preferred purchasing, longer-term contracts, and in some cases, a premium for certified products.

For FMCG companies, implementing necessary changes at the management unit, auditing, certifying and tracing responsibly produced commodities through the supply chain comes at a cost. In some product categories the expense of auditing, labelling, tracing and physically separating products in segregated supply chains can be higher than the immediate (financial) benefits.

Solution: Where there are costs, these can be viewed as an investment to generate the multiple benefits outlined previously. In addition, by getting to know its supply chain and suppliers better, an FMCG company may identify new efficiencies or cost savings. This process often leads to longer-term supply chain relationships that benefit both suppliers and buyers in terms of certainty and quality.

FMCG companies can reduce such costs by working together with internationally recognized standards to minimize duplication of efforts. Industry-wide initiatives can create efficiencies in auditing, certifying, monitoring and tracing. These industry-wide initiatives can include upstream producers and by working together in a precompetitive manner, FMCG companies can create coordinated demand, for example through voluntary sector agreements, that will bring down the costs of sourcing certified commodities.

Traded certificates are also a way to stimulate certified production while limiting initial expenditure in traceability and segregation. This is a useful model for FMCG companies to start with, and certified producers will receive a direct financial stimulus. However, it does not convey the full range of benefits to companies.

Examples: All standards mentioned in figure 5 on page 38 are widely recognized certification schemes including different supply chain options (for example, physically segregated). Over time, as these certification standards become widely accepted, the costs of certification will also fall.



OF EFFORTS

In September 2015 WWF and the Chinese Forestry Industry Association jointly launched the China Sustainable Paper Alliance with 10 leading producers and buyers committing to increase production and purchase of FSC and recycled paper. 151 Founding members include 10 domestic and international companies active across the whole supply chain of China's pulp and paper industry: China Paper (China's biggest state-run paper company), Sun Paper (the country's largest private paper company), global producers Kimberly-Clark, International Paper, UPM, Stora Enso and Fibria, as well as buyers such as HP, Fuji Xerox and Ikea.

The Alliance will seek to engage strategic market players within the paper industry supply chain, including producers, converters and buyers, to commit to responsible paper products procurement and sales, and to create a coordinated demand for responsible paper products through a pre-competitive platform. To raise awareness, companies will collaborate with WWF on communication efforts targeting corporate buyers and consumers in China.



HURDLE: LACK OF CONSUMER AWARENESS AND SUPPORT FOR SUSTAINABLY PRODUCED GOODS

There is a perception that Asian consumers are relatively less inclined to pay a premium for products made with responsibly produced commodities. This may partly be because Asian consumers are generally not aware of the environmental and social issues in the supply chains of the products they buy and are typically not pushing companies to tackle them. In addition, lack of clear labelling of products has impeded consumers' ability to act.

Solution: With increased prosperity for many Asian consumers, the opportunities for premium-priced brands that differentiate themselves with sustainability credentials are growing.



Companies should first consider their positioning carefully and obtain relevant research. This may identify that consumers are willing to pay a premium and help the company to identify product strategies. It may also require the company to educate consumers on the sustainability credentials of a product.

Examples: Consumers in Asia have indicated a 'willingness to pay' for responsible products. According to a 2014 Nielsen study, 64 per cent of the respondents in Asia-Pacific indicated a willingness to pay for products with positive social and environmental impact. 152 But there is a discrepancy between survey outcomes and actual behaviour. In practice, as in the West, customers may still favour low prices, food safety and health attributes over sustainability. However there are still many marketing opportunities, such as promoting the food safety assurance provided by chain of custody certification.



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THE COMMODITIES
IN THEIR SUPPLY
CHAINS

Examples: Australian food company **Coles Group Limited** has committed to label palm oil where it is used in its own branded products, so as to educate its consumers and assist them to make informed purchasing decisions. Coles is now using only sustainable palm oil in its branded food and drink and aims to source Identity Preserved and Segregated certified sustainable palm oil as more becomes available in the future. ¹⁵³ In seafood, Coles partnered with WWF¹⁵⁴ in 2011 to improve the sustainability of its supply, and educate consumers about sustainable seafood choices, including use of the MSC and ASC labels. In October 2015 Coles became the first major supermarket in Australia to offer customers certified sustainable seafood when they introduced ASC-certified fresh salmon and MSC-certified wild-caught prawns. ¹⁵⁵

Ikea announced in September 2015 that all seafood sold in its stores now comes from ASC- and MSC-certified sources. With 23 seafood species sold and served in the company's 47 markets, Ikea is the food service provider that offers the largest variety of certified seafood globally. Their commitment has enabled them to bring certified seafood to eight new markets, including Turkey, Thailand and the Middle East, where it was not available before. ¹⁵⁶

Nespresso AAA¹⁵⁷ is an example of a programme where a company has a 'story to sell' and has effectively used its responsibly produced commodity sourcing policy as a marketing tool. On its consumer facing website, it promotes its Positive Cup Vision¹⁵⁸ and highlights its sustainability commitments via its AAA programme, which it launched together with Rainforest Alliance in 2003. It gives support and technical assistance to farmers with the aim of improving sustainability (based on the Sustainable Agriculture Network standards) and productivity while maintaining high quality. In 2010, Nespresso was sourcing more than 60 per cent of its coffee from farmers that are part of the programme. Nespresso pays a premium of 30-40 per cent above the market price in line with its high value product segment.



HURDLE: LACK OF UNDERSTANDING OF SUPPLY CHAIN ENVIRONMENTAL AND SOCIAL RISKS

Many FMCG companies lack insight into the environmental and social risks in their supply chains and how they may be exposed to these risks. For example, CDP's *Global Forests Report 2015*¹⁵⁹ showed that companies further along the commodities supply chain are less likely to recognize operational risks to their business, with only 35 per cent of manufacturers identifying operational risks associated with soy when 83 per cent of producers see that same risk.

Due to outsourcing and the widespread use of commodity traders, many companies do not have relationships with their soft commodity producers and may not know where their products come from.

For example, for palm oil, the lack of transparency is inherent in all parts of the supply chain - mills buy origin-unknown fresh fruit bunches from outgrowers; plantation companies do not disclose how much land bank they have or where it is; related companies, subsidiaries and joint ventures are not clear; traders accumulate; FMCG companies substitute palm oil with other vegetable oils from other suppliers on a daily basis; and retailers do not label their products as containing certified sustainable palm oil.

Solution: Companies can start with a thorough assessment and risk analysis, and substantiate the operational, regulatory and reputational risks associated with the commodities in their supply chains. By understanding their own footprint and which suppliers are within their supply chain, they can begin engaging with them to develop and implement appropriate policies and practices.

Examples: WWF has developed a Supply Risk Analysis Tool (see www.supplyrisk. org) to help companies understand and manage the environmental and social risks of raw materials in their supply chains. This tool covers around 30 broad topics, from CO_o emissions and depletion of biodiversity to labour rights and water use. The 'risk matrix' gives a score based on the severity of the risk and how likely it is to occur. For example soy in Brazil scores the highest rating for habitat conversion, impact on biodiversity and GHG emissions. McDonald's and Johnson & Johnson are some of the many FMCG companies who have already used the Supply Risk Analysis Tool.

PepsiCo Inc worked with suppliers, as part of the CDP Supply Chain Programme, to share information about their own learning curve and worked together to tackle climate change. They realized that deforestation by their agricultural suppliers was one of the main sources of their GHG emissions. As a result of the programme, suppliers began to seriously analyze the impact of climate change on their business, often for the first time.160



HURDLE: LACK OF TRACEABILITY OR CONTROL OF SUPPLY CHAIN

An important tool to achieve greater transparency in supply chains is traceability. Traceability is the identification of suppliers and receivers for each operation in the supply chain. Ensuring full traceability in supply chains is not the same as sustainability but it will enable FMCG companies to ascertain that they are using certified products that reduce their exposure to environmental and social risks. In other words, traceability is an important step on the journey to fully sustainable supply chains.

In many cases a critical challenge in traceability is to establish the link between the location of harvesting and initial processing, i.e. field to mill. In timber and palm oil, it is crucial to go beyond the mill to the underlying forest or plantation to break the link with deforestation and other risks.

Solution: FMCG companies are increasingly being asked to ensure the traceability of the commodities they use back to verified sources. Larger commodity users may have the resources to deliver this themselves. But many companies using smaller volumes can rely on credible certification schemes like the FSC, MSC and RSPO, which have supply chain controls already in place to deliver the required traceability.

Examples: Kao Corp committed to purchasing only sustainable palm oil traceable to the mill for use in Kao products by 2015 and to the plantation by 2020. ¹⁶¹ Kao Corp has committed to zero deforestation by 2020 through cooperating with plantations, suppliers and third party organizations and intends to obtain RSPO certification of Kao Group factories in order to build a traceable supply chain for the Kao Group.

With regards to paper, by 2020, Kao Corp will purchase only recycled paper or sustainably sourced paper and pulp for use in its consumer products, packaging and offices. In the event that it has to use virgin pulp, Kao Corp has committed to zero deforestation at the source of wood fibre for raw materials and by 2020, Kao Corp will purchase only pulp for raw materials that is traceable to the source.

WWF has developed a transparency tool for pulp and paper producers, some of them selling brands directly (see *epci.panda.org*). The WWF Environmental Paper Company Index (EPCI) also provides valuable feedback from an international environmental organization on a company's pulp and paper production and can be useful for FMCG companies to develop more transparent and sustainable supplier bases. In 2015 the number of voluntary participants in the EPCI rose to 31 compared to 25 in 2013 and companies who participated in the EPCI 2013 were able to increase their overall scores on more than 90 per cent of product categories.



HURDLE: REGULATION AND PROLIFERATION OF STANDARDS CREATE CONFUSION FOR FMCG COMPANIES

Governments are increasingly becoming involved in 'voluntary' standards, from development of national production standards and defining sustainability standards for product labelling to investing public funds in development or implementation of standards. This results from increasing public and private sector awareness of the approach of transforming markets through responsible standards and presents both opportunities and risks.

There is also a proliferation of standards and schemes. Sustainability can become conflated with legality and traceability, resulting in weaker standards gaining traction. There can be public scepticism of institutions including governments, multinational companies and increasingly the claims of large NGOs.

Most stakeholders, including government buyers, brands and retailers, and consumers, engage with standards through ecolabels or other claims, and they need to be able to trust that those claims are an accurate reflection of what has been achieved.



WWF considers that for any sustainability standard or certification scheme to be credible162 and effective it should, among other factors:

- Focus on minimizing or eliminating important negative environmental and social impacts, as well as creating positive environmental, economic and social outcomes;
- Provide transparency through meaningful stakeholder participation in decisionmaking and public reporting on certification progress and outcomes;
- Require independent third party verification, certification and accreditation;
- Require truthful claims, and where applicable, traceability;
- Be committed to continuous improvement.

Solution: Companies should source commodities certified by international, credible, independent, multi-stakeholder-based standards that meet ISEAL codes of good practice for impact and assurance - see figure 5 on page 38 for standards WWF supports. Companies should dig into the details of the sustainability claims of the certification scheme; ISEAL is developing a good practice guide to bring higher quality and consistency to sustainability claims and labelling.¹⁶³



APPENDIX TO CHAPTER 1: DEFORESTATION

INTRODUCTION

Most of the soft commodities procured by Asian FMCG companies are closely associated with deforestation. This appendix gives some key information about this vital issue.

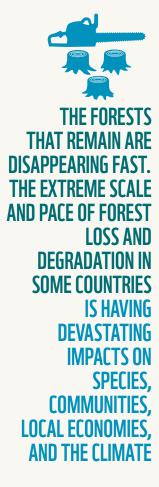
As both supply chain challenges and calls for transparency increase, FMCG companies can no longer afford to ignore the problems associated with deforestation without incurring risks to their operations, profitability, legal compliance, brand value and reputation.

FMCG companies urgently need to begin or increase sourcing of responsibly produced commodities as one of the main ways to break the link between their raw materials and deforestation/forest degradation. In addition to protecting crucial ecosystems, sourcing responsibly produced commodities will enhance the security of supply for FMCG companies, allow traceability of products back to responsibly produced raw materials and contribute to the long-term viability of supply chain partners — many of whom are small producers.

WHAT IS DEFORESTATION AND FOREST DEGRADATION?

- Deforestation is the conversion of forest to another land use or the long-term reduction of tree canopy cover. This includes conversion of natural or semi-natural forests to tree plantations, agriculture, pasture, water reservoirs and urban areas. It excludes logging if the forest is expected to regenerate naturally or with the aid of forestry measures.
- Degradation happens when areas of natural forest are more gradually transformed through processes including partial logging, burning and small-scale clearing. This can lower their value for wildlife, habitats, carbon storage, soil fertility and communities. Left unchecked, degradation can result in the forest becoming vulnerable to fire and invasive species. It can eventually lead to the forest being replaced by other land uses, especially in remote places where logging roads are used for encroachment. Avoiding forest degradation is just as important as stopping deforestation; sustainable forest management is a critical strategy to avoid these 'death by a thousand cuts' scenarios.





ABOUT DEFORESTATION

Rainforests are home to some of the world's most biologically and culturally diverse landscapes. Despite their importance, a significant part of the Earth's natural forests has already been lost or degraded through conversion to agriculture or urbanization, or through unsustainable forest management and fragmentation. This process has accelerated greatly in the last decades due to increased consumption and population growth.164

The forests that remain are disappearing fast. The extreme scale and pace of forest loss and degradation in some countries is having devastating impacts on species, communities, local economies, and the climate. It is also important to note that in addition to deforestation, the loss of other native vegetation such as highly critical grasslands should be considered. We focus on deforestation in this appendix given most of the soft commodities procured by Asian FMCG companies are more closely associated with tropical deforestation.

Certain agricultural and wood-based commodities can drive major sustainability issues if forests are cleared and/or degraded to make way for their production. The issue of deforestation can be significant in FMCG companies' supply chains as they are largely dependent on agricultural and wood-based commodities.

HOW CAN DEFORESTATION CAUSED BY COMMODITIES PRODUCTION BE **AVOIDED OR REDUCED?**

WWF advocates a global shift to Zero Net Deforestation and Forest Degradation (ZNDD) by 2020. ZNDD means no net forest loss through deforestation and no net decline in forest quality through degradation.¹⁶⁵ In advocating ZNDD by 2020 as a global target, WWF stresses that:

- (a) Most natural forest should be retained and the annual rate of loss of natural or semi-natural forests should be reduced to near zero; and
- (b) Any gross loss or degradation of natural forests would need to be offset by an equivalent area of socially and environmentally sound forest restoration. In this accounting, plantations are not equated with natural forests as many values are diminished when a plantation replaces a natural forest.

ZNDD is not the same as a call for no forest clearing anywhere under any circumstances. For instance, it recognizes people's rights to clear some forests for agriculture, new roads or schools, and the value in occasionally 'trading off' degraded forests to free up other land to restore important biological corridors, provided that biodiversity values and net quantity and quality of forests are maintained, and the rights of local communities or indigenous people are respected.



Although it is clear that the growing world population needs more natural resources, there are more sustainable ways to increase production than converting forests to agriculture and plantations. Average palm oil yield, particularly for the 40 per cent of supply from smallholders, is less than a third of that of the best yields achieved by the industry. This illustrates the potential to easily double production without any further expansion (and related deforestation) while at the same time improving livelihoods for the poorest producers.

Even where expansion is needed, there is appropriate land available for crops to be planted with little or no further impacts on wildlife, communities or GHG emissions. For example, non-forested lands in Indonesia are estimated to range from 12 to 74 million hectares, 166 compared to the current global total of 13.5 million hectares planted with oil palm. This means that even the lower estimate is more than sufficient to meet projected doubling in global palm oil demand by 2050.

Deforestation and degradation are avoidable if commodities and timber are planned, cultivated, sourced and managed in a sustainable way. Governments also have a crucial role to play in setting a policy framework to ensure production of natural resources is done sustainably. Certification of commodities is one way to help ensure sustainable methods of production that avoid deforestation and forest degradation.



DEFORESTATION THROUGH OPEN **BURNING LEADING** TO EXTENSIVE **FOREST FIRES** HAS BEEN **ANOTHER PRESSING ISSUE** IN SOUTHEAST **ASIA DUE TO THE** ANNUAL HAZE

WHAT ARE THE DRIVERS OF DEFORESTATION AND FOREST DEGRADATION?

There are proximate/direct drivers of deforestation and degradation as well as underlying/indirect drivers, as explained in the report Drivers of Deforestation and Forest Degradation. 167

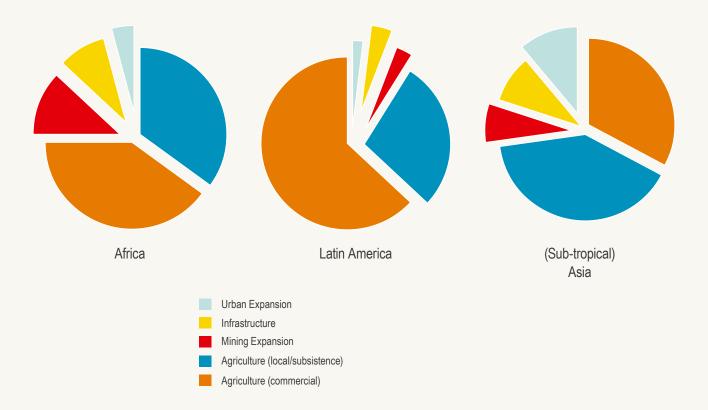
Direct drivers are human activities and actions that directly impact forest cover, such as removal of forests for agriculture, unsustainable timber extraction, logging and fuelwood collection, uncontrolled use of fire and clearing for roads and infrastructure.

Agriculture is by far the largest direct driver of deforestation (defined in this report as conversion from forest to other land use categories with the assumption that forest vegetation is not expected to regrow naturally in that area). It is responsible for an estimated 80 per cent of deforestation worldwide. 168 In (sub-tropical) Asia, agriculture is responsible for 70 per cent of deforestation; commercial and subsistence agriculture are responsible for more or less an even share.*

With forest degradation (defined as the reduction of the canopy and loss of carbon in remaining forests), unsustainable timber extraction and logging activities account for more than 70 per cent of total degradation in (sub-tropical) Asia.

^{*} It should be noted that slash-and-burn subsistence agriculture was traditionally stable as forests were left to regenerate fully. This is no longer the case due to shrinking habitats (partly caused by expansion of commercial agriculture) and rising populations.





Underlying or indirect drivers are interactions of social, economic, political, cultural and technological processes that affect the direct drivers to cause deforestation. Examples of indirect drivers include commodity prices, population growth, consumption patterns, national and international policies, financing, governance and poverty.

The most critical indirect drivers include economic growth based on the export of primary commodities (grown in former forested areas); and an increasing demand for wood products. ¹⁶⁹ Other indirect drivers are weak forest sector governance in many countries, lack of cross-sectoral coordination and illegal activity (related to weak enforcement).

Of course, the drivers of deforestation are different for each deforestation front. The figure opposite from WWF's *Living Forests Report* chapter 'Forests at Risk' published in

2015¹⁷⁰ provides a summary of these drivers of deforestation. The most common pressures causing deforestation and severe forest degradation in deforestation fronts in Asia are: large and small-scale agriculture, unsustainable logging, pulp plantations, mining, infrastructure projects and increased fire incidence and intensity.

Regions most impacted by deforestation include Latin America (Amazon, Cerrado, Gran Chaco), Africa (Congo Basin, East Africa) and Asia-Pacific (Sumatra, Greater Mekong region, Borneo, New Guinea).

Small-scale Livestock Large-scale Pulp Fires **Charcoal and** Mining Infrastructure Hydroelectric Unsustainable agriculture agriculture & plantations fuelwood logging power colonization Amazon Atlantic Forest/ Gran Chaco Borneo Cerrado Chocó-Darién Congo Basin East Africa Eastern Australia Greater Mekong New Guinea Sumatra

Figure 8: Drivers of deforestation on key fronts

Summary of main pressures on forests in different deforestation fronts Primary cause Important Not a cause Less of forest loss secondary important of forest loss and/or severe cause of cause of and/or severe degradation forest loss forest loss degradation and/or severe and/or severe degradation degradation

WHAT PROBLEMS DO DEFORESTATION AND FOREST DEGRADATION CAUSE?

Alongside the devastation to biodiversity, deforestation and forest degradation are key contributors to rising atmospheric CO₂ levels and climate change. Agriculture, forestry and other land uses account for 20-24 per cent of global anthropogenic emissions of GHGs. ¹⁷⁰ Moreover, less forest equates to a reduced carbon sink, further increasing atmospheric concentrations of GHGs. ¹⁷¹

Deforestation and forest degradation can also disrupt local weather, rainfall, and water retention systems critical for regional agricultural production. In addition, local communities depend on forests for food, fuel, medicine and fibre and risk losing their traditional livelihoods if forests are cleared or degraded.

DEFORESTATION IN ASIA

WWF has identified 11 places in the world as major deforestation fronts, as shown in the figure below from WWF's *Living Forests Report*. These places are where the bulk of global deforestation is projected to take place over the two decades from 2010 to 2030, under business-as-usual scenarios and without interventions to prevent losses. Of these 11, four are in Asia: Sumatra, Borneo, Greater Mekong and New Guinea.



Figure 9: The world's 11 major deforestation fronts

Indonesia has experienced the highest levels of deforestation across the region in recent years and is home to three of the 11 major deforestation fronts: Sumatra, Borneo and New Guinea (the Indonesian provinces of Papua and West Papua). Based on World Resources Institute (WRI) analysis for 2011, the country is the world's sixth largest emitter of GHGs, 173 but has the highest GHG emissions intensity per unit of GDP. Eighty-five per cent of its GHG emissions stem from land use change, such as deforestation and peat development as well as peat fires.¹⁷⁴

Recent work published by the RSPO¹⁷⁵ showed that total CO₂ emissions associated with land use change in Indonesia from 2005 to 2010 were in the region of 700 million tonnes per year - roughly equivalent to all of the commercial and residential emissions in the US in 2012, according to the US Environmental Protection Agency.

The same work showed that industrial palm oil plantations in the region increased from 3.5 to 13.1 Mha between 1990 and 2010, a mean annual increase of about 7 per cent. Of this 20-year increase, 3.5 Mha (36 per cent) came at the direct expense of natural forests with high carbon stocks. The net emissions of CO_a from the loss of this vegetation, the use of fires and the subsequent drainage and loss of peat soils increased from 92 million tonnes of CO per year from 1990 to 2000 to 184 million tonnes of CO per year from 2006 to 2010.

Deforestation through open burning leading to extensive forest fires has been another pressing issue in Southeast Asia due to the annual haze. The haze is frequently linked to the pulp and paper and timber industries, making it key for FMCG companies to ensure that their supply chains do not include any materials linked to this issue. The 2015 haze was particularly bad, with the WRI report 176 stating that from early September carbon emissions from the Indonesian forest fires had exceeded average US daily output on 26 out of 44 days. Given the US is the second largest GHG source after China, the magnitude of GHGs from the haze is remarkable.

The majority of the burning is taking place in peatlands which are being drained and cleared for palm oil and pulpwood plantations. But the burning itself is just the tip of the iceberg. Much of the GHG emissions from the agriculture and forestry sectors comes from extensive peat draining and deforestation. Such actions can create significant commercial risks for FMCG companies.

Paper production is the second most common cause of deforestation in Indonesia. Pulp and paper production has led to the loss of more than 2 million hectares of Indonesian natural forests in the last 30 years.¹⁷⁷ Companies having caused significant deforestation in the past have recently made pledges to stop conversion of HCV forests. Yet their legality still needs to be addressed on the ground and outstanding conflicts with local communities need to be solved.

The production of palm oil, soy, paper and beef in Indonesia, Malaysia, Brazil and Russia alone causes 50 per cent of all deforestation globally and contributes to the destruction of some of the world's most biodiverse regions.¹⁷⁸