Executive Summary
Financing oil palm expansion in Indonesia and Malaysia[1]
20 June 2013

Introduction

As global demand for palm oil for food, chemical and biofuel uses continues to grow, increasingly more resources are needed to finance investments targeting the expansion of oil palm plantations. This development may continue to threaten valuable forests and natural habitats in many tropical countries. Hence, careful planning of expansion plans for oil palm plantations is necessary to prevent further deforestation as much as possible.

Apart from governments, commodity producing companies and their investors also have an important responsibility in this respect. This report therefore aims to explore current patterns of investment and financing of the palm oil sector in the two biggest palm oil countries, Indonesia and Malaysia.

The objective of this report is to understand the patterns of public and private investments and financing in the production and processing of palm oil in Indonesia and Malaysia over the past ten years (2002-2011), thereby trying to identify likely future trends. A better understanding of investment and financing patterns will help to understand which mechanisms could be used to stimulate investors and financiers to avoid deforestation and reduce as much as possible the costs associated with land use change associated with oil palm expansion.

The contents of this report are as follows: Chapter 1 describes the research objective and methodology. Using this methodology, the next two chapters analyse the trends in the financing of the oil palm sector in Indonesia (Chapter 2) and Malaysia (Chapter 3). Chapter 4 gives a detailed overview of the most important financial institutions financing the oil palm sectors in Indonesia and Malaysia, and also combines the findings of Indonesia and Malaysia to draw conclusions on financing trends in the Asian Pacific oil palm sector.

Growth in acreage and production volume

Over the past decade, the total acreage planted with oil palms in Indonesia and Malaysia has increased with around 3.5 million respectively 1.1 million hectares. The CPO production increased in the same period with 14.8 million tonnes in Indonesia and 5.5 million tonnes in Malaysia. In the past decade Indonesia has clearly overtaken the leadership role in the global palm oil sector from Malaysia, which for a long time was the largest CPO producer in the world. Acreage increase in Indonesia was much larger than in Malaysia and the increase in CPO output was almost three times as high as in Malaysia.

Most important companies

For both Indonesia and Malaysia, we identified the most important companies active in the palm oil sector, both upstream (oil palm plantations) and downstream (palm oil refineries and biodiesel plants). We identified the 19 companies which invested most in the Indonesian oil palm sector in the past ten years. For 15 of them financial data were available. And we

1 A research paper prepared for Rainforest Action Network and Transformasi untuk Keadilan Indonesia (TuK INDONESIA) by Jan Willem van Gelder & Joeri de Wilde

identified the 15 companies which invested most in the Malaysian oil palm sector in the past ten years. As for four companies no financial data were available and Wilmar International, Sime Darby and Genting Plantations are among the largest investors in both countries, the total number of researched companies amounts to 27 instead of 34.

Most companies active in the palm oil sector in the two countries are domestic companies, but there is a remarkable difference between the two palm oil giants Indonesia and Malaysia in this respect: while several Malaysian companies are expanding in Indonesia, no Indonesian company is expanding in Malaysia. This difference is likely to be caused by the limited availability of land for oil palm plantation expansion available in Malaysia.

Investments in 2002-2011

In the past decade (2002-2011), the 27 companies invested a total amount of US$ 25.3 billion in the palm oil sectors of Indonesia and Malaysia: US$ 17.8 billion in Indonesia and US$ 7.5 billion in Malaysia. These investments represent at least half of all investments made in the palm oil sectors in Indonesia and Malaysia. The estimated half of total investments which we did not capture, has largely been invested by small and mid-sized companies in Indonesia and Malaysia.

This leads to the conclusion that Indonesia, has been the prime focus of palm oil investments in the past decade. But this pattern might slowly change. What we have seen happening with Malaysia, which for a long time was the dominant palm oil producer but where expansion opportunities are more limited now, could also happen with Indonesia. Some of the larger South-East Asian companies are already looking for other opportunities, especially in Africa.

Groups of financiers

For Indonesia and Malaysia we identified palm oil investments in the past decade for a total value of US$ 25.3 billion. Based on our analysis of these investments, we can draw the following conclusions:

- The expansion of the palm oil sector in Indonesia and Malaysia during the past decade was financed by entrepreneurs (35%), banks (24%), institutional investors (6%) , governments (7%) and unknown financiers (27%).
- While the global oil palm sector has expanded strongly in the past few decades, it still remains dominated to a large extent by family-owned and family-controlled businesses. This is reflected by the large share of domestic entrepreneurs (total: 31%) in the financing of palm oil companies in Indonesia (34%) and Malaysia (22%).
- Governments only played a small role in the financing of the palm oil expansion in the past decade, as they financed 7% on average. The domestic government is important in Malaysia (20%), but in Indonesia governments are not important.
- Overall, banks have provided 24% of the financing needed for the expansion of the palm oil sector in Indonesia and Malaysia in the past decade.
- Multilateral banks hardly played a role in the expansion of the oil palm sector. The multilaterals mainly seem to focus on paving the way for the development of the palm oil sector in countries where this sector is still absent or not well developed yet.
- Domestic banks account for a bit less than half of all commercial bank loans in Indonesia and Malaysia (11% out of 24%), with the other half being provided by banks from other South-East Asian countries (4%) and by banks from the rest of the

world (9%).
- Institutional investors financed at least 6% of the expansion of the Indonesian and Malaysian palm oil sector in the past decade. But it should be noted that for 27% of all investments we could not clearly identify which group of financiers is responsible. Most of these investments were financed by institutional investors as well, but we could not establish the country of origin of these investors.
- Within the group of institutional investors, domestic institutional investors account for only a small part of the financing provided by institutional investors in the past decade (1% out of 6%), while foreign and South-East Asian institutional investors account for the remaining 5%. However, we have to note that the group of unknown financiers (27%) mostly includes institutional investors of which we do not know the country of origin.

Important financial institutions

While the research has focused on classifying the financiers into groups, we also provided an overview of the largest individual financial institutions owning shares of the palm oil companies and of the banks providing them with bank loans. The largest institutional investors holding shares in the palm oil companies are Van Eck Associates (US$ 764 million), BlackRock (US$ 722 million) and The Vanguard Group (US$ 540 million). The financial institutions that provided the largest amount of loans are HSBC (US$ 1.5 billion), Mitsubishi UFJ Financial (US$ 1.2 billion), OCBC (US$ 961 million) and the Sumitomo Mitsui Financial (US$ 764 million).

Future trends

Despite upcoming competition in Africa, Latin America and elsewhere in Asia, South-East Asia will certainly continue to be the dominant force on the global palm oil market in the coming decade. But Indonesia now has definitively overtaken Malaysia as the most important CPO producer and aims to become the largest in the downstream segment as well.

In the coming years, major investments are expected in the upstream and downstream palm oil sector in Indonesia. The investments are especially driven by a range of tax incentives issued by the Indonesian government, which are directed at expanding the domestic downstream sector. Indonesian companies plan to nearly double refining capacity to 43 million tonnes of palm oil, or 80 per cent of total world output of palm oil. Investments of around US$ 2 to 3 billion in the coming three years are expected.

To feed these downstream investments, CPO production is planned to reach 40 million tons by 2020 (from the current level of 25 million tonnes). This would imply that the plantation acreages will continue to increase at the same rate as in the past decade.

These huge investments will be mainly undertaken by the existing Indonesian and Malaysian oil palm groups, which still rely for a significant part of their financing on domestic entrepreneurs and domestic banks. But foreign banks and institutional investors will play an increasing role, to make these huge investments possible.

Further growth of the Malaysian palm oil sector also is expected for the coming decade. However, the pace in which the oil palm plantation acreage is expanding is clearly decreasing, as the available land bank is limited. Malaysian companies have long since recognized that land expansion domestically is going to be hard, and as a result have radically increased oil palm investments and landholdings in other countries such as Indonesia and Liberia.

Over the next six to ten years, while Malaysia’s oil palm acreage continues to expand, it is still expected to marginally increase annual palm oil production. But thereafter production should stagnate until there has been considerable progress in replacing older trees with new higher yielding varieties.

While the role of the families (and the Malaysian government) owning a dominant shareholding in many of the Malaysian oil palm groups will continue to be very important, the oil palm groups will increasingly rely on external financiers to finance their expansion. These will include both domestic and foreign banks and institutional investors, whose role in financing the further expansion of the Malaysian palm oil sector will continue to grow.