I. INTRODUCTION

1.1. Background

Palm oil (Elaeis guineensis) is grown commercially in at least 43 countries and accounts for almost 10 per cent of the world’s permanent crop land (Sheil et al., 2009). Currently, 80 per cent of palm oil is used for food (Soyatech, 2011) ranging from cereals, crisps, sweets, baked goods, margarine and cooking oil. Palm oil accounts for 32 percent of the global production of edible vegetable oils (World Growth 2009; Geibler et al., 2010; Janurianto 2010). Figure 1 shows the importance of palm oil as one of key commodities in the international market.

Source: Oil World

Figure 1. World Vegetable Oil Production of 2010
Together, Indonesia and Malaysia account for about 85 per cent of the ca 46 million tons of crude palm oil (CPO) produced globally per annum (Janurianto, 2010). Both countries, Indonesia and Malaysia, have an important role to play in fulfilling the world’s growing need for oils and fats in general, as shown in Figure 2, and since 2006, Indonesia has become the largest and most rapidly growing world producer of palm oil as shown in Table 1 (MPOB, 2009). At current annual rates of increase, Indonesia could theoretically double existing national oil palm acreage by 2030 and increase palm oil production to 60-65 million (USDA, 2010).

Palm oil industry as a major driver of rural economic development in Malaysia and Indonesia has become a substantial export and a key contributor to poverty alleviation and higher living standards. Plantation management and harvesting of palm oil fruit are labor intensive activities leading the industry to become an important source of employment in selected regional areas (World Growth, 2009). In Indonesia, currently over 3 million people work in the oil palm sector (USDA, 2010).

Table 1. World Major Producers of Palm Oil: 2000 – 2009
There is also national benefit for the country: export revenues earned Indonesia over more than USD 12 billion in 2007, USD 12.4 billion in 2008, USD 10.4 billion in 2009 – contributing roughly 4.5 per cent of GDP - and is expected more than USD 12 billion in 2010 (Juoro, 2010). In 2006, the Indonesian Bureau of Statistics (BPS) estimated that 45% of the total palm area was owned by private plantations, a further 33% was owned by small holders, and the remaining 12% was owned by the government (World Growth, 2009), the figures then shifted to 33% to small holders, 53% private plantation and the rest of 14% to state owned in 2010 (Juoro, 2010) with total area planted to palm oil (immature and mature) in 2010/11 is now estimated at roughly 7.65 million hectares, having increased at an average annual rate of 300,000 hectares over the past 10 years (USDA, 2010).

Concurrently, global demand on palm oil is growing as populations increase and standards of living improve, world consumption on vegetable oil is 145.1 million tons above its production of 144.5 million tons as shown in Table 2 (Janurianto, 2010) and this growing demand is also in favor due to its price, the cheapest among edible oils, and its wide arrays of usage for industrial application both for food and chemical (Pahan, 2010; USDA, 2010).
Table 2. Comparison on World Production and World Consumption

<table>
<thead>
<tr>
<th>TYPE OF OIL</th>
<th>WORLD PRODUCTION</th>
<th>WORLD CONSUMPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vegetable Oil</td>
<td>144,5</td>
<td>145,1</td>
</tr>
<tr>
<td>Animal Fat</td>
<td>24,3</td>
<td>24,4</td>
</tr>
<tr>
<td>Total (In Mio Ton)</td>
<td>168,8</td>
<td>169,5</td>
</tr>
</tbody>
</table>

* Note: Exclude ending stock 2009 of 18.4 Mio Ton
Source: Oil World, LMC

From the consumer perspective, there is a growing awareness to pave a path toward environmental stewardship and sustainable development, hence demand to obtain products that have been produced sustainably is increasing. This understanding has led to challenging topics related to the environment declining, such as; deforestation, loss of biodiversity and threat to wildlife including new concerns on carbon emission from development of peat land; for which palm oil industry has been accused generating it.

Consequently, no surprise that Indonesia’s palm oil industry faced many issues related to this global sustainability challenge; from never-ending allegations by Non Governmental Organizations (NGOs), strict demands from the Roundtable on Sustainable Palm Oil (RSPO) to conditions imposed by the European Union (EU) through the EU Renewable Energy Directive (EU RED) 2001/77/EC and 2003/30/EC which has set criteria on the use of palm oil as feedstock for bio-fuel production (Suharto, 2010) wherein palm oil did not meet the required standards.

One of the efforts set by the government to gain and to ensure sustainability of Indonesian palm oil industry is through a sustainability standardization called the Indonesian Sustainable Palm Oil (ISPO). ISPO is managed by the Agriculture Ministry and planned to be launched in March of 2011. It is now held on trial in 20 oil palm
plantations as part of the government’s plan to require oil palm plantations to apply for ISPO certification beginning in 2012 (Anonymous, 2011a). It is highly expected that ISPO can attend those environment related allegations and at the same time show government commitment towards sustainable palm oil development. The primary focus of ISPO is to ensure legal compliance according to the Indonesian laws and regulations which serve as the baseline of sustainability standards.

Unlike the RSPO, ISPO is mandatory and has clear legal framework based on Indonesian regulations and concerns of several ministries; the Ministry of Agriculture, the State Ministry for the Environment, the Ministry of Forestry and the National Land Agency. At the later stage, ISPO will be notified to the World Trade Organization (WTO). Through the mechanism and recognition of the WTO and other multilateral or bilateral agreements with buyers, ISPO is expected to get an international market guarantee (Suharto, 2010).

A landmark in sustainability effort for palm oil actually was started with the conception of the RSPO in 2004 with the principal objective of promoting the growth and use of sustainable palm oil through co-operation within the supply chain and open dialog between its stakeholders. This not-for-profit association has members representing major players along the palm oil supply chain; oil palm growers, palm oil processors and traders, consumer goods manufacturers, retailers, banks and investors, environmental/nature conservation NGOs and social/development NGOs. As of November 2010, the RSPO members from Indonesia totaled 74 institutions, consisting palm oil growers, processors, traders and NGOs at the same time total members of the association has reached 500 (Suharto, 2010).

The RSPO has developed a ‘verifiable standard for sustainable palm oil’ and encouraged palm oil companies to adopt more responsible practices. In 2007, the RSPO
developed together with UTZ, provider for traceability services, the label ‘Certified Sustainable Palm Oil’ to give buyers assurance that the product came from oil palms cultivated on legal agricultural land using approved management practices. A traceability system for palm oil has been implemented which allows palm oil products to be monitored from the mill through to the end users. This will facilitate the trade in sustainably-produced palm oil between companies at different points on the supply chain. Industry participants also plan to launch a system that will allow segregation between certified and non-certified oil (World Growth, 2009).

Several companies have experimented with the RSPO standards, but have found it to be complicated, hard to implement with more than 120 indicators (major and minor), and kept on changing (IPOC, 2010). The auditing process to obtain the certification is a lengthy process and it will take some time for widespread participation in both countries. Some companies have already gained the RSPO certification and several are in the process of achieving certification. The cost of the auditing process has been an impediment for participating in the scheme, especially for small holders.

Indonesian Palm Oil Association (GAPKI) fully supports the Indonesian government plan to implement ISPO, however some discourage notions stated by environmentalist NGOs; such as, ISPO is an necessary duplication to RSPO, RSPO is acknowledged international standards, why should create a country one?, ISPO with Indonesian laws baseline is not enough to ensure sustainability and ISPO establishment is meaningful only with stakeholders participation. (Mongabay.com, 2010a). In addition, need to be marked too that the success of a certification schemes is depend in part on the ability of commercial players to gain a price premium to off-set the costs of certification and compliance. It will also depend on market acceptance of the independence of the assessment process (World Growth, 2009) by providing reliable,
consistent and verifiable information on its production and management decision and
criteria (Yusoff, 2009)

1.2. Problem Statement

Palm oil is the only edible oil crop and perhaps the only crop that can be
subjected to auditing under a sustainability certification system in world trade (World
Growth, 2009). Gaining and sustaining the sustainability standards for palm oil is the
only ticket for the industry to be accepted by international market consumers, to
eliminate strong public/consumer negative opinions on environment issues and to meet
most of processors requirements of sustainable palm oil starting from 2015. In
responding to these challenges, the Indonesian government is issuing ISPO as one of its
efforts to advance sustainable palm oil production. ISPO is expected to build
international market confidence over Indonesian palm oil industry to meet sustainable
development standards.

Having a consistent and credible ISPO is what the government, especially, and
other stakeholders of the palm oil industry must partner with to support ISPO achieves
its objectives through standard development, standard implementation and
establishment of institutional framework that can address the consistency and gaining
credibility in the international market to enhance the competitive advantage of
Indonesian palm oil.

On ISPO certification implementation, its cost is expected to be far lower than
RSPO of USD 25 per hectare; and the government has targeted by 2014 all auditing and
certification process of ISPO for more than 2,000 palm oil companies, (with only 467 are
member of GAPKI and only 74 are members of RSPO), would be completed. For this
big project, to meet every stake holders’ expectation and international market demand at
the same time, definitely a strategic and thorough master plan on implementation, communication, evaluation and transparent criteria of ISPO are needed.

1.3. Research Question

The (sustainable business development) management questions for this research are:

1. Why ISPO is needed for Indonesian palm oil industry?
2. How can ISPO enhance the competitive advantages of Indonesian palm oil in the global market?
3. What are the necessary conditions and obstacles for implementing ISPO?

4. Specific Research Objectives

1. To identify fundamental situations of Indonesian palm oil industry
2. To identify the success factors of ISPO to be able to enhance Indonesian palm oil competitive advantage in the global market
3. To formulate strategic actions for ISPO implementation.