



## Investor Brief:

# Sustainable Land Use of Soft Commodities-Challenges and Opportunities in Indonesia

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## Global Concern for Deforestation-free and Sustainable Supply Chains of Soft Commodities

Global demand for soft commodities continues to increase as the world's population is expected to grow to almost 10 billion by 2050, accompanied by economic growth. These trends put pressure on land use as well as pose challenges for soft commodities supply chain sustainability.

Various elements of society, including businesses, have started to jack up their awareness of this issue. In November 2015, 14 US-based FMCG companies, such as General Mills, Mars Inc, and PepsiCo, signed a joint letter urging world leaders to adopt a strong global climate deal at the COP21 climate conference in Paris. The corporations emphasized in their letter that the government, civil society, and industry all had a role to play in combating climate change, and one of the three commitments they disclose was to increase the efforts to make their supply chains more sustainable (WWF, 2016). Five years later, at COP26, an ambitious strategy

was announced by 12 of the largest agri-commodity traders including Wilmar and GAR from South-East Asia. They pledged to develop a sectoral roadmap initiative to keep temperature increase within 1.5 degrees. Numerous factors contribute to this trend, including consumer rejection of products that contribute to negative environmental and social outcomes; the naming and shaming of companies that engage in environmentally damaging manufacturing and sourcing processes; and increased investor awareness of market and reputational risks associated with commodity-driven deforestation (Pirard et al., 2015).

A variety of approaches have been implemented to support sustainable supply chain efforts, one of which is the implementation of sustainability standards through commodity certification. The table below maps some of the certifications for the main commodities in Indonesia.

Table 1. National and International Standard / Certifications for Main Commodities in Indonesia

No	Standard / Certification	Commodity	Voluntary / Mandatory
1	Roundtable on Sustainable Palm Oil (RSPO)	Palm oil	Voluntary
2	Indonesia Sustainable Palm Oil (ISPO)	Palm oil	Mandatory
3	Program for the Endorsement of Forest Certification (PEFC)	Rubber, timber	Voluntary
4	Forest Stewardship Council (FSC)	Rubber, timber	Voluntary
5	Timber Legality Verification System (Sistem Verifikasi Legalitas Kayu / SVLK)	Timber	Mandatory
6	UTZ (Rainforest Alliance)	Cacao	Voluntary
7	Indonesian National Standard (Standar Nasional Indonesia / SNI) for cacao	Cacao	Mandatory

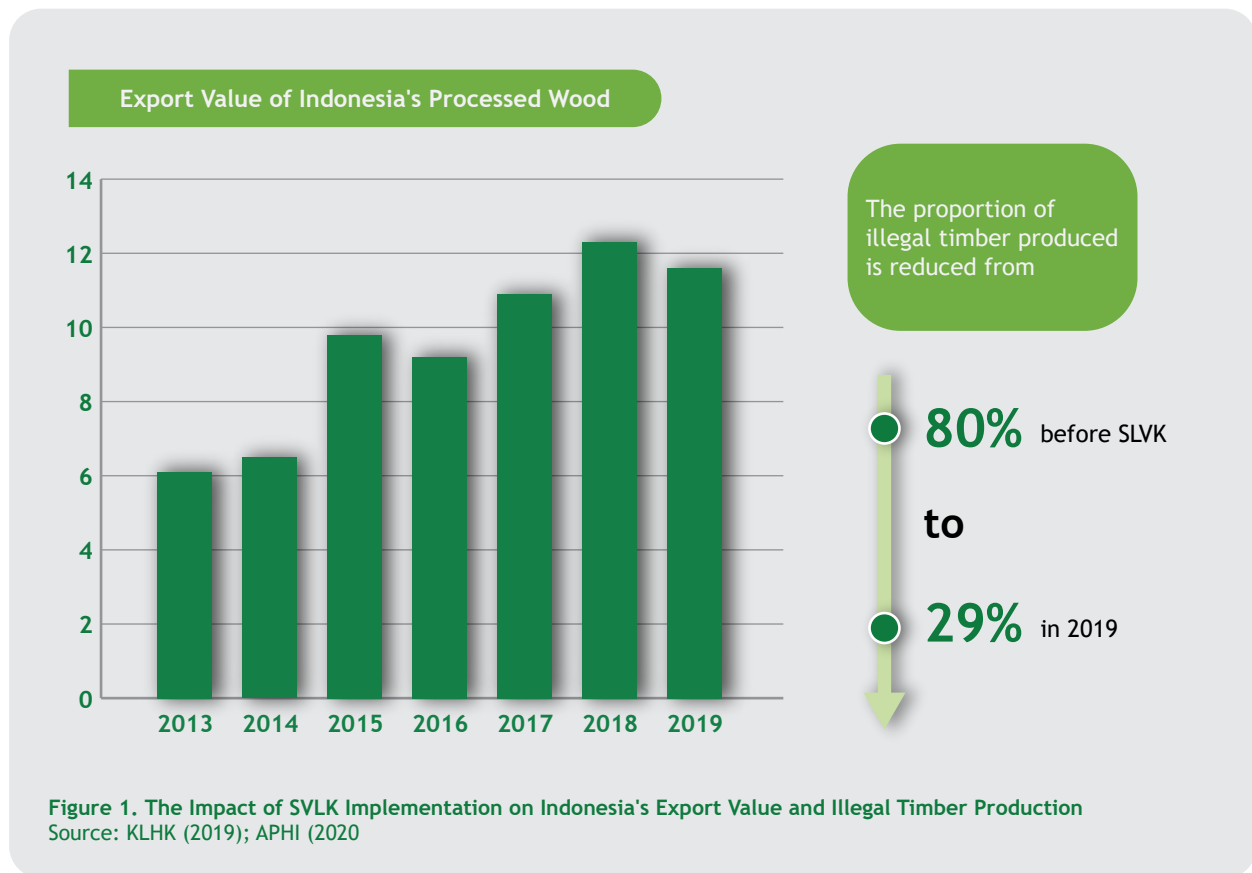
### Impacts of certification on the supply chain: A case of Timber Legality Verification System (Sistem Verifikasi Legalitas Kayu / SVLK)

Increased awareness of sustainability issues has a major impact on the supply chain of soft commodities around the world. This impact is not only influenced by domestic demand, especially for Indonesia's main commodities which are the mainstay of exports. One good example of exercising certification in soft commodities can be seen in the SVLK for timber.

SVLK was developed through multi-stakeholder involvement including civil society groups, non-governmental organizations, forest observers, the private sector, academics, and the government. SVLK was then put into Minister of Forestry Regulation P. 38 of 2009. SVLK serves to ensure that wood products and their raw materials are obtained or come from sources whose origins and management meet legal aspects. Timber is called legal if the origin of the wood, logging permits, systems, and procedures for

harvesting, transporting, processing, and trading or transferring it can be proven to meet all applicable legal requirements.

The SVLK brought benefits to Indonesia's forestry sector. Economically, SVLK-certified timber has met the demands of the world market for legal and sustainable timber. It was recorded that in 2019, the export value of Indonesia's forestry industry products worldwide reached USD 11.6 billion, an increase of almost double since the implementation of the SVLK in 2013. In addition to the economic benefits, the SVLK has also reduced deforestation and illegal logging. As of 2019, the proportion of illegal timber production decreased from 80% before the implementation of the SVLK to 29% in 2019. Currently, there is 24 million ha of forest land and 3000 business actors have been certified by the SVLK (APHI, 2020).



## Indonesian Climate Policies and Challenges of Sustainability Standard

The latest data shows that Agriculture, Forestry, and Land Use (AFOLU) sector is the second-largest source of GHG emissions in Indonesia, accounting for 36% of the total national emissions (Ministry of Environment and Forestry, 2019). In this regard, Indonesia has stated its commitment to reduce emissions since at least the 2016 Nationally Determined Contribution (NDC). Most recently, through the Indonesia Long-Term Strategy for Low Carbon and Climate Resilience 2050 (LTS-LCCR 2050), some innovative policies and measures (PaMs) have been issued to transform land-use systems to curb greenhouse gas emissions. These PaMs are directed to reduce deforestation and forest degradation, accelerate reforestation and restoration of the peat ecosystem, and improve agricultural productivity and land-use efficiency. Policies that have been issued include a permanent extension of the forest and peatland moratoriums (Presidential Instruction 5/2019) and mandatory certification for sustainable forest management. On the other hand, for increasing agriculture productions to meet the future domestic and global demand without significantly conducting land expansion, Indonesia also put significant efforts to boost productivity and increase land-use efficiency and optimize the use of unproductive (idle) lands.



Photo credit: canva.com

### Average deforestation in Indonesia has fallen by:



-53% according to the GOI, from -734,000 (2015-2017) to 339,000 (2018-2020) ha per annum

>55% according to WRI, from -775,000 (2015-2017) to 346,000 (2018-2020) ha per annum

>52% according to Daemeter, from -1.2M (2015-2017) to 569,000 (2018-2020) ha per annum

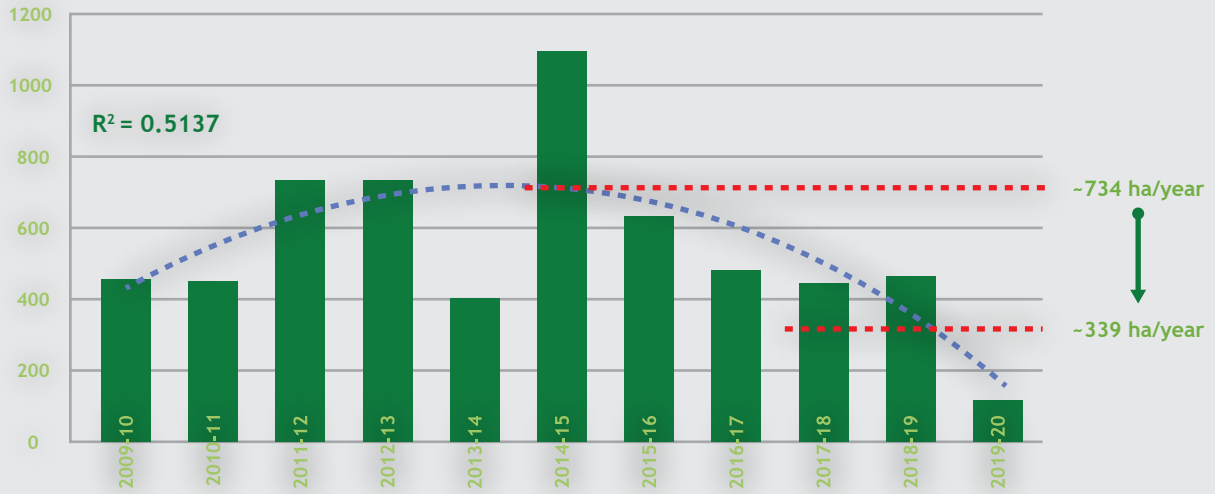
While in some countries the rate of deforestation still shows an increasing trend, data in Indonesia shows a massive reduction, especially since the Paris Agreement. In the last three years of available data (2018-2020), average deforestation in Indonesia has fallen significantly when compared to data from the previous 3 years (2015-2017) (see Figure 2). A similar trend is shown when the figure is dissected more in commodity-driven deforestation. According to the latest data from WRI, the average deforestation caused by the expansion of three major commodities (rubber, pulp & paper, oil palm) in 2013-2015 is fell by more than 60% compared to the 2010-2012 average (Daemeter & Tropical Forest Alliance, 2020) (see Figure 3).

Those reductions in deforestation rates show that the various efforts made by the Ministry of Environment and Forestry recently, have shown significant results. These efforts include the implementation of the Presidential Instruction on Stopping the Granting of New Permits and Improving the Governance of Primary Natural Forests and Peatlands, Controlling Forest and Land Fires, Controlling Peat Damage, Controlling Climate Change, Limiting changes in Forest Area Allocation for the non-forestry sector (HPK), Completion of Land Tenure. in Forest Areas (PPTKH/TORA), sustainable forest management, social forestry, and forest and land rehabilitation, and combined with the adoption of better sustainability practices from companies.

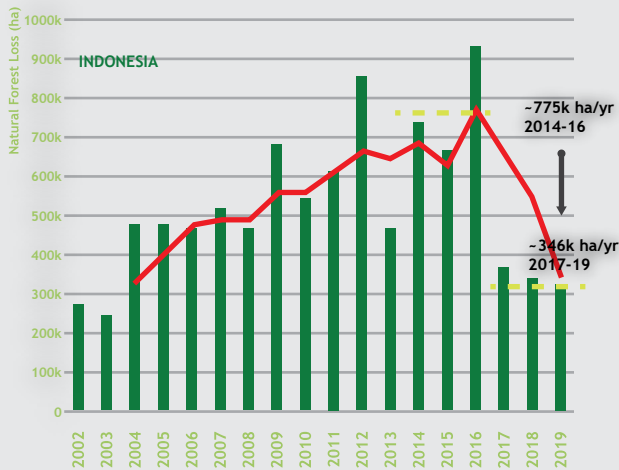
To support the climate policies, standards and certification for key commodities could provide solutions. However, in its implementation, there are various obstacles to overcome. Many business actors feel that the commodity certification process is complicated and does not necessarily produce commensurate benefits. Not to mention the costs that need to be incurred to obtain certification. Furthermore, in the agriculture sector, where a huge proportion of the farmers are smallholders, legality issues are also an obstacle. Many farms are administratively taken place in forest areas and many still do not have ownership certificates. In addition, there are still many farmers who are not classified as cooperatives or farmer groups. In fact, being incorporated into a legal entity is one of the requirements for certification.

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Government of Indonesia's Panel ('000 ha)



WRI's Panel (ha)



Daemeter's Panel (ha)

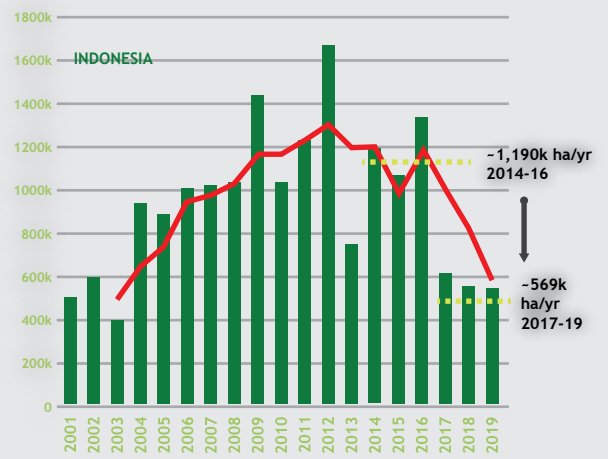


Figure 2. Annual Deforestation Rate in Indonesia  
Source: Daemeter & Tropical Forest Alliance (2020)

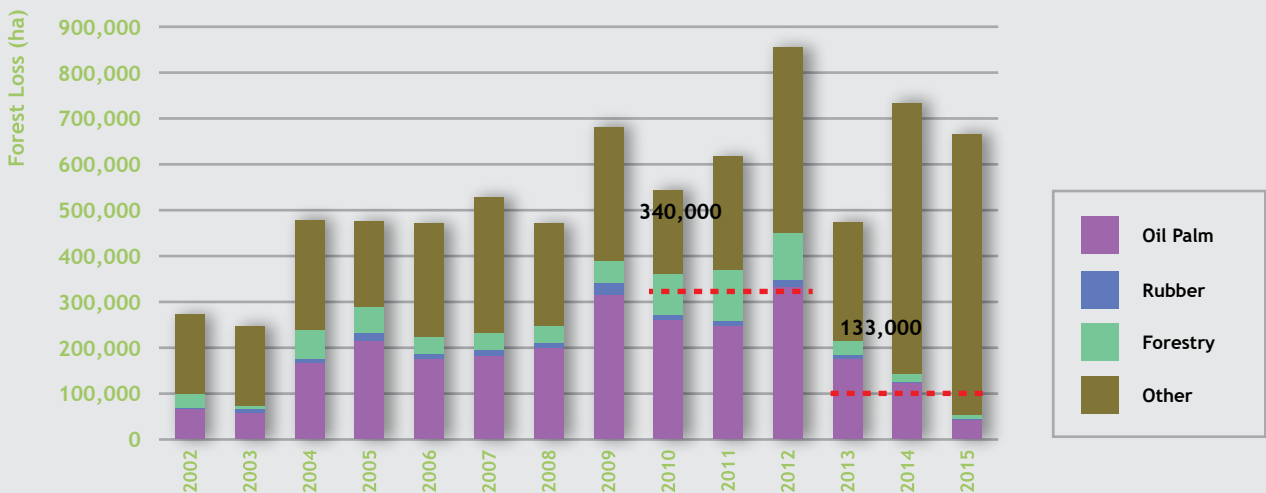


Figure 3. Annual Deforestation Linked to Commodity Production in Indonesia  
Source: Daemeter & Tropical Forest Alliance (2020)

# Sustainable land use of soft commodities: producers' perspectives

## Cost-Side

To support sustainability standards, companies might be required to invest in resource-efficient and sustainable farming practices. A study of 16 emerging countries estimated that compliance with standards costs about US\$425,000 per firm, largely due to increased spending on labor and capital (Maskus et al., 2005). Nor are these one-time expenses. SMEs need to spend money over time to maintain and document their compliance. Even voluntary certification standards cost money to achieve and maintain.

### Commodities Certification Fees

The whole certification process has several stages, each of which usually has its fees. Part of these fees are paid to the certification body, hence have huge variations and the data tends not to be publicly available. The following are some publicly available fees from several certification programs where the data shown is only part of the total fee for the whole certification process.

#### RSPO

The membership fee for ordinary members: EUR 2,000/year

The membership fee for smallholders in producing countries: EUR 500/year

Source: Roundtable on Sustainable Palm Oil (2018)

#### PEFC

Fixed one-off notification fee: USD 500

Yearly notification fee (except for international multi-site schemes): USD 140-1,500

Source: Program for the Endorsement of Forest Certification (2018)

#### FSC

The membership fee for individual members: USD 38-100

The membership fee for non-profit organizations: USD 75-5,000

The membership fee for-profit organizations: USD 100-10,000

Source: Forest Stewardship Council (2021)

#### UTZ (Rainforest Alliance)

Membership fee (cacao): EUR 250-4,000

Program fee (cacao): EUR 10/MT

Source: Forest Stewardship Council (2021)

#### SVLK

Assistance fee: IDR 10-25 million

Certification fee: IDR 30-40 million

Source: Asosiasi Industri Permebelan dan Kerajinan Indonesia (2015)

### Tangible Benefit

#### Operational benefits

Certification systems result in higher yields and more stable long-term supplies, according to evidence from studies on a variety of commodities. Certification can also increase efficiency, hence lowering operational costs. Companies can build more resilient supply chains with more transparency and quality control by encouraging their suppliers to get certified (WWF, 2016).

#### Access to a premium market

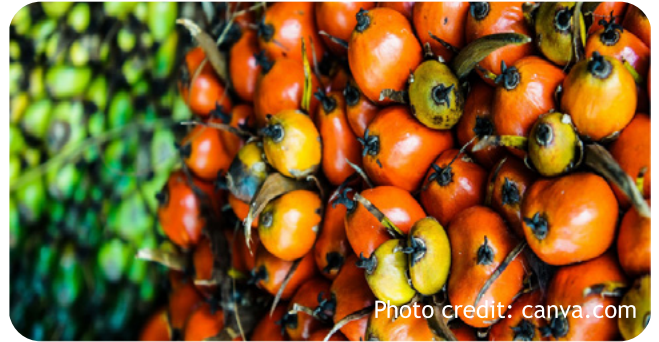
With a growing demand for eco-labeled commodities, there is access to a premium market that gives the premium price as well. In the case of rubber commodities, most companies would pay a premium price of 1-5% for eco-certified rubber, though the highest offer was 10-25% (World Agroforestry, n.d.).

### Intangible Benefit



#### Reduce reputational risk

Companies that do not attempt to source sustainably produced commodities risk being labeled as laggards by civil society stakeholders, investors, and consumers, resulting in bad public perception.



#### Access to finance

The emergence of OJK's sustainable finance roadmap, accompanied by the growing market of green instruments creates unique access to finance for sustainable commodities. (will be elaborated further in section 3)

#### Positive branding opportunities

Products developed with sustainably produced commodities have a marketing edge over conventional products, according to data from product take-up and marketing surveys. According to Nielsen (2014), Asia-Pacific has the highest proclivity to buy socially responsible brands.

#### Reduce regulatory risk

Companies may be sourcing commodities that aren't compliant with producer countries' domestic regulations if they don't have certification. According to research conducted by the World Wildlife Fund (2015), 5 to 50% of globally marketed food commodities are not produced lawfully in the country of origin (the amount varies depending on the commodity).

#### Increase resiliency in the changing dynamics of climate transitions

Climate targets and climate-related legislation are unpredictable due to the shifting dynamics of climate transitions. In dealing with this, the implementation of sustainability principles can avert large changes in operating strategy. (climate target, climate-related regulation e.g., NPDE)



## How Certification in Palm Oil Industry Could Increase Resiliency Amid Climate Transition Risks

As one of the sectors with a high contribution to the Indonesian economy (3.5% of GDP), business players in the palm oil sector need to pay special attention to the risks arising from the climate transition. There are at least two main risks that arise, the No Deforestation, No Peat, No Exploitation (NDPE) policy and the imposition of carbon prices on the land sector. Currently, is not in place through-out the sector. Only major corporations have implemented this practice. However, once NDPE is manifested as policy, concession areas will be no longer arable, causing 76% of the total area to become stranded assets. In addition, conservation areas and forest cover will also be expanded, resulting in limited land availability which will increase land prices. On the other hand, the imposition of a carbon price will cause emission costs to increase, thereby increasing operational costs. In this regard, oil palm planters will face uncertainty if they continue to run the business-as-usual practice. Intensification of oil palm plantations then becomes the key in dealing with the risk of climate transition. In the case of Indonesia, the intensification of oil palm plantations can be done by following the community palm oil rejuvenation program (Peremajaan Sawit Rakyat/PSR). This program is targeted to increase the productivity of smallholder farmers, from 2 to 3 tons/ha/year, to 10 tons/ha/year with part of the financing subsidized by the government. The certification plays an important role in PSR as the ISPO certificate is a requirement for smallholder farmers to follow the program.

## Sustainable land use of soft commodities: Investors' perspectives

### Overview of Sustainable finance adoption

The dramatic consequence of climate change and environmental degradation have brought the need for a more sustainable economy and climate-resilient. The UN 2030 agenda and sustainable development goals and the Paris Climate agreement also urge many countries to commit to a more sustainable economy as well as low carbon and climate-resilient development. To achieve the target, the government needs a tool to finance their activity towards a sustainable and climate-resilient economy with sustainable finance and investment. Sustainable finance and investment are a process of taking **environmental, social, and governance (ESG)**<sup>1</sup> considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects (European Commissions, 2021). Until 2020, sustainable investment has reached USD 35.3 trillion in five major markets (Europe, United States, Canada, Australia, New Zealand, and Japan) 15% increase in the past two years (2018-2020) and a 55% increase in the past four years (2016-2020) (Global Sustainable Investment Alliance, 2020). The number would still increase as many governments aim to achieve net-zero emission in the future.

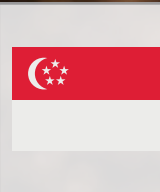


Nowadays, sustainable financing in Indonesia is also showing its growth. The term sustainable finance and investment (SRI) in Indonesia was widely recognized when the Otoritas Jasa Keuangan (OJK) released their first sustainable finance roadmap in 2014 and their second [sustainable finance roadmap in 2021](#). Later, the OJK [also released OJK Regulation No.51/2017](#) about Sustainable Finance. The regulation gives a mandate for all financial institutions in Indonesia to have an action plan on sustainable finance and issue sustainability reports so that their economic, social and environmental work can be monitored transparently. OJK also released [OJK Regulation No. 60/2017 about Green Bonds](#) which include financing for sustainable agriculture practices. Both regulations also resulted in the establishment of Inisiatif Keuangan Berkelanjutan Indonesia (IKBI) by 8 major banks (now 13 banks) in Indonesia to support the implementation of SRI and ESG in Indonesia. Several initiatives such as ICCTF, Indonesia SDG One, BPD LH, and SWF has emerged as a tool for sustainable financing. However, the implementation of SRI and ESG in Indonesia is still low compared to other neighboring countries (Alfaruq,2021).

<sup>1</sup> Environmental considerations might include environmental issues in broad such as preservation for biodiversity, pollution control, waste management, and climate mitigation and adaptation. Social consideration could refer to inequality, inclusiveness, labor relations, investment in human capital and communities as well as human rights issues. While governance considerations refer to public and private institutions (European Commissions, 2021). [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance\\_en#important](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance_en#important)

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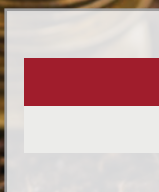
Table 2. Indonesian ESG Position Compared to ASEAN Countries

Country ESG Rank

Country	ASEAN Rank	World Rank (179 Countries)
	1 <sup>st</sup>	48 <sup>th</sup>
	2 <sup>nd</sup>	72 <sup>nd</sup>
	7 <sup>th</sup>	113 <sup>th</sup>

Source: <https://risk-indexes.com/esg-index/>

World's Stock Exchange based on ESG Disclosure

Country	ASEAN Rank	World Rank (47 Countries)
	1 <sup>st</sup>	9 <sup>th</sup>
	2 <sup>nd</sup>	22 <sup>nd</sup>
	5 <sup>th</sup>	36 <sup>th</sup>

Source: Corporate Knights, 2019

Photo credit: canva.com

As sustainable finance and ESG become popular, impact investment has also gained popularity as an investment tool. Based on KPMG, 2018, impact investing is a financial undertaking that aims to generate specific and measurable beneficial social or environmental effects in addition to financial gain. In other words, the investor does not solely seek financially profitable investment but also provides a positive benefit to the environment and society. Based on the results of a study conducted by the Global Impact Investing Network (GIIN), the impact investment sector has grown from USD 4.3 billion in 2011 to USD 502 billion in 2018 and is predicted to reach USD 1 trillion in 2020. In Indonesia, the number of impact investors reached 66 investors with almost 35% of the investors having more than 1 investment (Ulfa, 2020). There are at least 4 promising impact investment sectors in Indonesia namely agriculture, waste management, gender lens investment, and the digitization of MSMEs (Ulfa, 2020). Specifically, the highest impact investment could be allocated to the agriculture and soft commodities sector for USD 140 billion. This is the window opportunity that investors can contribute to more sustainable practice in agriculture including soft commodities.

Another sustainable financing instrument has also been growing in Indonesia. In 2019, Indonesia became the first country who release Green Sukuk for financing eligible green projects including agriculture and soft commodities projects. Corporate and project financing given by local banks has also increased for financing sustainable and green projects while it can be used for other non-sustainable financings. The Kredit Usaha Rakyat /microloans (KUR) instrument can also be used for financing sustainable agriculture practices, especially for smallholders. The government also allocate its funding for sustainable agriculture, but the investor needs to find government institution to collaborate in PPP Scheme. Many multinational options are also available for financing sustainable and green projects such as Green Climate Fund (GCF), and Global Environment Facility (GEF). All those financing instruments can support sustainable agriculture practice as well as avoid deforestation practice in agriculture.

## Translating producers' E&S risks to financial risks and investors' portfolio/ credit risks: an impact pathways framework

Nowadays, producers not only face pressure from both consumers and investors in their decision-making process but also climate transition risk. Climate transition risks can be in the form of physical risk, transition risk, and liability risk. These risks make the producers need to respond optimally. The response from producers needs to consider

their ESG performance as well as enterprise value. If they did well in responding to the risk, they will get better ESG performance and enterprise value leading to more access to the sustainable investor (Figure 4).

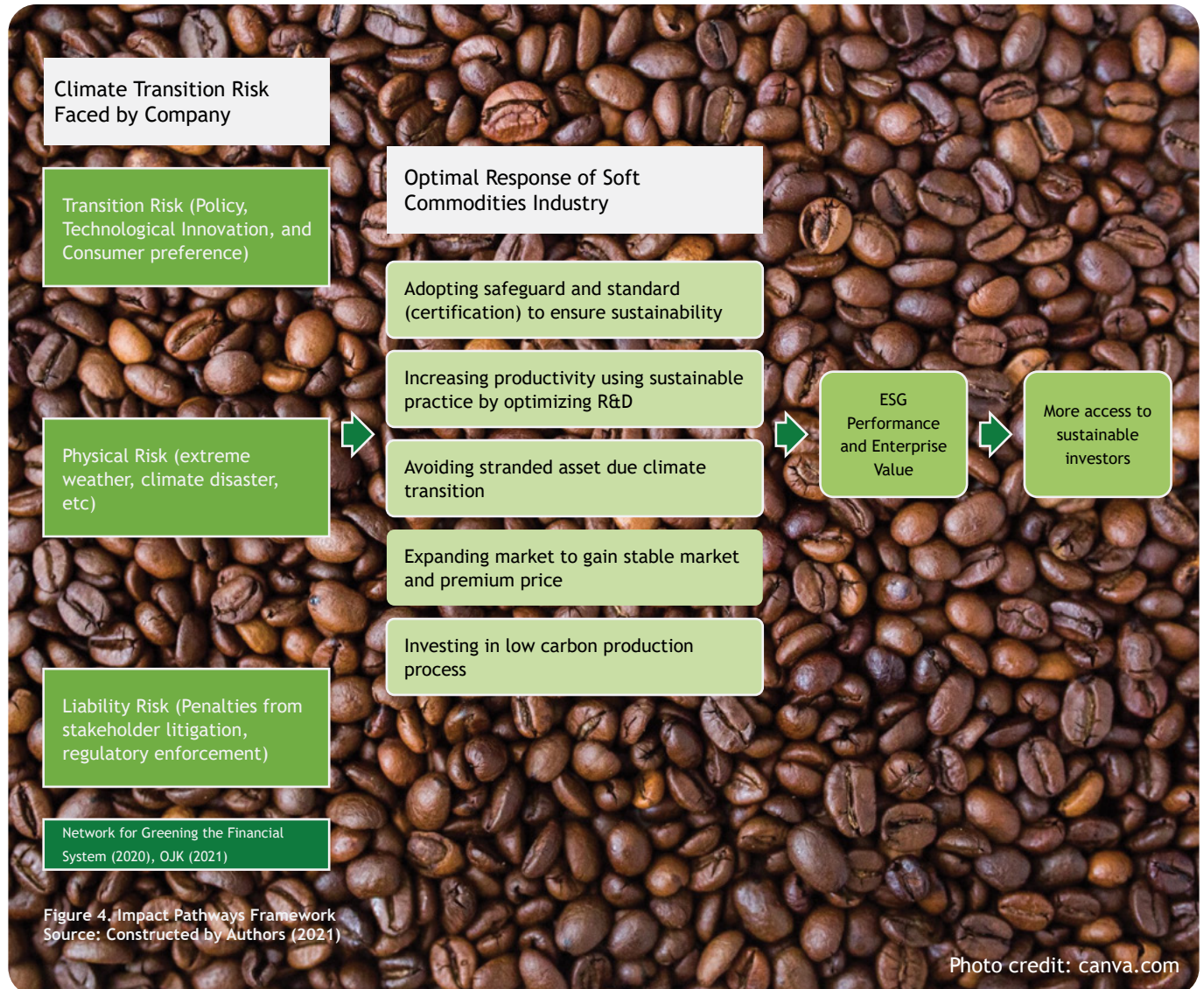


Figure 4. Impact Pathways Framework  
Source: Constructed by Authors (2021)

The figure represents that Producers may have direct exposures to the climate transition risk (e.g., the production area is vulnerable to climate disasters such as a flood), most exposures are indirect and arise from their consumer's and investors' exposures to these risks. As illustrated in Figure 4, transition risks and liability risks will affect the operations of businesses and the wealth of households, thereby creating financial risks for lenders and investors. Physical risks affect the economy in two ways. Acute impacts from extreme weather events can lead to business disruption and damage to property. Historically these impacts were

considered transient but this will change with increased global warming. These events can increase underwriting risks for insurers and impair asset values. Chronic impacts, particularly from increased temperatures, sea levels rise, and precipitation may affect labor, capital, and agriculture productivity. These changes will require a significant level of investment and adaptation from companies, households, and governments (Network for Greening the Financial System, 2020)

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Facing all of the risks, the producers need to optimally respond to the risk. There are several optimal responses that producers can perform to avoid the risk. All of the responses are intended for mitigating the climate risk by implementing sustainable agriculture practices. Producers' responses such as adopting safeguards and standards, increasing productivity from R&D, avoiding stranded assets, expanding the market, and investing in low carbon processes are small examples of how the producers could respond to the risk. Once producers respond to the risk optimally their ESG performance will be soaring and leverage their enterprise value. This will lead to more opportunities to gain investment, especially sustainable investment. However, there are several barriers that producers face to respond to the risk. First, awareness of producers of the risk. Despite the existence of the risk, the producers need to acknowledge it and internalize the tangible benefit from their potential responses. Second, the producers still have a short-term view of the sustainable product. In the short term, the producers are still comparing their unsustainable

products with their potential products which lead them to choose unsustainable products for various reasons. However, they often neglect climate risk in the future that will arise from the unsustainable practice that will cost them more than the cost of implementing sustainable products. Third, regulation barriers. As the government has its climate target from sustainable agriculture practices from private sectors, the government needs to support the adoption of the sustainable standard. If the government does not support it, the efforts from the private sector will be minimalist and they cannot achieve their target. Fourth, awareness of investors regarding their client unsustainable practice. Some investors and financiers do not have the appetite or do not realize the bad impact of their clients unsustainable practices. Thus, the producers do not have any incentives to operate more sustainably. Thus, raising investor awareness of sustainability issues will increase the adoption of sustainable finance and then increase producers' sustainable practice.

### Investment for Sustainability: The Case of PT Dharma Satya Nusantara Tbk.

PT Dharma Satya Nusantara Tbk. (DSNG) is a business group focusing on wood and palm oil sectors and already implementing the sustainable practice of agriculture. DSNG received USD 30 million loan facility from Stichting &Green Fund for 10 years starting from 2020. Accepting the fund makes DSNG have the challenge to be more sustainable. Thus, DSNG has a stronger commitment to conserving forest, land sustainably intensified, forest restored, and smallholders benefiting. One of DSNG success factors to secure the fund is the ecosystem in East Kalimantan where they do their production. The government of East Kalimantan and stakeholders' success to develop a sustainable environment in wood and palm oil production. This environment reduces risk and increases the return on investment. Therefore, stakeholder movements are needed to build the enabling environment for the producer to implement sustainable agriculture practices and secure funding for their production.

Source: Habir (2021)

## Changing patterns of the global financial landscape for sustainable soft commodities

### How the business is transforming: fulfilling international standards and connecting the smallholder to market

The current pressure from the consumer for soft commodities to fulfill consumers' standards towards the environment and social aspects such as international standard or ecolabeling. Transforming their business using sustainable practice to meet the standard brings new opportunities for the business. If they can utilize their business, they will create a competitive advantage in a sustainability-focused world. For instance, business in soft commodities needs to fulfill several standardizations such as RSPO for palm oil or FSC for timber producers at the global level. The first thing that they need to change is their practice, they need to utilize good agriculture practices in which they produce without

harming the environment (e.g., deforestation, etc.). Once they already applied good agriculture practice, the next thing is meeting the standard by improving their product quality through investment in machinery or capacity building. On the social aspect, the businesses have the opportunity to give back to society especially smallholders within the area. Involving the smallholder in production will give another opportunity to the business to fulfill their products' demand without expansion. The smallholder gets involved in a supply chain that generates stable income for them. Thus, undertaking a sustainability transformation can create meaningful business value.

### Sample Case: SFM (Sustainable Forestry Management) PT Royal Lestari Utama

PT Royal Lestari Utama (RLU) is a natural rubber company that had concern to produce rubber sustainably. Since it was established in 2015, PT RLU holds 88,761 ha of industrial plantation forest (HTI) located in Jambi and East Kalimantan. PT RLU is widely recognized for its sustainable practice by setting its policy on no deforestation and no peat. So, in their production, PT RLU does not burn and produces in high conservation value (HCV) areas and high carbon stock (HCS) forests but they protect both HCV and HCS. They also get their highest title in sustainable forests management certification from the Ministry of Environment and Forestry of Indonesia for their HTI management. In

terms of rubber production, PT RLU has already got Ecovadis CSR rating that shows that they have done their best in the business and applied good sustainability practices in their production. To support their rubber production, PT RLU also collaborates with smallholders within the operating area. Those smallholders are given the training to implement good agricultural practices to increase their rubber yield, quality, and productivity following the RLU standard. The smallholders in East Kalimantan are also joined the Rubberway Program to give them knowledge about social and environmental risks as well as the supply chain of rubber products.

## Gap identification

### Adoption of sustainability regulations and standards for soft commodities in Indonesia

Indonesia has already implemented sustainability regulations and standards for soft commodities such as Indonesian Legal Wood (SVLK) and Indonesian sustainable palm oil (ISPO) for palm oil products. Both standards have the same purpose to make soft commodity production to be more sustainable. However, those standards are poorly adopted even though it has been mandatory for all value chain actors. The compliance of smallholders has is still partial. For instance, the smallholder in east java believed that the SVLK verifications cost is too expensive, no advantage in complying with SVLK, and there is no pressure for smallholders to comply (Susilawati et al., 2019). Those smallholders still can operate but they operate informally. On the other hand, the smallholder that can comply with the SVLK standard is the smallholder who is already influenced by external parties such as business entities who give them assistance and NGOs who give them financial assistance for complying with SVLK Standard (Susilawati et al., 2019).

The compliance issues in the ISPO standard are also a problem in applying the standard. Since 2009, the standard has already been implemented by 755 plantation groups (BPDP, 2021). From that number, there are 688 plantations from the private sector, 67 from state-owned enterprises, and 20 smallholders. For smallholders, the standards are hard to comply with. First, the smallholders need to have documentation on their land which most of them do not have. Second, the verification cost is too expensive for the smallholder. Not to mention, ISPO only can be given to legal institutions. To have full compliance with the standard,



Photo credit: canva.com

the big business needs to involve smallholders so that they involve in the supply chain and the big business can leverage their position towards sustainability practice.

### The challenges in implementing sustainability standards in Indonesia



The Implementation of sustainability standards in Indonesia has bottlenecks from both the government and business sides. There are two bottlenecks from the government side. First, the government needs to hold the business or financial institutions to be accountable for implementing sustainability standards if they still producing. One possible solution for this problem is to make all the business entity information related to the certification to be publicly accessible information. So, the public could help the government in doing the monitoring, reviewing, and evaluating (MRV). The second bottleneck from the government is defining the right standards and complying with the standards with existing international standards. The right standard not only will generate a better outcome in terms of the product but also attract more players to be involved.

From the business point of view, the bottlenecks of implementing sustainability standards are twofold. First, the accessibility of the information related to sustainability standards. The information especially for smallholders is limited which makes the smallholder reluctant to get the

standards. Second, there are difficulties for businesses especially small businesses to meet the requirement of the standard. Both stories in SVLK and ISPO has explained the problem of applying sustainability standard for business. The bottlenecks that both government and business faced led to an opportunity for the investor to contribute. Investors have an opportunity to make the business apply sustainability standards. For those who already get the sustainability standard, the business practice will get several benefits such as they can expand their market and getting a premium price for their product. For those who already comply with the national sustainability standard (i.e., ISPO, SVLK), investment for an investor could force the business to comply with international standards (i.e., RSPO, FSC). This will leverage the business position at the international level which opens a new market. If the business runs well, the investor will get benefit from their investments. However, the regulation should enforce the condition of standard.

## Way Forward

The following are recommendations to build an ecosystem to promote sustainable investment in soft commodities:

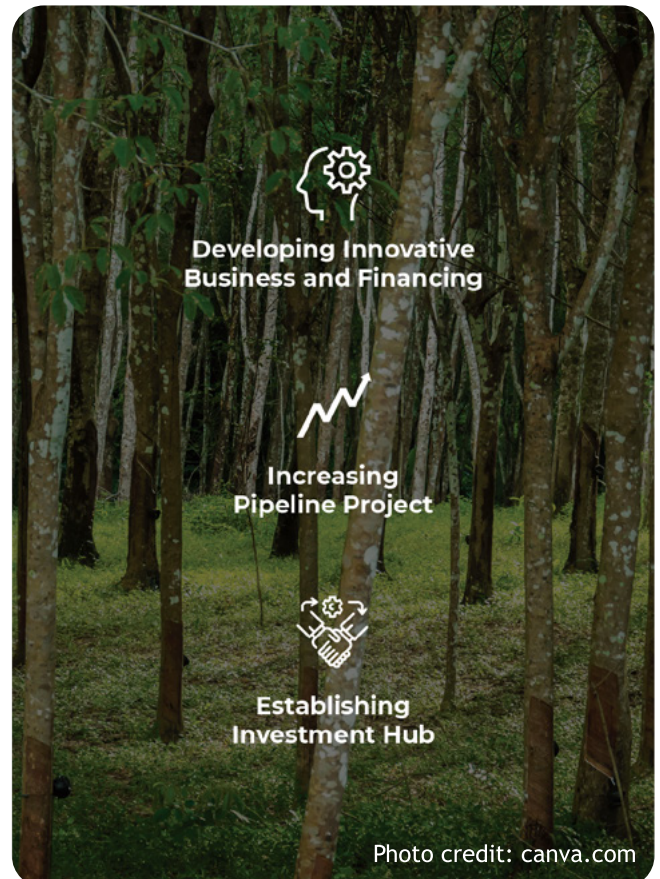
### Developing Innovative Business and Financing

Sustainable soft commodities project has a wide range of characteristics such as moderate and low Return of Investment (ROI) but high social and environmental (S&E) impact or high ROI with low S&E environment impact. Those projects who are less commercial (low ROI) need an investor who values S&E impact more than a financial return or needs blended finance instruments such as subsidy, equity financing, or grant. Thus, to accommodate the wide span of ROI, an innovative business and financial model needs multistakeholder collaboration. The involved stakeholder role needs to be mapped clearly so there is no overlapping responsibility. These business and financing models are important to accommodate the different preferences of investors.

As the first step, the business model is important for developing a pilot project. After the project was implemented, evaluation of the project is a must. Once the pilot project is successful, the business model can be duplicated for a large span of investors and various projects. However, if the project is not successful, developing another business model is one of the solutions.

### Increasing Pipeline Project

Indonesia has immense potential in soft commodities, yet the practice of sustainable agriculture is still limited leading to lower investment. To enhance investment in sustainable agriculture projects in soft commodities, increasing pipeline projects is one of the solutions. By developing a pipeline project, investment opportunities will be identified under the condition the proposed company knows what activities that they can implement sustainable agriculture practice. For the Investor, the proposal needs to identify what kind of opportunity is offered or the investor will seek another opportunity from the project. Once the opportunity is identified, the challenge is developing a good proposal. A good proposal is intended for attracting investors to invest. To develop a good proposal, there are needs to enhance the capacity of the proposal maker which is lacking in the case of Indonesia. Thus, we recommend having capacity building for local players before developing a pipeline project.



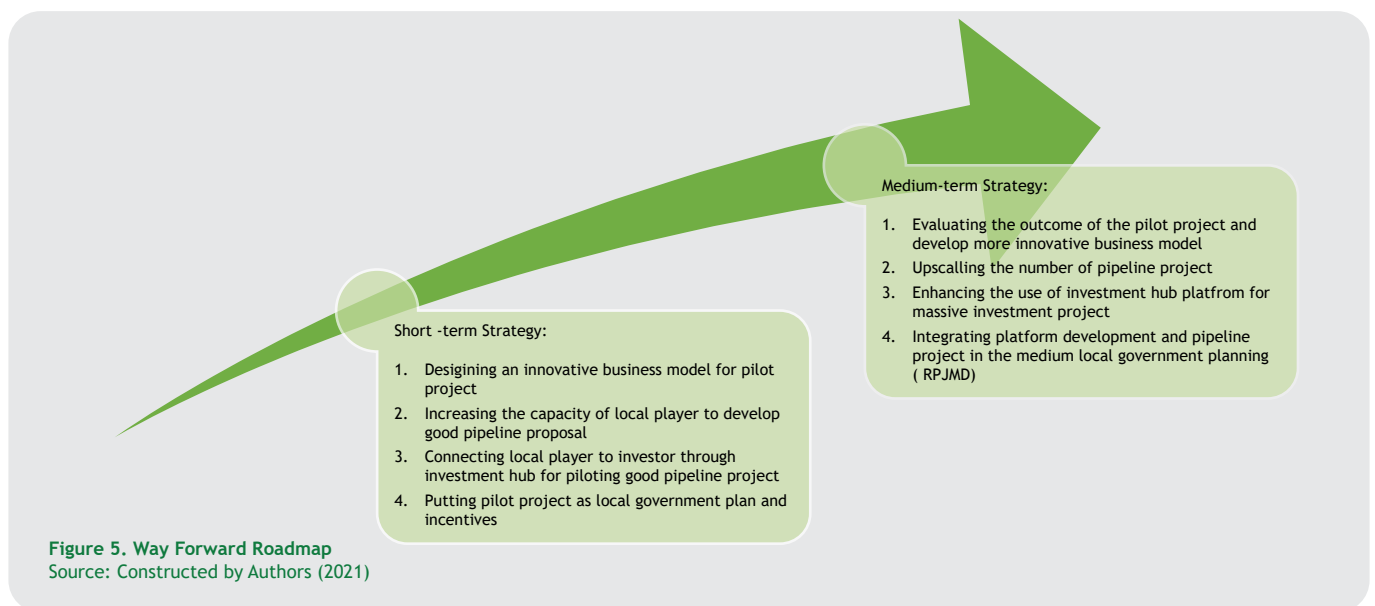
### Establishing Investment Hub

The potential of soft commodities in Indonesia is spread out in many regions yet it is barely known by investors especially international investors. To overcome the problem, we recommend the government establish an investment hub around Indonesia. The main purpose of the establishment of Investment Hub is to facilitate investors who seek an investment opportunity in soft commodities projects in Indonesia. The Investment Hub will have three main mandates which are data manager, project sorter, and matchmaker. The mandate to manage data means that the investment hub must gather data about the potential project available all-around Indonesia. This is essential because the data in Indonesia is still scattered. As project sorter, the investment hub must present all the project that is ready to be funded. Lastly, the Investment will act as a matchmaker to support the project to get massive investment projects.

### Involving Local Government (Pemda) to Support Investment

Currently, the role of local government in supporting investment in soft commodities is limited whereas the investment is located in their areas. Thus, we recommend that the local government act as a collaborative government. Collaborative government means that the government act as a collaborator in the whole investment process such as being involved at the investor forum. The local government also needs to involve by creating an environment that supports the investment in soft commodities such as

incentivizing the pilot project of sustainable agriculture practice in soft commodities. To create the environment, the government is suggested to know their potential in soft commodities, current statutes of sustainable agriculture implementation in their area, and creating safeguards (e.g., spatial planning). All those activities need to be described in their regional planning (RPJMD) as a support signal for investors from the government.



### Enabling Environment for Sustainable Agriculture Practice: The Study Case of PCI Implementations in Matto Grosso, Brazil

The Produce, Conserve, and Include (PCI) Strategy is a jurisdictional approach for sustainable development in the State of Mato Grosso, Brazil. The Strategy aims to promote economic and social development in Mato Grosso through sustainable use of land. Thus, the increase in agriculture productivity will be achieved by maintaining native vegetation and reducing deforestation. To achieve their target, it was estimated that R\$39 billion investment to reach their targets. Until 2020, the amounts that were executed were R\$ 15.48 billion consists of R\$8.78 billion in the produce area, R\$ 205.20 million in the Conserve area, and R\$9.48 billion in Include Area. All those financings were funded through several financing mechanisms including public and private investment. Among those financing mechanisms, eight instruments come as priorities which are donation, green bonds, combined financing, reduction of emission from deforestation and forest degradation (REDD), investment funds, carbon-backed fund, revolving fund, and guarantee fund. All of this will be expected to fund their investment gap in 2030 by R\$150.4 billion.

The success of PCI strategy to build an environment for funding sustainable agriculture practice in Matto Grasso happens because several support. First, the support of the government. The government of Matto Grasso realized that they need more sustainable instruments and mechanisms so that the government focused to developed and supporting the mentioned green financing instrument. Currently, the government still developing legislation to support more green finance. Second, Fundraising is the key source for conservation and sustainable practice. The mechanism of fundraising is more politically viable than relying on the fiscal budget from the government. Fundraising also opens more opportunities for the community to involve in achieving the PCI goals. Thus, developing enabling conditions are more favorable to market mechanisms.

Source: PCI (2020)



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## The Tropical Forest Alliance

TFA is a global multistakeholder partnership platform initiated to support the implementation of private-sector commitments as well as to amplify demand-side engagement in major economies towards the transition to reduced deforestation commodity supply chains. Hosted by the World Economic Forum, TFA partners with 170+ organizations - companies, government entities, civil society, indigenous peoples, local communities and international agencies. TFA operates regional platforms in Latin America, West and Central Africa, China, and Southeast Asia.

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Faculty of Economics and Business, University of Indonesia, or better known as LPEM FEB UI, is a research institute under the Faculty of Economics and Business, University of Indonesia, and the largest community of academic researchers at the University of Indonesia. For more than 60 years, LPEM FEB UI has become one of Indonesia's leading educational institutions, which plays an essential role in contributing ideas through research, consulting, and education.

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We hope that this Investment Case could inspire and scale sustainability commitment and further collective actions across all stakeholders in our journey towards a deforestation-free commodities supply chain, other forest-positive shared agendas, and eventually our pursuit towards deforestation-free commodity production.

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