



THE COST OF CONFLICT IN OIL PALM IN INDONESIA

Executive Summary

The Cost of Social Conflict in Oil Palm

Why this Study Matters

Palm oil is an important sector for the Indonesian economy, contributing nearly USD 17 billion of export revenue, or 9% of the country's total exports in 2015.¹ As the world's leading producer of palm oil,² Indonesia is well placed to meet growing future demand for the commodity, with targets to increase production nearly 60% to 40 million tons by 2020.³

In recent years, palm oil has drawn growing attention due to environmental impacts caused by forest and peat land conversion, as well as social impacts linked to land disputes and conflicts with local and indigenous communities. This attention has prompted many palm oil companies to adopt and implement new standards for best practices to mitigate these impacts. Increasing numbers of major producers, traders, processors and manufacturers today are committing to eliminating deforestation, protecting peat lands and avoiding exploitation of people and communities within their supply chains.

Although pledges and commitments may not necessarily translate into changes in implementation, they can lead to greater public scrutiny. With increased communications resulting from growth in social media, companies are realizing that avoiding or resolving conflict is becoming an important component of their license to operate. This recognition is meaningful, but insufficient to guide management decisions and strategy. Although costs resulting from social conflict are appreciated as material within industry, managers in oil palm companies do not currently have the necessary data to inform their decisions related to investments and operations.

Study Purpose

To address this shortcoming, the **Indonesia Business Council for Sustainable Development, IBCSD, through their Conflict Resolution Unit (CRU)**, with funding support from UK Climate Change Unit⁴, commissioned a team from **Daemeter Consulting** to conduct a study **to monetize the costs of social conflict in the palm oil sector**. By assigning financial values to all costs, expenditures, direct and indirect costs and loss of value from both tangible and intangible assets, the study aims to provide a clear picture of how social conflict impacts the bottom line of palm oil companies. We used data from conflicts in five plantations in Kalimantan and Sumatra to calculate financial values for direct and indirect costs and loss of value from tangible and intangible assets.

Findings

Our study provides a clear indication of how social conflict impacts the bottom line of palm oil companies and will hopefully allow executives and managers to make better- informed policy and operational decisions with respect to avoiding and managing conflict. We conclude that the cumulative costs of

¹ www.kemendag.go.id (sourced from BPS and accessed September 19 2016)

<http://www.kemendag.go.id/en/economic-profile/indonesia-export-import/export-growth-hs-6-digits>)

² Index Mundi, through United States Department of Agriculture

³ Quote, Vice Agriculture Minister Bayu Krisnamurthi, as reported by the Jakarta Post, February 6 2010. Accessed online at <http://www.thejakartapost.com/news/2010/02/06/govt-set-three-sezs-agribusiness.html> in Oct 2016.

⁴ This material has been funded by UK aid from the UK government; however the views expressed do not necessarily reflect the UK government's official policies.

social conflict are significant, undervalued and potentially pose a serious obstacle to productivity for companies, as well as imposing costs on communities and local government.⁵

We found that:

- The tangible costs of social conflict range from USD 70,000 to USD 2,500,000 in the cases we studied. The largest direct costs are lost income from disrupted plantation operations and staff time diverted from other tasks to address conflict. Company profits are decreased by delays in plantation development and stoppage of maintenance, production, and mill operations. Indirect costs result from the opportunity costs of using human and financial resources to address conflict rather than investing it to improve plantation productivity. Tangible costs represent 51% to 88% of plantation operational costs, and 102% to 177% of investment costs on a per hectare per year basis.
- Intangible or “hidden” costs may range from USD 600,000 to USD 9,000,000, representing expenditures or indirect losses associated with, for the purposes of this study, risk of: conflict recurrence or escalation; reputational loss; and risk of violence to property and people. Reputational loss could affect companies’ ability to borrow at market interest rate, result in decreased product demand, or reduce stock market value of the company. We calculated intangible costs by applying a conflict risk premium on borrowing, which raises borrowing costs. We found that property violence occurred in 7% of cases and human violence in 1%, which have far larger financial consequences than other risks.

Table 1 Tangible costs as percentage of operations and investment costs (per year/ha)

	Total Tangible Costs	Time-frame (yearly)	Tangible costs / year	Number of hectares impacted or in dispute	Total costs of conflict / hectare / year	Annual costs of conflict as % of investment costs /ha	Annual per ha costs of conflict as % of operational costs
PT A	117,873	.25	117,873	400	295	133%	65%
PT B	613,972	9	68,219	300	227	102%	51%
PT C	2,682,151	1	2,682,151	9000	298	134%	66%
PT D	110,345	5	22,069	90	254	114%	56%
PT E	70,886	3	23,629	60	394	177%	88%

⁵ We did not address the costs of conflict to communities or government within this study, although we acknowledge that these costs may be significant.

How We Conducted Our Study

We initially consulted key informants including palm oil industry executives, plantation managers, economists and NGO leaders to develop a social conflict framework and the methodology for the study. We then visited three palm oil estates in Sumatra and Kalimantan that have experienced different types of conflict and interviewed plasma and mill managers, community development officers, financial staff, community members and government representatives. Interviews focused on the cause and chronology of social conflict, notable events, and parties involved. Field visits were complemented by engagement with executives at company headquarters and financial data collection. We analysed two other cases of

A note on scope: We acknowledge that costs brought on by social conflicts in the palm oil sector burden not only the palm oil companies, but also local government, and, most notably, the communities or individuals involved in the conflict. As a proportion of total budgets and expenditures, these costs may in fact be most severe in their impacts to these parties. We recognise the significance of these costs to these other parties and appreciate a need to understand and define them. However, they are not included within this study. We recommend they be considered in future research efforts.

conflict through visits with management teams and headquarters staff. To provide context for our case studies and better calculate intangible costs, we compiled data on social conflict from local newspaper articles and online portals in three provinces: West, Central and East Kalimantan. This data set contains information on social conflicts experienced by 174 oil palm companies in these three provinces, which allowed us to calculate the potential range for the probability and intensity of conflicts and other factors necessary to calculating intangible costs.

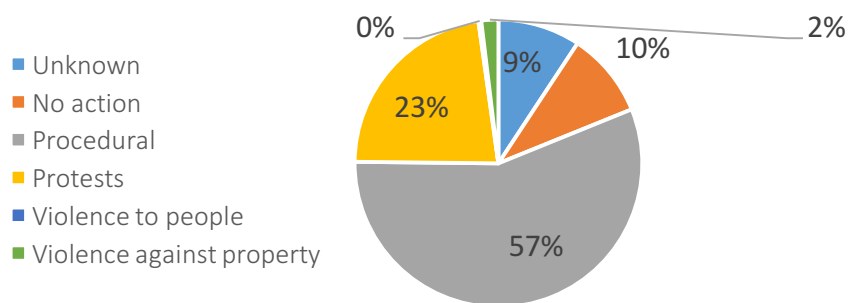
Through the social conflict framework, we defined the common elements of the conflicts including drivers underlying the conflict, manifestations of conflict in actions taken by claimants, and mechanisms and approaches to resolve the conflict. Local communities or groups of smallholder farmers were the aggrieved parties, or claimants, and palm oil plantations were the object of grievance in the cases we studied. Other parties that may intervene in conflicts include local government, law enforcement, the courts, and NGOs or farmer's groups. Land disputes were determined to be the primary driver of most conflicts, representing 67% of all cases in the Kalimantan Data Set. Problems related to smallholder schemes is the second most common cause of conflict, representing 24% of total cases. Some conflicts have multiple drivers, including disputes over compensation payments and approaches.

Table 2 Main Causes of Social Conflicts (West, Central, & East Kalimantan)

Driver	West Kalimantan		Central Kalimantan		East Kalimantan		Total	Overall %
	Number	%	Number	%	Number	%	Number	%
Land disputes	30	59	49	73	37	76	116	67%
Plasma smallholder	13	26	20	30	9	18	42	24%
Labour	2	4	8	12	5	10	15	9%
Environment	7	14	5	8	8	16	20	12%
CSR programmes	10	20	8	12	0	0	18	10%
Other	5	10	6	9	1	2	12	7%

Conflict manifestations range from peaceful protests and formal complaints to destruction of public and private property, and in some cases violence to persons. In our review of media reports, 57% of conflicts start with formal complaints, meetings, and negotiations but also included court appearances or third-party mediation. A quarter of cases involved demonstrations or road blocks. Conflicts thought to be resolved had re-emerged or escalated in over 50% of cases. Initiatives to resolve conflict vary by company but usually involve negotiation, compensation, and in some cases, legal settlement.

Chart 1 Manifestations of Conflict, Sourced from Kalimantan Data Set (n=174)



Conclusions

Through the case studies and analysis relative to this study, we were able to identify several common themes that provide some insights around social conflict in the palm oil sector. These include:

Conflict as a resource drain: Despite the small sample size and narrow scope of this study, our findings indicate that the costs relative to conflict are significant, misunderstood, and potentially pose a serious obstacle to productivity for companies, communities, and the government, and therefore, Indonesia as a whole. For the companies, this drain in productivity is a product of staff time but also a misallocation of capital. For example, there is no analysis currently being conducted by companies to evaluate whether or not the expenditures in social conflict management are more or less than expenditures in conflict mitigation or CSR programmes.

Land (and livelihood) is the most important driver of social conflict in the palm oil sector: In all five cases, land rights were the cause of the disputes. In two cases, disputes were also based on disagreements over compensation for land. In one case, in addition to a land dispute, there was a dispute related to the smallholder scheme. This finding is supported by the literature review we conducted and secondary data which indicates the value of land as an important, and often the only, production asset in rural areas.

Disputes tend to start with non-violence: Procedural manifestations, including letters, meetings or court action, were the first approach taken by all but one of the five cases. This trend is substantiated by the Kalimantan Data Set which indicates that 57% of manifestations start as procedural disputes. Although more research on conflict escalation is needed, anecdotal evidence indicates that when procedural manifestations go unnoticed or ignored, the conflict often escalates to physical protests.

Conflicts often recur: Information of the case studies focuses on single conflict events. However, secondary data indicates that 57% of companies that experience initial conflict can have a recurrence of conflict. This means that over half of companies experience multiple conflict incidents, involving a new conflict or the recurrence or escalation of a conflict previously believed to have been resolved.

Conflicts tend to take place during production: All of the case studies we reviewed occurred in the early stage of production. During this phase companies are more likely to respond as they stand to lose income and profits should their operations be disrupted.

Recommendations

Our study, although limited in scope and sample size, demonstrates that social conflict is a significant and costly problem in the palm oil sector that merits greater attention from companies, the palm oil industry, government, and researchers to address its business, social, and livelihood dimensions. We recommend that the following actions be considered:

Improve company policy and management procedures, including employee incentives and KPIs: None of the companies we studied had a tracking mechanisms for conflict-related expenses but rather assigned expenditures to other line items on an ad hoc basis. This obscures the full cost of conflict, makes it impossible to evaluate whether social conflict management is costing more than conflict mitigation or CSR programs, and reduces the urgency for management to develop policies and allocate resources to avoid or reduce conflict. Company policy and internal communication protocols appear to be inadequate to effectively address conflict and employee incentives for rapid plantation development may perversely incentivize actions that ultimately lead to social conflict. Companies should consider incorporating incentives for estate management linked to good social relations and develop a tracking system enabling them to more effectively recognise potential for conflict escalation. An early warning system could help companies recognise the onset of conflict and take quick actions to minimize escalation.

Expand the knowledge base on the causes, progression and implications of social conflict: Currently social conflict is not being documented in a systematic, transparent manner at the national or sub-national level. Developing a data set on social conflict in land-use sectors would be valuable to: (i) define trends and characteristics of social conflict; (ii) better understand and define tangible and intangible costs; and (iii) better understand the factors that drive conflict escalation. An analysis of socioeconomic and environmental implications and costs of social conflict would allow both government and the palm oil industry to better develop policies to address it and allocate resources accordingly. This could include the costs incurred by communities and the government and be expanded to quantify the cost of land conflict across Indonesia, examining its implications for economic competitiveness and investment readiness.

Build capacity of local stakeholders: An indirect cause of conflict is that stakeholders who should or could act as intermediaries between companies and communities do not play this role effectively because they are not trained in conflict mediation or the rapidly evolving legal framework for oil palm plantations. District government officials are key stakeholders because of their regulatory authority over plantations and responsibility for spatial planning and award of land titles. Law enforcement officers, relevant NGOs should also be trained. The number and skill level of professional, independent mediators must also be increased to handle the number of on-going conflicts.

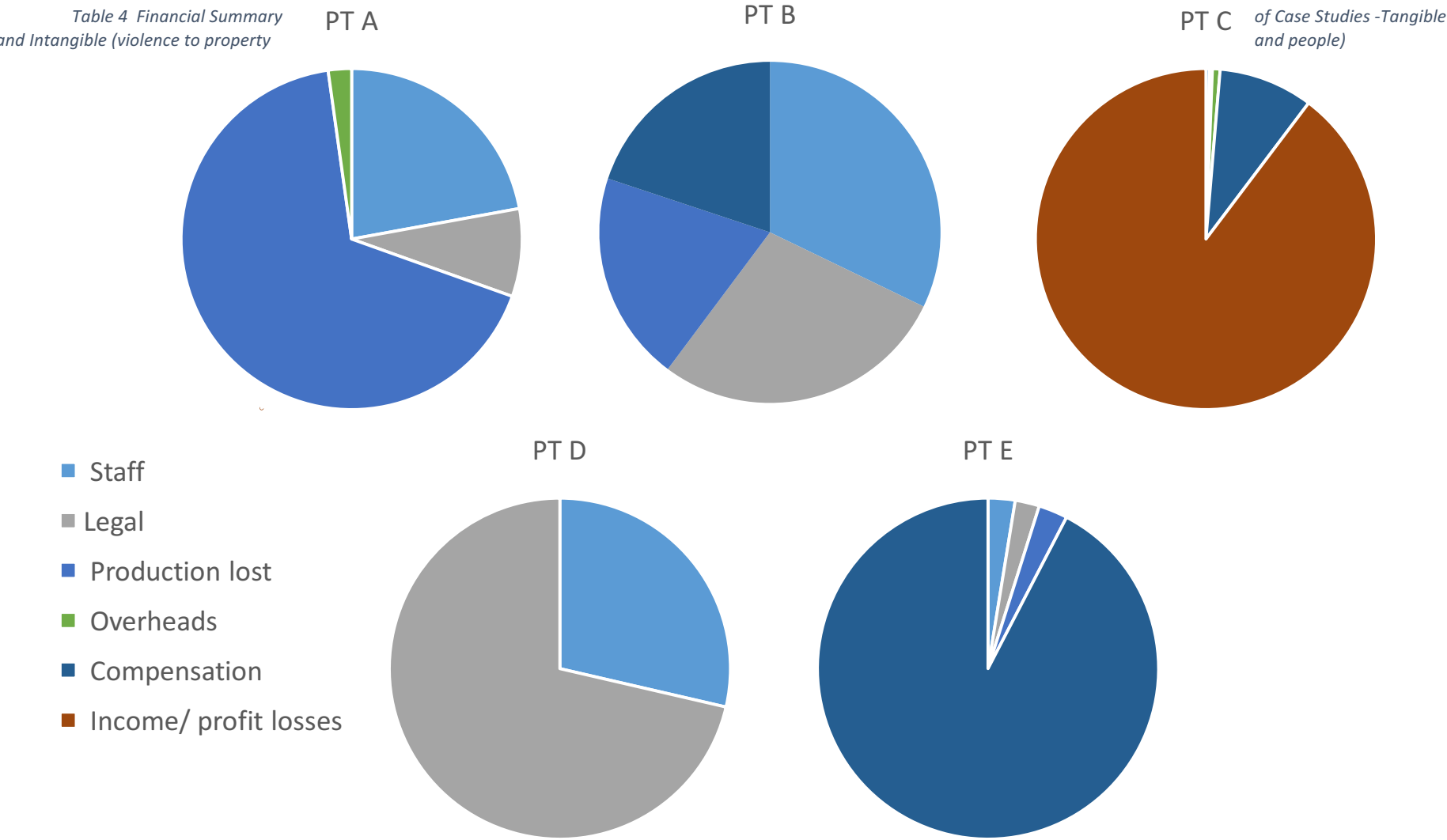
Develop best practices for conflict prevention, mitigation and resolution: Very little information exists on the types, success rates and cost-effectiveness of current efforts to address and resolve conflict. We should study and understand what is being tried and what is working as a basis for developing best practices to be disseminated throughout the industry. Compensation payments require specific attention given the central role they currently play in conflicts.

Pilot conflict prevention and mitigation at the jurisdictional level: The jurisdictional approach is being promoted and tested as a means to reduce the environmental and social impacts of oil palm plantations at the district or province level over extended time periods. This approach includes all stakeholder groups who should be involved in reducing conflict, providing a promising mechanism for piloting approaches to institutionalizing conflict reduction at the local government level.

Table 3 Financial Summary of Case Studies -Tangible and Intangible (recurrence and reputational)

Company	Total Tangible Costs	Intangible Costs (USD) - Recurrence and Reputational						Grand Total (tangibles & intangibles) (minimum)	Grand Total (tangibles & intangibles) (maximum)	High Likelihood 72%
		Recurrence Minimum	Reputational Minimum	Total Intangible Costs (Min)	Recurrence Maximum	Reputational Maximum	Total Intangible Costs (Max)			
PT A	117,873	61,020	531,394	592,415	244,082	1,123,289	1,367,371	710,288	1,485,244	
PT B	613,972	426,823	423,546	850,370	1,707,293	895,229	2,602,522	1,464,342	3,216,494	
PT C	2,682,151	1,969,085	489,079	2,458,164	7,876,340	1,033,741	8,910,082	5,140,315	11,592,233	
PT D	110,345	426,823	423,546	850,369	1,707,293	895,229	2,602,522	960,714	2,712,867	
PT E	70,886	426,823	423,546	850,370	1,707,293	895,229	2,602,522	921,256	2,673,408	

Chart 2 Distribution of primary cost components for the five case studies.



Company	Total Tangible Costs	Intangible Costs (USD) - Violence to Property		Grand Total (tangibles & intangibles) (minimum)	Grand Total (tangibles & intangibles) (maximum)	Low Likelihood 7%
		Total Violence to Property Minimum	Total Violence to Property Maximum			
PT A	117,873	676,548	3,397,569	794,421	3,515,442	
PT B	613,972	539,313	2,707,830	1,153,285	3,321,802	
PT C	2,682,151	622,756	3,126,792	3,304,907	5,808,943	
PT D	110,345	539,313	2,707,830	649,658	2,818,175	
PT E	70,886	539,313	2,707,830	610,199	2,778,716	

Company	Total Tangible Costs	Intangible Costs (USD) - Violence to Persons		Grand Total (tangibles & intangibles) (minimum)	Grand Total (tangibles & intangibles) (maximum)	Low Likelihood 1%
		Total Violence to People Minimum	Total Violence to People Maximum			
PT A	117,873	1,694,201	6,830,829	1,812,074	6,948,702	
PT B	613,972	1,350,400	5,443,548	1,964,372	6,057,520	
PT C	2,682,151	1,559,337	6,285,787	4,241,488	8,967,938	
PT D	110,345	1,350,400	5,443,548	1,460,745	5,553,893	
PT E	70,886	1,350,400	5,443,548	1,421,286	5,514,434	