



IMPACT FOR CHANGE: SMALLHOLDER INCLUSIVITY

The Case of Siak, Riau

07 / 2021



Introduction

This business case aims to document best practices of collective actions among stakeholders in assisting smallholders. The case study showcases scalable solutions to potential private stakeholders in generating a more inclusive business model among companies. This in turn will be crucial in exploring growth opportunities and supporting sustainable value creation among smallholder palm oil farmers; in this case for smallholders in Siak Distrik, Riau. More than fifty percent of palm oil productions in Riau, Indonesia can be traced back to the private sectors; however, smallholder farmers make up for 380,000 plantations which cover a total area of one million hectares, producing an estimated number of 5.9 million tons of fresh fruit bunches (FFB) per year. Emphasized in this document are the problems faced by smallholder farmers – which contribute to a number of sustainability issues, such as deforestation and social consequences – and what can be done, as well as what has been done, to establish a healthy ecosystem, improve sustainability and practice business inclusivity with the end goal of mitigating future risks. The case study also explores business opportunities through collaborative actions, such as the inclusion of smallholder farmers as part of the business value chain, mapping the heterogeneity of actors that make up smallholder palm oil economy, implementing sustainable solutions, overcoming certification challenges, and understanding the complex nature of the palm oil sector.

At a Glance



1

As a world-leading palm oil producer, there has been an increasing demand to produce sustainable palm oil production in Indonesia.

2

Public and Private sectors step up to commit in sourcing deforestation-free supply chain through NDPE commitment and strengthening local certification.

3

Benchmarking global production through RSPO render smallholders to hold critical position.

Indonesia is the world's largest producer of palm oil with a total production rate of 42 million metric tons in 2018¹ – this translates to the palm oil industry making one of the largest contributions to the country's economy, primarily in foreign exchange revenue.

In 2017, 2.46 percent of the country's gross domestic product (GDP) came from palm oil¹. As a global agro-commodity, palm oil presents complex challenges, such as deforestation, natural resources exploitation, and other social damages, yet its contribution to economic growth remains vital. There is a strong demand nowadays for sustainable and conflict-free palm oil, and the key to achieving that highly depends on meaningful collaborative partnerships², initiatives and actions generated by both state and private institutions.

Public concerns over these challenges have led governments, companies and consumers to restructure the value chain through the creation of self-regulatory commitments, initiatives, certification and public policies. By 2018, according to Climate Advisers⁴, more than 170 palm oil companies have made the commitment to source and produce palm oil which do not contribute to deforestation, exploitation and away from peatlands (NDPE). The Indonesian government has further strengthened the national regulation by implementing a moratorium on new palm oil plantations and Indonesian Sustainable Palm Oil (ISPO) certification system, which apply uniformly across all stakeholders, including smallholders⁵.

However, smallholder farmers - who are scattered across Indonesian vast and numerous provinces – remain left behind. They are not aware of the need for these commitment in their practices, changes or the ways to go about them. To them, these commitments may ring hollow. Smallholder farmers' position³ in the value chain is vulnerable because they are facing compliance barriers rooted in the informal ownership, the nature of their organization (ungrouped), poor management of palm oil plantations, and substandard production practices. More than that, because of their vulnerability, smallholder farmers are prone toward illegal practices which threaten the sustainability of protected areas.

In 2004, the Roundtable on Sustainable Palm Oil (RSPO) initiative was established as a global non-profit association whose primary purpose is to transform the markets by making sustainable palm oil the norm. The multi-stakeholder initiative is recognized by buyers and producers of palm oil as a necessary approach in benchmarking global production, consumption and governance standard. RSPO certification helps smallholder farmers to improve management practices, produce higher quality fresh fruit bunches (FFB), increase yields and gain better access to the supply chain. Whilst in the country, Indonesian Sustainable Palm Oil (ISPO) was devised by the Indonesian government to ensure the laws which govern sustainable palm oil are followed by all entities who produce palm oil and manufacture its derivatives throughout the whole supply chain⁶.

Acknowledging Challenges, Opportunities and the Important Role of Independent Smallholders in Riau

Despite their essential role in the national production of palm oil, smallholder farmers continue to face increasing challenges. Quality benchmarking and best practice management – such as safety and quality standards, quality-based competition, and rising market concentration – are central to the landscape of power relations between farmers and processors/retailers, with most practices favoring the latter. In particular, Indonesian independent smallholders across a variety of areas face different challenges³.

There are four primary issues⁷ smallholder farmers often face: access to finance, legalities, access to market and access to good agricultural practices (GAP).

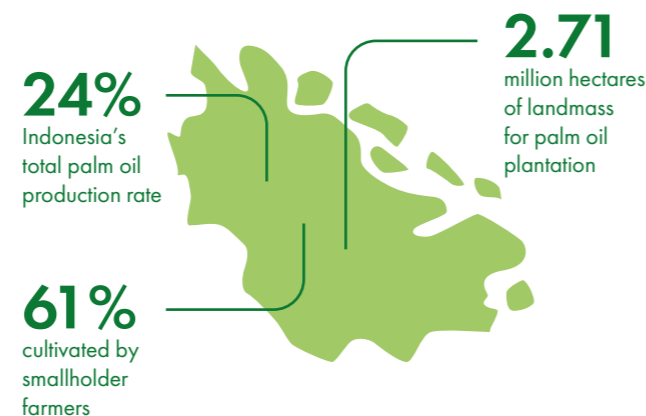
Not all smallholder farmers share the same situation, or status, in their respective community and within the supply chain. Some of them are affiliated with local cooperatives; while others are going it independently, or are linked to informal “agents” or middlemen. The latter makes it difficult for farmers to receive the necessary access toward better farming techniques, or fertilizers – crucial issues most farmers are facing³. Because a low yield means farmers are on the losing end of the market, unable to receive better pricing over low-quality bunches they produce. On the other hand, their inability to mobilize themselves in a group setting presents challenges for them to negotiate with big buyers or, in the least, to access seeds, fertilizers and capacity trainings from both private and public sectors.

Palm oil smallholder farmers in Indonesia⁸



Given the above challenges, both governments and businesses find it crucial to improve the current state of smallholder farmers and acknowledge their contributions to the palm oil industry. In Indonesia alone, smallholder farmers are responsible for at least 35 percent of total crude palm oil production⁸. Altogether, they manage more than 40 percent of the total palm oil plantations around the country, or roughly 3.1 million hectares of land. The largest of these are located in the Riau Province, which contributes up to 24 percent of Indonesia’s total production rate. According to recent statistics, palm oil plantations in Riau take up some 2.71 million hectares of landmass, or approximately 21 percent of the province’s total size; and 61 percent of these are cultivated by smallholder farmers⁸.

Riau Province



Reaching Out to Smallholders in Siak

Riau became the worst affected area of forest and land fires in the country due to illegal forest and land clearing practices. In 2019, Riau’s Regional Disaster Management Agency Badan Nasional Penanggulangan Bencana (BNPB) recorded 8,168 hotspots in the region, 72 percent of which occurred in peatland areas⁹. These forest fires led to a massive deforestation, numerous health issues among local communities and prompted a public outcry for better land management by the government and private companies.

Siak District, however, shows the lowest count of hotspots in the entire province, with 493 points recorded in 2019, or 6 percent of the total points, even though it is regarded a region with the largest peatland on the island of Sumatra.

Following the massive forest and land fires back in 2015, Siak District quickly initiated efforts to prevent future disasters by developing the Green Siak District Road Map the following year. Then, in 2017, the local government of Siak District reached out to private companies and small entrepreneurs to begin implementing Good Agriculture Practice (GAP) for sustainable management of palm oil plantations⁷.



In 2018, the Green Siak Initiative was formalized through the issuance of Regent Decree No. 22/2018 by the local government. The initiative covers, among others, zoning arrangements for spatial conservation, agriculture, industrial, plantation and residential areas. Around the same time, more private companies were shifting their business model and strategy in support of sustainable goals and practices. This case study intends to highlight – in clear and measurable terms – the experience and perspectives of collaborations of supply chains and developing partner, Goldern Agri Resources (GAR), Neste and SKPS who have been in supporting smallholders and business transformation in Siak District.

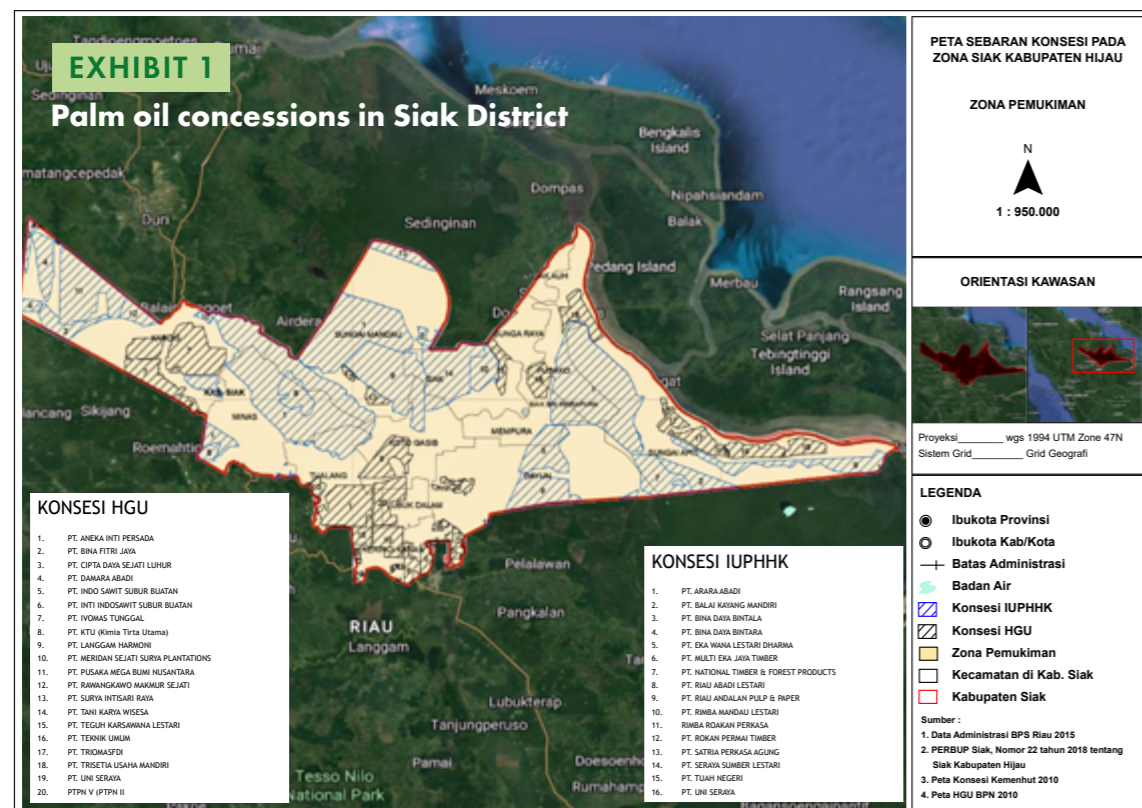
Moreover, this case study focuses on collaborations of supply chains of GAR and Neste, supported by the local government and smallholder associations, to include smallholders in the supply chain by mapping out smallholders, a crucial initial step for businesses to support independent smallholder farmers to adopt sustainable practices, to get wider exposure.

Aware of the challenges faced by Indonesia's palm oil smallholder farmers, collaborative initiatives have been created and implemented by private stakeholders, working with local government bodies, to mitigate environmental risks and improve the quality of life of communities surrounding palm oil plantations.

Siak District oversees 232,680 hectares of palm oil plantations with a production rate of 749,159 tons in 2018. Nearly 90 percent¹⁰ of all the households in the regency participated in the production process as smallholder farmers. Currently, there are 20 mills operating in the area, but it is not enough to cover all the fresh fruit bunches (FFB) harvested by smallholder farmers – therefore, the processing has to be illustrated through this business case study is the critical value of collaboration among private companies in driving change and promoting sustainable value creation in Siak District.

The role of private companies in addressing the high yield gap and level¹¹ of business and compliance challenges faced by smallholder farmers is central to the purpose of improving their lives and livelihood according to the standards of emerging markets. To that end, the collaborative actions of private stakeholders in implementing sustainable solutions and creating impacts will raise the competitive value of the palm oil sector and ensure smallholder farmers are included in the supply chain.

The locations of palm oil concessions in Siak district can be seen in the following exhibit.



Source: Daemeter, 2018

Collaborations between Businesses and Smallholders

GAR and Neste act as supply chain collaborators, whose commitment in advancing their business partnerships aimed toward smallholder farmers' certification serves as a beacon of light in an industry rife with controversies.

Golden Agri-Resources (GAR), a vertically-integrated palm oil plantation company committed to responsible palm oil production, is among the first private companies to adopt sustainability as the pillar of its operational activities, which is reflected in GAR's Social and Environmental Policy (GSEP) guidelines. GAR is well-aware that in order to push the envelope on sustainability, it must include independent smallholder farmers in the value chain. On the ground, GAR works with 350 - 450 suppliers across Siak region, as well as smallholder farmers located in their surrounding mills. The collaboration with smallholder farmers helps advance GAR's commitment all the way to their tri-party supplier, not to mention their contribution in building a comprehensive governance system for smallholders. From a business perspective, GAR's commitment in ensuring the sustainability of their palm oil production means they must include smallholder farmers within their supply chain and business value chain. In 2016, GAR signed a working agreement with one of its primary customers, Neste, the world's largest producer of renewable diesel and sustainable aviation fuel, to help boost independent smallholder farmers' sustainability.



GAR smallholder farmers in the value chain

350 - 450
suppliers across Siak region and smallholder farmers located in their surrounding mills





Neste is the world's leading sustainable private company whose work and work ethic are directed toward reducing greenhouse gas emission by at least 20 million tons per annum by 2030, and to reach carbon-neutral production by 2035. Neste's commitment has propelled it to take on a leadership role in combating climate change and driving the circular economy. Among its priorities is to achieve palm oil sustainability and traceability within Indonesia's complex palm oil industry. This sustainability and traceability cover all palm oil actors: the big players and also smallholders. Neste believes by reaching out to the marginalized smallholders, it can play an active role in empowering smallholder farmers to become responsible in conducting sustainable practices on a smaller scale.

According to Neste's 2017 Annual Report: "Adoption of sustainable practices enables smallholders to get certified, which Neste requires from all its palm oil suppliers. By sourcing raw material from the certified smallholders, Neste provides them with a financial incentive to remain committed to sustainable practices and continuous improvement." Neste's leadership role means it is allowed to make even larger contributions in the project even though its supply chain is far removed from smallholder farmers.

Takeaway

- 1 Shared agenda in sustainable commitment
- 2 Businesses value and potential target of engagement
- 3 Building mutual trust to kick off the partnership agreement

GAR and Neste's agreement points toward a shared goal in enabling smallholder farmers' group certification which leads to the supply of certified palm oil. The project aims to be mutually beneficial for all parties. For Neste, the general premise is to obtain even more certified sustainable palm oil products from the GAR supply chain (mills and refineries) in Riau; and among the most urgent action steps is to certify smallholder farmers who partake in the process of palm oil production – because there are recorded cases where certified palm oil plantations are managed by uncertified farmers. Therefore, by assisting smallholder farmers to be certified, more sustainable palm products will be available through the GAR supply chain to meet Neste's requirements. From the smallholders' point of view, on the other hand, this means they are guaranteed to receive quality palm oil seeds and sustainable farming practices. Thus, the project was created, which aims to help smallholder farmers adopt sustainable practices and gain a wider market access: in line with the sustainable policies of both GAR and Neste.

To kick-start the project, the first thing to do is to engage, map and identify smallholder farmers within GAR's supply chain in Siak District, Riau. This is where the Oil Palm Farmers' Union (SPKS), an intermediary as well as smallholder's union, one of GAR partner's in Siak District, came into the picture. By that point, SPKS had been supporting the farmers Kandis Sub-District in their effort to submit Tanah Objek Reforma Agraria (TORA) to the Ministry of Environment and Forestry (MoEF). Between 2016 and 2019 they carried a series of steps of interventions to help establish Koperasi Makmur Belutu Barokah. Their work helps connect smallholder farmers with private companies (GAR is one of their partners). The training resulted in the farmers' improved yields and productivities and it led to the success of establishing Koperasi Makmur Belutu Barokah in 2017, which initially had 26 early registered members and rose to 100 and 350 farmers by 2019. In total, they produced approximately 250 tone FFB/month.



These efforts have granted SPKS access to an agreement (MoU) with the local government in Siak District to drive certification among smallholder farmers in the area. In line with the goal to create sustainable palm oil, SPKS and the regency administration have collaborated in generating green initiatives and capacity building programs for communities in the district, particularly those involved in the production of palm oil. They reached out to independent farmers and helped them formulate a cooperative that would sustain their work and further their means of growing palm oil and processing them by becoming part of the business value chain. A series of trainings and workshops are held throughout the year to help farmers increase their yields and gain access to financial aid, with the goal of Surat Tanda Budidaya (STBD) (Registration Document for Plantation Cultivation) application and RSPO/ISPO certification. To that end, the role of the local government is pivotal in ensuring effective, legal and fair processes, as well as the socio-economic welfare of the surrounding communities.

Both GAR and Neste agreed to approach SPKS as the smallholder's governing body and negotiate the terms to execute mapping activities, especially for smallholder farmers living in the adjacent areas from GAR's mills, as well as SPKS's member's in Kandis sub-district.

The first round of mapping activities was to identified smallholders living in the adjacent areas all eligible to take part in Innovative Financing, another initiative by GAR which endeavors to raise smallholder farmers' productivity through an inclusive financial and agronomic support. The initial path of collaboration agreed to identify smallholder farmers by conducting environmental and social risk analysis as well as to document and map out independent smallholders' profiles across eight villages in Siak District.

This is where the partnership across business and smallholders has come to intersect in mutual collaborative ways.



Overcoming Challenges through Collaborative Actions

Between 2019 and early 2020, the collaboration between GAR, Neste and SPKS finally bore fruit as they moved from planning to on-the-ground implementation. Their actions were focused on conducting a sustainability gap analysis among approximately 876 smallholder farmers who managed a total area of 2,500 hectares across three priority villages which were identified to be able to supply to GAR mills (which in turn produced palm products for the Neste supply chain).



The gap analysis identified behavioral characteristics of smallholder farmers in Siak District, as well as the size of land owned, type of land (soil), land clearing method, type of seed, origin of seedlings, and age of the plant. Perhaps the most intrinsic part of the study is the farmers' mindset, attitude and decision-making process, which influence the management aspects of each plantation. Benchmarking the productive age of smallholder farmers, for example, can greatly impact development programs and activity planning suitable for particular age groups; because, as the study finds, smallholder farmers who belong to a productive age bracket are better at absorbing information and more able to innovate their practices to increase production.

During focus group discussions, together with farmers and SPKS, they identify farming practices, plantation management, and natural boundaries – crucial elements for the farmers to understand beyond their current practices to comply toward sustainable production with better yield productions and pricing. Sometimes discussions on network typology and plantation management go beyond the technical issues of agrarian management practices; and while such exercises are not common for smallholders to be involved in, it helps them gain a better understanding of the process and of plantation boundary, high conservation knowledge and, most importantly, of best management practices. It also takes into account, for example, the farmers' social network and how network structures can make or break the exchange of complex information and the adoption of best management practices which often drive higher results.

With Good Agricultural Practices and Certification process knowledge given by GAR staff and District government official during the mapping process, farmers begin to get a clear view of the location of their plantation, the process of planting and farming practices, as well as how to ensure legality through Surat Tanda Budidaya (STBD) application. This way, smallholders are proactively included in the chain of capacity building process and are not excluded merely as receptors.

The mapping process toward STBD certification which aims for replanting programs resulted with the seven clusters of typologies of smallholders in these areas: small local farmers, medium local farmers, large resident farmers, small migrant farmers, medium migrant farmers, small-and-medium peat farmers, and large investor farmers. Each cluster is defined by the farmers' characteristics, ethnic origin, productivity level, plot size, income ratio, and land type. Once the groups have been identified based on the typologies, training programs and awareness campaign can be tailored to address specific problems faced by each group of farmers – because every area and every group requires a specific solution. For example, farmers who are primarily facing supply chain management challenges can't be given equal solutions to farmers who are facing financing challenges.

Information collected in this exercise is then processed to provide a baseline data not only for the success of the Neste-GAR-SPKS project, but also for the local government to develop the Green Siak Initiative. Earlier, detailed information about independent smallholders in the adjacent areas of GAR mills were unavailable. Farmers are scattered across the region and their legal status unidentified. The collaboration in mapping process is also aligned to the national government's initiative to boost Indonesian Sustainability Palm Oil (ISPO), whereas the process of identification helps support the farmers in accessing financial aid, improving technical qualities and more. The identification process is validated by on-the-ground information to target eligible farmers to be further selected into the certification process. Eventually this would enable market access for independent smallholder farmers within the whole Siak District, and also provide them with the necessary link to the surrounding mills.



Remaining Challenges

The leadership position assumed by GAR, Neste and SPKS in mapping out the typology of smallholder farmers across Siak District resulted with identifying the root causes of problems in order to identify challenges and formulate the appropriate solutions. Some of those challenges found as follow:

Over the existing 10,000 smallholder farmers who have been mapped out, the project discovered some of them are caught in a legal battle, eg. not allowed to plant on certain areas allocated by the government; and these battles are not easily resolved. It would require time, effort and willingness from different levels of government to resolve - not easy to put into a business context which requires a fixed timeline to obtain products through their supply chain. Ideally, all smallholders living in the area surrounding the plantation are able to be certified

In terms of land productivity, the mapping discovers there are two primary challenges linked to productivity which can be addressed. The first is how to **improve land productivity** through efficient land-use and benefits to farmers. The second is to **replant aging plantations** and ensure existing agricultural plots remain vital to the livelihoods of farmers by remaining productive.

Due to changing regulations and policies, **legal and administrative compliance** remain one of the most challenging aspects of developing sustainable palm oil in Indonesia. Part of the problem is lack of comprehensive information and action plan, which leads toward risky practices of the smallholders.

The analysis also reveals organizational challenges. Logistics/infrastructure challenges vary across plantations and the associated infrastructure network, including the mode and frequency of collecting fresh fruit bunches (FFB). Smallholder farmers are often entirely reliant on an external agent to collect their FFB, while others with greater capital have the ability and accessibility to control their own delivery to the next point of sale. Organization challenges also lead to certification delays - most certified agencies require the smallholders to be organized both in the cooperative style or farmer's groups.

Smallholder farmers are having **difficulty accessing credit application** due to reasons stated above, ie. organizational challenges, legal challenges, etc. It's important for these farmers to begin gaining access for credit application if they are to develop their ability to manage their plantation better and raise their productivity rate.

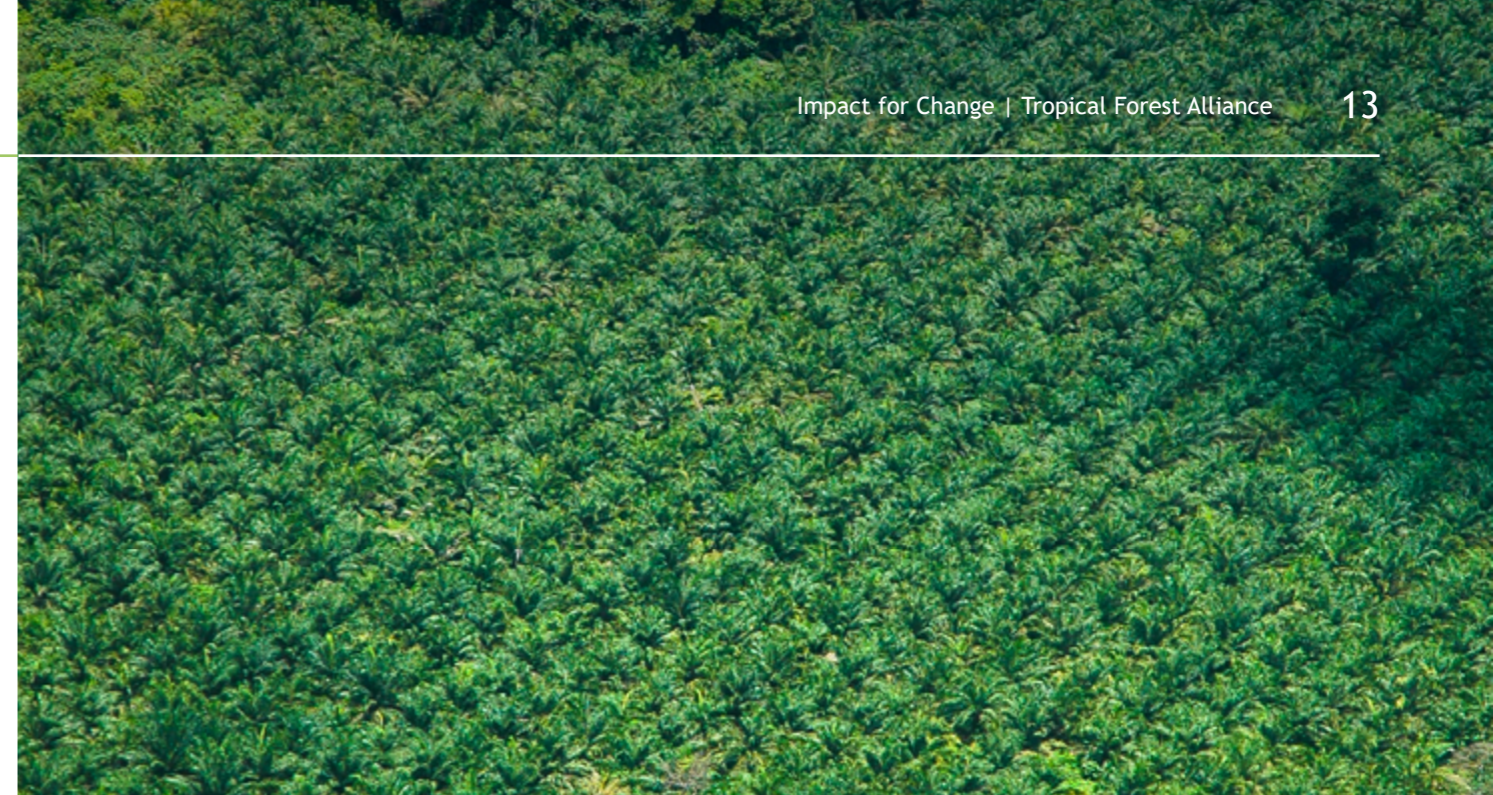
More than just organizational challenges, it's also important for smallholder farmers to understand **group dynamics** within the supply chain. Through the implementation of organization and inclusive measures, smallholder farmers will be able to better navigate the supply chain and their social networks.

As part of the information tree and distribution, safety training should be prioritized to help smallholder farmers gain a better understanding of what it means to embrace modern best practices when they manage and work at palm oil plantations. Not only for their own safety, but also to minimize environmental risks.

Engagement with local government (Dinas Perkebunan Siak) is very critical from the get go, because Neste - GAR and SPKS' partnership initiative is aligned with the government's target on smallholder replanting. This way, the outcome of the initiatives can be leveraged to further steps toward the certification process; and its continuation depends on the partnership's agreement.

Smallholders need a pathway to support them in breaking the bottleneck of legality issues of their land, and eventually gain opportunity to be certified by ISPO, RSOP or any other market-based certification system

Eventually the result of this partnership is still in progress, and more challenges may lay ahead. However, the importance which can be learned from this project is the fact that there is a possibility for partners within the supply chain - with the help of NGO - to work together and provide access to the global sustainable commodity markets. The learning from this project can be used for others aiming to seek solutions to play an active part in integrating smallholders to their supply chain.



Lessons Learned and the Road Ahead



It is clear that agricultural development requires a clear and present action from all stakeholders, but primarily those whose partnerships and collaboration are integral to the delivery of tangible results. Strategy and plans have been put in place by GAR and Neste, in collaboration with SPKS to begin training and development programs in Siak District through initial identification process; however, the pandemic has delayed many of the programs due to safety reasons. In going further, this collaborative action still has several goals to achieve in order to push sustainable initiatives forward.

The learning curve from the mapping of land-legality of smallholders is the need of an established database for the district government - of which all smallholders (independent and scheme) are registered. This would facilitate companies to understand the risks and better develop the skills and capacity of smallholder farmers.



It is impossible for the regional government to tackle these challenges by themselves, or for private companies to come up with a silver bullet project to eventually resolve smallholder sustainability issues; and worse, to expect smallholder farmers to handle their own problems without the provision of aid is also a tall order.

Neste and GAR's partnership, in line with their vision to lead the industry in developing sustainable products and practices, is what enables sustainable strategies to become actionable solutions.

More than just creating initiatives, both GAR and Neste are committed to sharing resources, implementing solutions and driving the supply chain to be more inclusive toward smallholder farmers.

This paper has demonstrated the various challenges, solutions and work involved in creating and developing sustainable palm oil in Siak District, Riau. It has also shown how partnerships and collaborations among private companies are able to generate benefit toward business value, while providing an inclusive approach toward smallholder farmers within the palm oil supply chain.

GAR and Neste's partnerships have shown how crucial it is for private companies to not only provide solution, but also to map the problem and identify the root causes; and although the work is not yet finished, it is clear that area mapping and farmers' identification are the first steps toward a greater body of work in exploring growth opportunities.

Built on these visions is a series of resolute commitments to improve smallholder farmers' lives and livelihoods by providing sustainable means of including them as part of the business value chain and the palm oil supply chain. So much is riding on the private sectors' investment and contribution in driving these initiatives forward, such as the industry's sustainable future, as well as its social and environmental benefits. Taking the problem-solution approach, a collaborative effort between governments, community organizations and private companies makes it possible for the industry to grow toward creating sustainable and conflict-free palm oil.

But more needs to happen soon. Further collaborations, and more collaborative partners from private companies who are willing to share the vision and responsibility toward a more sustainable world and business practice. Prior, a plan was put in place to train smallholder farmers across 7 villages in Siak District. The training would involve RSPO as a sponsor, a crucial partner to help independent farmers receive RSPO certification. Unfortunately, the pandemic forced the plan to be rolled out at a much slower pace, due to difficulties to conduct field activities.

Nevertheless, the pandemic hasn't dampened the commitment of all stakeholders to continue on to the next phase for smallholder farmers' certification process. The local government, associations (cooperatives) and every element of the supply chain continue to work together and equally contribute toward sustainable palm oil production. Capacity building programs and sustainable initiatives have begun to be implemented at the start of 2021, albeit at a slower pace than usual due to the on-going pandemic.

Suggestion for Business Inclusive Collaboration with Smallholders

There are a few things this paper would like to recommend based on its case study in Siak District, Riau, which we believe are able to bring into reality sustainable practices and development we envision:

- Finding business partners with shared vision and commitment toward sustainable commodity production.
- Amplify awareness on issues of legality and certification; prior engagement with government is critical to seek practical solutions for smallholder legality issues that cannot be resolved by any temporary interventions from non-state actors.
- Continued the collective action spirit from end-to-end buyers to step up as a game-changing process that helps build the narrative for both the producer and end-buyers.
- Integrate solutions into production for markets interested in sustainable products - ensuring continued demand for the sustainable production.
- Develop intrinsic value toward community cooperatives by strengthening its base toward agriculture best practices.
- Maintain enthusiasm among smallholder farmers to continue being a part of the supply chain.
- Drive momentum, despite the pandemic, toward embracing sustainable practices among smallholder farmers.

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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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It is our hope that this study could inspire scaled sustainability commitment and further collective actions across all stakeholders in our journey towards deforestation free commodities supply chain, other forest-positive shared agendas, and eventually our pursuit towards net zero.

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