

## PepsiCo sourcing of palm oil from Indonesia

### Our vision and objectives

In 2016, Indonesia was the world's largest supplier of palm oil, producing over 35 million tonnes and representing over half of the total global market<sup>1</sup>. We are striving to sustainably source the palm oil used in our products in line with our policies and commitments on [palm oil](#), [human rights](#), [forestry stewardship](#), [land rights](#) and our [Supplier Code of Conduct](#). Achieving this requires us to address the systemic challenges associated with the palm oil industry in Indonesia by tackling issues in our own supply chain and by working with peer companies, civil society, governments, certification bodies, and others so that high environmental standards become the norm and human rights are respected.

Our approach is based on:

- Having appropriate **policies and commitments** in place and embedding them in our business and supply chain through a comprehensive due diligence approach that includes risk assessments and addressing non-compliances
- Driving **traceability and certification** of the palm oil that ends up in our products, including 100% RSPO physically certified palm by 2020, traceability to the mill which is verified by third parties and traceability to the plantation level
- Building capability through **supplier engagement** to initiate improvements
- Addressing **systemic issues** through collaboration that go beyond certification
- Ongoing and transparent **disclosure** of our progress and challenges
- Addressing **grievances** raised by third parties through a formal process that is consistent with the UN Guiding Principles on Business and Human Rights

Full details of our global priorities and progress can be found in our most recent [Palm Oil Action Plan Progress Report](#).

### PepsiCo's palm oil supply chain in Indonesia

In 2016, PepsiCo bought approximately 480,000 tonnes of palm oil globally, representing less than 0.8 percent of the global supply, from 60 direct palm oil suppliers, supplied by approximately 1,500 mills, which collectively rely on tens of thousands of producers ranging from large plantations to individual smallholders. As of July 2017, we estimated that approximately 92 percent of the palm oil we used during 2017 will have been traced to specific mills, up from 65 percent in 2015.

PepsiCo's primary palm oil markets are Malaysia, Mexico, and Indonesia, which is the largest single country that we source from. Based on our 2016 traceability data, over 40% of the mills that our suppliers source from in Indonesia are in North Sumatra and Riau and nearly 75% are based on the island of Sumatra. Most of the rest of the mills are situated in Borneo, with the majority of those in East, West, or Central Kalimantan.

### Social and environmental risks associated with sourcing palm oil from Indonesia

PepsiCo has developed an understanding of key risks associated with sourcing palm oil from Indonesia from a number of sources, including:

- Experience and knowledge of PepsiCo employees.
- Proforest, an organization with expertise in managing natural resources sustainably, provides ongoing feedback as part of a partnership agreement. Additionally, we commissioned an internal report from them on the structure of the palm oil industry in Indonesia, including social and environmental risks.
- Engagement with direct and indirect suppliers based in Indonesia.

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<sup>1</sup> Sources: Index Mundi; USDA Oil Seeds: World Markets and Trade, March 2017

- Participation in collaborative forums on palm oil such as the Roundtable on Sustainable Palm Oil, Consumer Goods Forum, and the IDH Landscapes Working Group.
- Feedback from civil society through direct meetings and workshops.
- Reports by civil society and other organizations such as: [The Great Palm Oil Scandal: Labour Abuses Behind Big Brand Names](#) (Amnesty International, 2016).

From these sources we have established that the following risks are most significant to our palm oil supply chain in Indonesia:

- Smallholders. Over 40% of the 11million hectares dedicated to palm oil in Indonesia is managed by smallholder farmers<sup>2</sup>. Delivering a sustainable palm oil supply chain requires that we engage and build capability, working with our direct suppliers, civil society, and others. As well as supporting appropriate steps through the RSPO to ensure their certification process supports smallholders, we are looking to invest in projects that engage smallholders in sustainability and give PepsiCo and others a better understanding of how to deliver positive impact on the ground.
- Worker rights. As with other agricultural commodities that rely on seasonal labor and workers meeting “piece-rate” quotas, there are a number of risks for workers in the supply chain. This includes rights of temporary workers, working hours and pay, forced labor, and underage labor. These risks exist throughout Indonesia. Our [Sustainable Sourcing Program](#) ensures that suppliers meet the terms in our [Supplier Code of Conduct](#). This year we began implementing our supplier scorecard for all of our first-tier suppliers in Indonesia, which scores their policies and commitments on worker rights as well as deforestation and other risks, and their capability to implement these policies through their management systems and their ability to deal with grievances from NGOs and others. These scorecards will help us identify opportunities to help build capacity in our supply chain to better manage these issues. We will also be developing further plans to manage our salient human rights risks as identified in our [Human Rights Statement](#), which includes working hours and wages and vulnerable workers.
- Deforestation / peatlands. Indonesia has the fifth highest deforestation rate globally, with over 20 million hectares of forest lost between 2001 and 2015. The bulk of this deforestation has taken place on Sumatra and Borneo, which continue to undergo rapid conversion. The majority of the mills that supply into PepsiCo are based here. Until recently, Papua has been left relatively untouched, but it is now at risk given recent acceleration in the establishment of oil palm and large forested areas already issued as concessions to companies. In 2016 PepsiCo received palm oil via our direct suppliers from four mills in Papua. In addition Indonesia contains 50% of the world’s tropical peat; maintaining the remaining peatlands primarily in Riau, Papua, and West, Central, and East Kalimantan is a significant priority for managing the related environmental and other impacts. Through our Sustainable Sourcing Program, our Sustainable Sourcing Goals and engagement with suppliers, we are implementing our [Forestry Stewardship Policy](#), which includes a commitment to zero deforestation, and moving towards traceability and certification of our supply chain. In Q2 of 2017, 92% of our global palm oil supply chain was traceable to the mill level. By the end of 2017, 30% of our global palm oil was physically certified.
- Land rights. There is growing potential for land rights disputes as new plantations are established. While some laws are in place, enforcement is patchy and certification schemes are not well established, meaning that companies need to have policies in place and work on implementation on the ground. PepsiCo introduced a [land rights policy](#) in 2014, which includes the requirement that suppliers implement Free, Prior and Informed Consent (FPIC) in line with the International Finance Corporation (IFC) Performance Standards. We will continue to engage with RSPO and others to ensure that sufficient standards are in place and look for opportunities to increase knowledge and capacity throughout Indonesia. PepsiCo will also seek to engage with an external organization to improve the way we can manage and implement issues on the ground.

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<sup>2</sup> Daemeter, 2015: Overview of Indonesian Oil Palm Smallholder Farmers

In addition to taking actions to tackle the specific risks set out above and in our most recent Palm Oil Action Plan Progress Report, we will:

- Invest in on-the-ground projects that engage farmers and other stakeholders to seek to address these significant risks. As well as delivering impact on their own, we will also utilize our experience of these projects to better understand how we can:
  - positively impact farmers and communities, including by working with the direct and indirect suppliers that sit between them and consumer-facing companies such as PepsiCo; and
  - improve the ways we are able to incorporate feedback directly from workers and local communities, including women who may be exposed to additional impacts, about the issues and opportunities they see in being part of the palm oil supply chain in Indonesia, and
- Expand our internal capacity to address issues and engage with stakeholders, including by appointing a public policy specialist to improve our capability to engage with local communities, civil society and governments on palm oil in Indonesia as well as other parts of Asia.

We will provide a public update on our progress in May 2018 through our annual Palm Oil Progress Report.

### **Managing grievances raised by third parties**

In July 2017, we introduced a [grievance mechanism](#) for our agricultural supply chain to formalize and improve our approach for handling concerns raised by third parties about palm oil and other commodities. Our aim is to build a transparent, fair, and credible approach that upholds our policies and prioritizes outcomes for people affected. Therefore, we look to engage suppliers and promote and deliver corrective actions that solve problems and build capability for sustainable palm oil and other commodities in our agricultural supply chain.

#### Complaint against IndoAgri Resources (IndoAgri)

In April 2016, the Rainforest Action Network (RAN), OPPIUK, and the International Labor Rights Forum (ILRF) raised a grievance against IndoAgri. The complaint is now registered in our grievance mechanism, and it focuses on alleged labor rights issues such as: laborers under 18 years of age, low pay, health & safety conditions, production quotas, and use of informal labor. It was formally filed with the RSPO in October 2016. The complainants published a follow up report in November 2017 claiming that the alleged labor practices were ongoing. Previously, IndoAgri has also been the subject of separate complaints relating to deforestation and social/land conflicts. IndoAgri is not a direct supplier to PepsiCo, but they supply palm oil to international traders which then sell to PepsiCo. The company is also a subsidiary of Indofood, a food manufacturer, and PepsiCo has a joint venture with Indofood to make some of our products in Indonesia.

#### *Our actions to date*

PepsiCo is very concerned about the allegations that our policies and commitments on palm oil, forestry stewardship and human rights are not being met. As set out in our grievance mechanism, and recognizing our responsibilities as set out in the United Nations Guiding Principles, we have sought to use our leverage to promote resolution of the complaint in a way that prioritizes outcomes for the workers and communities that might be affected. Specifically, and because IndoAgri is an indirect supplier and we have a relationship with their parent company, PepsiCo has taken substantial actions to help resolve this complaint, including:

- Supporting the RSPO complaints process: We have engaged with RSPO, including a letter from our Chief Human Rights Officer, requesting RSPO to expedite their complaints process and make a ruling on the allegations in the pending complaint against IndoAgri. We also called upon all parties in the complaint to support the RSPO process in good faith.
- Engaging with the complainants: PepsiCo has met with the complainants on numerous occasions to discuss the allegations, understand the solutions they would like to see from PepsiCo and IndoAgri, and relayed their perspectives and expectations to Indofood and IndoAgri in the absence of direct dialogue.

- Engaging with IndoAgri. We have undertaken extensive, ongoing engagement with Indofood and IndoAgri on the specific allegations and potential steps to help progress the complaint process and resolution of the complaint. This includes several meetings and calls involving senior executives over an 18 month period and direct contact between our CEO and the CEO of Indofood to highlight the importance of addressing the matter in a transparent manner.
- Engaging our direct suppliers: PepsiCo does not source directly from IndoAgri but receives IndoAgri volumes through a number of direct suppliers. We are in regular contact with those suppliers to highlight the need for them to engage with IndoAgri about the complaint, to share the actions they are already taking and engaging with them about further possible actions they might take which would support resolution in line with our and their policies and commitments, as well as registering the complaint in our grievance mechanism process.
- Advising IndoAgri and IndoFoods on their palm oil policy and program: We have benchmarked their palm oil sustainability policy and program and provided recommendations for improvements, including reference to the UN Guiding Principles on Business and Human Rights, ILO conventions, and commitment to adopting the outcome of the High Carbon Stock convergence process. IndoAgri updated and strengthened its policy in February 2017
- Ending the sourcing of IndoAgri palm oil to our Joint Venture with Indofoods: IndoFood Fritolay Makamur (IFL) is a joint venture between PepsiCo and IndoFood that produces snacks in Indonesia under the Lays brand. Previously, the joint venture sourced palm oil from IndoAgri, a wholly owned subsidiary of IndoFoods that operates as a separate company. IndoAgri has taken a number of steps to address the concerns raised by the complainants, as outlined on page 49 of their sustainability report. However, the decision was taken for the joint venture to suspended procuring palm oil from IndoAgri in January 2017 pending further progress and visibility around the issues.

#### *Our next steps*

Despite the steps taken by PepsiCo, IndoAgri and others, the complaint remains open. We are committed to further engaging with RSPO and the parties to the complaint to highlight the need for a resolution and to help in overcoming the barriers that have so far prevented the case from being resolved. We therefore urge RSPO to prioritize the case and take timely actions and decisions, and to continue to develop and improve its complaints resolution process.

While the RSPO continues its efforts to resolve the complaint, PepsiCo asks that IndoAgri further demonstrate their commitment to sustainability by:

- Providing further public information on the steps they have taken to investigate and address the complaint and the systemic issues raised, including engagement with direct and indirect customers and actions taken as a result of the completed audits of its plantations highlighted on the RSPO website, so that stakeholders can evaluate and acknowledge the steps taken, and to take further action as necessary to fully resolve the complaint.
- Joining PepsiCo and others in their value chain to engage with stakeholders from civil society, industry and government on the systemic issues that exist in some palm oil plantations in Indonesia, including those related to worker rights, to understand the issues and drive collaborative solutions.
- Building on the improvements made to their policy on sustainable palm oil in February 2017, for example, by improving IndoAgri's internal grievance mechanism with respect to management of human rights and environmental risks and impacts.

These steps are necessary for the potential re-establishment of palm oil supply from IndoAgri to the joint venture. We will also continue over the course of 2018 to review on a quarterly basis IndoAgri's progress against the requested actions outlined above, and in that context we will continue the dialogue with our direct suppliers around IndoAgri-sourced palm oil in our supply chain, including the possibility of change of source.

In addition to the above, we will:

- Seek to engage the complainants on our approach and our implementation of it with a mutually agreeable third party facilitator. We will also invite others in IndoAgri's supply chain to be part of these discussions.
- Work with our direct suppliers to encourage resolution of the complaint and adoption by IndoAgri of the steps set out above, as well as supporting additional actions that they are engaged in with IndoAgri as a result of the complaint.
- Continue to ask civil society experts to advise on PepsiCo's approach and help us to evaluate whether the rate of progress undertaken is sufficient.