

Strategic Thrust in Addressing Current Challenges:

THE PLANTATION PERSPECTIVE

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ABSTRACT

The paper briefly analyses the problems currently faced by the plantation companies and explains why the price of crude palm oil (CPO) has fallen month by month through 2000, with sharper falls since January 2001 and why the price has not recovered.

Some fundamental strategies to help the palm oil industry sustain through these difficult times and to strengthen and transform it overtime are suggested, covering stock reduction and management, marketing and sales, shipping, port improvements, improving storage capacities in mills and refineries, replanting and revamping the organization structure of estate management.

The intention is to trigger further thinking and discussion which hopefully will lead to positive actions.

INTRODUCTION

From the heady days of 1998 when CPO prices were as high as RM 2500/t and palm kernel (PK) was RM 1200/t, the economy is now wallowing in the depths of CPO at RM 720/t and PK at RM 407/t (average prices for January 2001). There are many worried faces in the corporate offices of plantation companies these days.

Current prices are very close to direct production costs and Sabah and Sarawak producers who have to absorb the East Malaysia discounts are further disadvantaged. If over-

heads and financing costs are added on, most producers will be in the red.

While it is normal for prices to fluctuate, the speed and sharpness of the price declines have hit the oil palm industry very hard and everyone from the big plantations to the smallholders are suffering. Because of the strong multiplier effect, the low CPO and PK prices have a serious negative impact on a very large and important segment of our economy - the rural economy.

It exposes once again the importance of the oil palm industry to our national economic growth and so-

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cial development which, in turn, has strong political implications. Hence, the Malaysian Palm Oil Association (MPOA) appreciate the concern of the government and the Malaysian Palm Oil Board (MPOB) and their attempts to find solutions to tackle the problem.

THE PROBLEM

Three frequently asked questions are: 1) why does the price problem persist? 2) why did prices drop? and 3) why is it not recovering?

it is unlikely that the high yields will sustain for another year, rising production trend from vast areas of young palms will continue to drive the production momentum and higher production in 2001 is again expected.

Favourable weather conditions and large increases in planted areas in the major producing areas of North and South America have resulted in another record output of soyabean last year, which more than offset declines in the production of rape/ canola and sunflower oils

If 2000 was a difficult year, 2001 may be worse for us.

SUGGESTED STRATEGIES

The usual response of plantation companies to low prices is to tighten belts and cut costs and many companies have initiated such measures by now.

The industry needs to consider other strategies which will help sustain it through these difficult times and make it stronger and more dynamic overtime.

TABLE 1. MALAYSIAN CPO PRODUCTION (million tonnes)

Year	1999*	2000*	2001**
CPO Production	10.55	10.84	11.50
Export	8.91	9.05	9.50
Internal consumption	1.28	1.55	1.60
Total disappearance	10.19	10.60	11.10
Year end stock of palm oil products	1.18	1.42	1.82

Notes: * MPOB; ** personal forecast.

Despite a small increase in production to 10.84 million tonnes and an increase in total disappearance to 10.60 million tonnes, the 2000 year end stocks rose to 1.42 million tonnes (Table 1). The main contributors to the stock increase were:

- the 1.18 million tonnes carry-over stock from 1999;
- the increase in CPO production; and
- the marginal increase in export.

Contributing to the problems is Indonesia, who despite her domestic problems, has become a very significant exporter and an aggressive competitor in all our palm oil markets. Indonesian production of CPO rose sharply to an estimated 6.9 million tonnes last year (Oil World), and with its weak Rupiah was able to sell below Malaysian prices.

Reports from Indonesia indicate that 2000 was a very high yield year with average yields per hectare well above the previous five years. While

elsewhere. The bumper production was even in excess of increasing demand for beans and soyameal and contributed to downward pressure on soyaoil and palm oil prices. Meanwhile, the 2001 South American soyabean crop currently being harvested is headed for a fresh record.

Malaysian CPO production is likely to increase by 5% - 6% in 2001, which brings the potential production to 11.4 - 11.5 million tonnes. Add on the 1.42 million tonnes stock carried forward and the industry will have 12.8-12.9 million tonnes of oil. Unless the total disappearance in 2001 increases substantially to around 12 million tonnes, our stock levels will remain well above one million tonnes by the end of 2001. At this point in time, the possibility of a substantial increase in export volume appears to be dim and local consumption is unlikely to rise materially.

Stock Reduction and Management

The most immediate and critical need is to bring stock levels down quickly and put in place a strategy to allow the industry to manage its stock levels.

The palm biodiesel project to produce 500 000 t of biofuel per year from CPO promoted by MPOB is an exciting proposal with tremendous potential to expand the use of palm oil. Members of the plantation industry and Petronas have indicated strong support and with MPOB have come together to form a consortium company for the project.

However, the biodiesel project will only come on stream two years from now. It therefore does not address the immediate problem of high stocks.

An immediate impact can be achieved if the industry substitute CPO as a replacement for the fuel oil used by some of Tenaga National Berhad (TNB) power stations to generate electricity. This is likely to remove close to 300 000 t of CPO per year from the national stocks and can be implemented almost immediately with the advantage of flexibility and with little or no capital cost.

Marketing and Sales

Past efforts in marketing had been adequate until the sharp rise in pro-

duction in 1999 left the industry with a high stock overhang at year end.

In 2000, the situation worsened. Despite prices sliding month by month and despite a widening discount between RBD palm olein and SBO prices, Malaysian export volume grew marginally.

Malaysian palm oil lost market share in many of the major vegetable oil markets in the last two years. The industry could not match the aggressive marketing efforts of soyabean growers from the Americas and palm oil producers from Indonesia.

The challenge from Indonesia is particularly worrying (Table 2) as she had increased her export volume considerably in the last two years.

expense of refined oils, the off-take of which slowed down significantly.

This year, with the early allocations of the CPO export quota, a sizeable volume has already been sold to Rotterdam, thereby, opening a new market for Malaysian CPO. The Indian market will still be the big challenge ahead as Malaysians will have to fight for their market share.

In marketing, Indonesian traders have the edge over us as they are usually integrated with refineries and plantations under the same ownership. Whereas in Malaysia, plantations, refiners and traders are normally separately owned, and therefore, pursue separate and often conflicting agendas and are much less agile and flexible in decision-making.

ponents of growers, refiners and traders and mergers of these three components should be encouraged. Mergers will reduce the divergent agendas and increase flexibility for marketing and sales.

Marketing and promotion of Malaysian palm oil have been spearheaded by Malaysian Palm Oil Promotion Council (MPOPC) aided by MPOB. A few traders and refiners have also been actively involved in emerging markets and some have aggressively targeted the end consumers. This more aggressive approach needs to be more widely adopted so that promotional activities do not end with seminars for institutions and corporations in the big cities but go on to push palm oil to consumers in the villages. Such programmes have already been very successfully adopted by competing vegetable oils.

TABLE 2. MALAYSIA AND INDONESIA:
PALM OIL EXPORTS ('000 t)

Month	Indonesia*			Malaysia**		
	1998	1999	2000	1998	1999	2000
Jan	63	87	218	660	525	639
Feb	115	198	230	537	465	645
Mar	165	219	345	582	623	777
Apr	75	162	257	551	692	633
May	139	193	238	531	734	635
Jun	149	166	395	583	759	741
Jul	230	333	406	631	787	696
Aug	171	531	459	760	920	701
Sep	200	534	432	756	836	791
Oct	164	372	410	770	879	1 004
Nov	323	247	420	535	816	890
Dec	208	276	360	525	878	910
Total	2 002	3 318	4 170	7 425	8 914	9 064
% Increase	-	65.7%	25.7%	-	20.1%	1.7%

Sources: *Oil World; **MPOB.

The industry's response was slow, allowing Indonesia unhindered access to new CPO markets. Last year, approval to export 500 000 t of CPO duty free was only received in late August, by which time, Indonesia had built up its market share especially in India and although it did well to sell almost all the CPO after receiving approval from the Malaysian Government, it was at the

Malaysian growers, refiners and traders must work to a single agenda: to sell, sell, and sell. They must adapt to the changing market requirements in the oil trade, sell what the customer wants, be it CPO or processed palm oil, and ensure that commitments are met speedily and reliably.

To achieve this, there has to be greater integration of the three com-

Image building through advertising - Malaysian palm oil. In the face of the increasing supply of palm oil, care must be taken to ensure that the industry should not only seek new markets but also jealously guard and maintain its share of markets which the players have arduously developed over the years. The industry cannot afford to rest on its laurels and be complacent. Competitors are fast moving into Malaysian share of the markets and this should already ring an alarm bell in the industry.

Our advantage is that 85% of our palm oil production is exported, thus Malaysia dominates the market with 63% share of the world palm oil trade and 26% share of the global oils and fats market. Therefore, the promotion of Malaysian palm oil should be intensified in consuming countries such as the Indian Subcontinent, European Union/Eastern Europe and West Asia. The present concern and fear that such strategy will be capitalized by Malaysia's neighbouring competitor, Indonesia, should be allayed. Indonesia has

a population of 220 million and she is traditionally a coconut oil user. In the long-term, with the recovery in the Indonesian economy from her present difficulties, the country is expected to capitalize on the export of the more attractively priced lauric oils. This will be at the expense of palm oil exports which will be diverted to feed the growing Indonesian population. It is in this context that Malaysian palm oil can be expected to fill the gap in the world demand for palm oil.

Markets have to be aggressively sourced for the increasing production of palm oil and palm products from Malaysia. All things being equal, the consumption of palm oil and its products is still largely influenced by price. But should the industry continue to allow price to dictate the off-take of palm oil? From a marketing perspective, it is rarely desirable to compete solely on the basis of price. Instead, the industry should attempt to satisfy people's requirements through value and image benefits which means pricing is dependent upon the perceived value to the customer. The ability to compete on dimensions other than price is critical in areas where there are substitutes especially in the oils and fats sector, since it allows for more opportunities to differentiate beyond low price.

The world has to learn to appreciate the techno-economic advantages and nutritional benefits of Malaysian palm oil. If olive oil can sell on virtues of its health benefits which to some extent has been an image created through advertising and promotional efforts, why can't the image of Malaysian palm oil be elevated to the same or much higher level? Advertising may be the long-term answer to ensure that the industry does not lose our stronghold in price sensitive markets.

We cannot discount the powerful role of the media in helping to mould public opinion. The effect of globalization will only increase

the power of the media. While highly specialized seminars will continue to reach a very selected target group, the media lend a hand in disseminating messages to the masses in every nook and corner of the world.

Shipping

As the industry's exports grow, another critical issue has arisen - the insufficient vessels to ship the produce to buyers and consumers of palm oil. This has resulted in a backlog of deliveries to our export markets.

Currently, the industry is mostly dependent on foreign flag vessels to provide tankers. Malaysia does not have enough vessels of the right capacity to handle its needs. According to Maritime Institute of Malaysia (MIMA) in a workshop held in February last year, Malaysian flag vessels carry only 10% of the export of Malaysian palm oil.

That is a weak link in our business and leaves us very vulnerable to external factors disrupting our supply line to our export destinations.

There is insufficient shipping capacity to even move the CPO produced in Sabah and Sarawak to Peninsular Malaysia ports. A large volume of oil sold for export from Sabah and Sarawak is also awaiting shipment as vessels are not available. This situation has created a build-up of stocks in refineries, forcing them to reduce the intake of CPO from mills. With their own storage tanks filling up, mills in turn have to curtail their acceptance of fresh fruit bunches (FFB) from their supplying estates or smallholders.

This is the appropriate time to consider and put in place a National Policy on Shipping for our palm oil. The policy should ensure sufficient vessels for shipping oil, especially from East Malaysia ports to overseas destinations and address the local requirements for shipping of oil be-

tween East Malaysia and Peninsular ports. Malaysian ship owners, including Malaysian International Shipping Corporation (MISC), need to be encouraged and persuaded to act on the problems and only a clear national policy can create the shipping capacity required for exporting our palm oil.

Meanwhile, our problem of shipping backlogs will remain for some time and is likely to worsen as we come to the second half of the year when production rises.

As a temporary measure, the Ministry of Transport can assist in the issuance of domestic shipping licences to allow foreign flag vessels to transport CPO from East Malaysia to straits ports for processing and export.

Port Improvements

The growth area for oil palm production has shifted to East Malaysia, particularly to Sabah where strong double digit growth is expected to be the norm for the foreseeable future. With low local consumption, virtually all the palm oil produced is exported.

The shipping problem in Sabah is compounded by the quality of its ports. Except for Lahad Datu which can accommodate larger vessels, the ports of Sandakan and Tawau have restricted draught which severely limits the size of tankers that can call there. This problem will increase over time as siltation builds up

Dredging to deepen the harbour or its access and other improvements to port facilities will improve the capacity of the ports and will complement efforts to improve the shipping situation.

Storage Capacity in Mills and Refineries

Oil storage tanks in the country are almost full and the situation is acute in East Malaysia. Although the shipping problem is the main rea-

son for full storage tanks in Sabah and Sarawak, a contributing factor is the available storage capacity in these two states.

Yet, looking back on last year, storage tanks were underutilized for all of the first three quarters of the year and it was only in the fourth quarter that problems piled up and spilled over to this year.

Last year, Sabah and Sarawak produced 3.110 million tonnes and 0.520 million tonnes of CPO respectively. Production in 2001 is expected to rise sharply. The storage problems could be worse later this year if the shipping constraint continues.

Producers cannot be expected to stop harvesting during the peak period. If mills have to stop taking FFB because their storage tanks are full, crop will be left rotting in the fields.

Mills and refineries in East Malaysia should, therefore, be encouraged to expand oil storage facilities. As these extra storage tanks will only be utilized for a limited period each year, some additional fiscal incentive, over and above the normal reinvestment allowance granted by the Inland Revenue Department needs to be considered by Malaysian Government to encourage the installation of additional storage tanks. The situation is urgent and requires immediate action if we want to avoid problems in the next peak period.

Producer Strategies

Vegetable oil production will continue to rise despite the declining trend in prices.

The record soyabean production year by year is a good example and clearly, the low prices have not deterred growers in South America from expanding.

It is believed that Brazilian soyabean farmers can break even at US\$ 3.80/bushel or US\$ 140/t ex-farm which translates to approximately US\$ 160/t FOB. With current Brazil new crop prices at

±US\$172/t FOB, they still have a profit margin of ±US\$12/t. At average production levels of 2.5/t/ha, they have a US\$ 30/ha profit - very slim but still profitable.

Malaysian palm oil producers have become high cost producers and unless the industry can contain the cost, it will continue to be pressured by lower cost producers of CPO and soyabeans.

To reduce production costs, some plantation companies have shifted their expansion programme to Indonesia where, for the time being, land and labour costs are lower. However, due to the unstable situation there, many of the companies are facing a number of problems, some of which are serious, such as illegal occupation of HGU (*Hak Guna Usama*) land by villagers.

These are temporary set-backs and hopefully, the situation in Indonesia will improve and the Malaysian companies can regain their momentum.

Meanwhile, some of the strategies that can lead to long-term reduction in costs include the following:

Replanting. Over 21% of the country's total planted area of 3.37 million hectares, *i.e.* 700 000 ha consists of old palms above 19 years of age (*Table 3*).

The call to the industry to accelerate replanting is most appropriate as there is an urgent need for plantation companies to address their

stagnating yield trend in order to remain competitive. Replanting will set the impetus since current planting materials are not only precocious but also give significantly higher oil extraction rates than the old palms they replace.

Accelerated replanting over the next four to five years will have an immediate impact on production, estimated by MPOA to be in the range of 525 000 t of CPO per year if 175 000 ha are replanted per year over the next four years.

Estates in the course of replanting will also be able to put in place field infrastructure for effective mechanization and other improved agronomic practices.

To stimulate and encourage plantation companies which are all facing sharply reduced cash flows to accelerate replanting, short-term assistance from the government over the next five years is suggested in the form of provision for:

- a. double tax deduction for replanting; or
- b. to treat replanting as *reinvestment* and hence, benefit from the reinvestment allowance of 60% as accorded to the manufacturing sector.

Organization structure - estates. The organization structure of our estates has evolved through the years from monocrop rubber estates to mixed crops and now, very often, to monocrop oil palms. While there

TABLE 3. AGE PROFILE OF MALAYSIAN OIL PALM

No.	Age profile	Planted area (%)	
		1999	2000*
1	1 - 3 years	13.78	15.39
2	4 - 8 years	30.82	28.89
3	9 - 13 years	18.98	17.22
4	14 - 18 years	15.65	16.92
5	19 - 24 years	13.81	13.81
6	25 years and above	6.96	7.77
Total planted area/ha		3 313 393	3 374 485

Source: MPOA. Note:* estimated.

has been a gradual restructuring over the years, Malaysian estate units are still too small and, as a result, our managers are not fully extended. Estates need to be regrouped so that management units are larger in area; smaller units becoming division of a larger estate. *Figure 1* shows an example of the organization structure adopted by a local company.

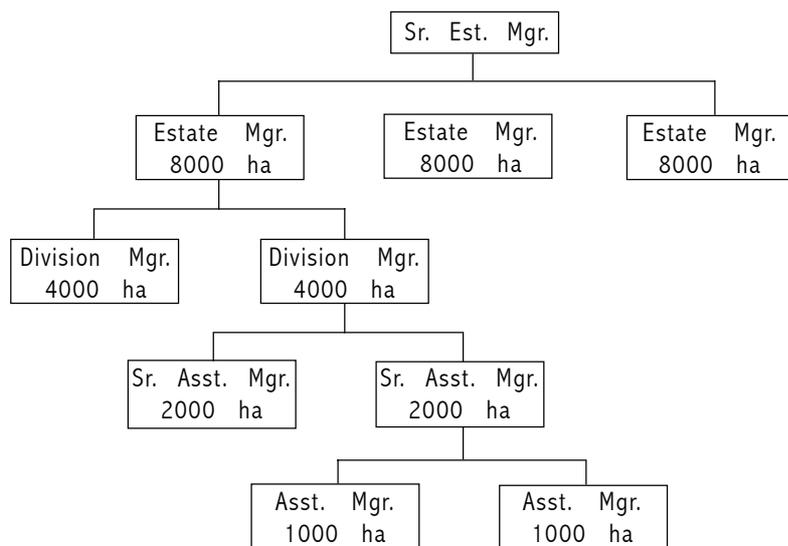


Figure 1. Organization structure - estates.

The suggested structure gives broader and heavier responsibilities at each level but has the advantage that good performance will stand out and management will be in a better position to reward high fliers.

The Senior Manager is located on site and will act as the agricultural auditor, mentor and the custodian of agricultural standards to meet the *best practice* standards and ensure that everyone performs.

The best time to restructure however is when prices are good and management can ease off surplus personnel to other companies who may be busily recruiting. Once the restructured team settles down, it will be ready and fully geared to meet the challenges by the time the downturn comes.

Maintain steadfast values. On the boards of the major plantation

groups are many illustrious people. A fair number of Board members are recent converts to the commodity business and would not have experienced any of the previous slumps in commodity prices. Thus, the current situation will be a major shock, more so as the position was so euphoric just three years ago.

The reactions of Boards will vary

same agility from the government. Speed and flexibility are essential and MPOA had suggested at a meeting held on 6 November 2000 between the Minister of Primary Industries and the captains of the industry, the formation of a permanent task force comprising representatives from his Ministry, the Treasury, Bank Negara, Ministry of Trade and Industry, Ministry of Transport and other relevant ministries and including MPOA, MPOB and MPOPC. The task force is urgently needed to monitor and make assessments of the state of the palm oil industry so that quick decisions can be made, policies issued and implemented to sustain the continued growth of the industry. While the Ministry of Primary Industries has agreed to the concept, the establishment of the permanent task force has yet to materialize and hopefully, this can be formed soon. By cutting across ministerial boundaries, it is hoped the success of the NEAC can be duplicated.

CONCLUSION

The industry must maintain its faith in itself and in its ability to sustain in the face of increasing competition.

The suggested strategies are provided to facilitate discussion. In the course of discussion, other strategies will emerge which will help to strengthen and propel Malaysian palm oil forward as the Vegetable Oil of this 21st century.

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and the solutions they prescribe will depend on internal circumstances. Whatever their prescriptions, Boards should maintain their deepest values and goals so as to avoid compromising such values with severe short-term measures which can damage the long-term objectives and well being of their companies.

Formation of Task Force

During the economic crisis, Malaysian Government tackled the uncertain economic climate by forming the National Economic Advisory Committee (NEAC) to make recommendations quickly to adjust to the sudden shifts in the economy. Decisions were made and changes executed faster than before, contributing significantly to the nation's recovery.

The palm oil crisis needs this