THE IMPACT INVESTMENT CASE FOR RUBBER REPLANTING

A perspective from Indonesia and West Africa

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Introduction

Rubber production is a key income stream for several million smallholders in Southeast Asia and West Africa. However, these smallholders are often caught in a vicious cycle of low yields and low international rubber prices. Replanting high-quality rubber trees and improving planting and tapping practices have the potential to increase yields and, subsequently, smallholders' incomes for which large investments are required.

Impact capital and the design and roll-out of innovative financing schemes, like the outgrower program of Corrie MacColl in Cameroon (see more under 'pathways to finance') play an essential role in the improvement of the economic well-being of rubber smallholders and forest protection. This paper further investigates the challenges and opportunities regarding investments in the rubber sector in Indonesia and West Africa.

Challenges of Rubber Smallholders

While there are some contrasting experiences in the rubber industry in Southeast Asia and West Africa, a shared theme across both regions is that the sector is dominated by smallholders with low incomes. These low-income levels are driven by low farm yields, deflated natural rubber prices, and small farm sizes among others.

Although yields are higher in Cote d'Ivoire's industrial plantations (1.8 tons/acre), for instance, the average annual yield in the country is rather low at 1.2 tons/acre. This yield rate is comparable to Indonesia where it is about 1.0 ton/acre. In a similar manner, international market prices for rubber have been in decline with average annual rubber price falling from 4.68 USD/kg in August 2011 to 1.87 USD/kg in July 2021 (SICOM, TSR20). The low global rubber price combined with low yields have placed significant pressure on rubber smallholders in both Cote d'Ivoire and Indonesia. Consequently, many smallholders prefer to shift from rubber production into more lucrative commodities such as oil palm and other (more fixed) income-generating crops. This situation is rather acute in Indonesia where smallholders own most of the rubber plantations (84.4%).

At the current levels of production it is rather unlikely that even with secondary income sources and frequent tapping that smallholders would be able to produce enough to earn above the World Bank's poverty line, let alone the living income benchmark. Several interventions should be considered to help rubber smallholders reduce the living income gap. Primarily, smallholders could increase their productivity by applying good agricultural practices ("GAP") which include rubber replanting where trees are aging. However, GAP alone will not be sufficient to close the living income gap due to the small land sizes and low rubber prices. Therefore, this would need to be complemented with other income-generating activities like intercropping or livestock farming, and where possible increasing land size to at least two hectares.

To effectively implement these measures would require financing for purchasing good clones, supporting replanting activities, and in setting up an intercropping scheme to prevent cash shortfall in the first few years after replanting. Thus, addressing smallholder financing needs is critical to improving productivity and, consequently, their income levels.

Obstacles to Access Finance

In both Indonesia and Cote d'ivoire, the financial sector does not offer products that meet all the requirements for smallholder rubber replanting. The loan products needed by the smallholders require i) a tenor that is greater than five years, ii) a repayment schedule linked to cash flows, iii) an affordable interest rates for long-term borrowing, iv) reduced collateral requirements for smallholders without a formal land title, and lastly v) a sufficient loan amount to cover replanting cost and cash shortfall during the crop's immature years.

In Indonesia, the official land title (Sertifikat Hak Milik) is the most common collateral accepted by the financial institutions ("FIs") in most traditional financing schemes. Smallholders often lack these formal land titles and are, therefore, locked out of the financial system. This is particularly true for high-risk long-term replanting loans. Aside from that, the operational costs alone of reaching out to the dispersed smallholders in rural areas are often too high that FIs find it an unprofitable venture.

In Cote d'Ivoire, the downward price trend alongside the overproduction of rubber, have increased the risk perception from FIs. As a result, FIs have started to limit rubber funding. Overcoming these obstacles are essential to achieve the scale and replicability required to develop a successful business case for smallholder replanting.

Pathways to Finance Rubber Replanting

Climate & biodiversity funds
Replanting high-quality rubber trees (good clones) in conjunction with agroforestry and/or intercropping schemes have the potential to increase yields and enhance livelihoods. Improving smallholders' planting and tapping practices also have the potential to boost their income while preserving existing rubber plantations and jungle rubber plots.

Plantations and plots of jungle rubber are critical for carbon stocks and biodiversity. Smallholder rubber plots have substantially higher carbon stocks and biodiversity than palm oil monoculture, which is the most prevalent alternative. Animal diversity is also higher in smallholder rubber plots and jungle rubber than in large monoculture commercial estates, especially with regards to birds and bats.

Smallholder rubber agroforests (jungle rubber) may be able to mimic the diversity observed in natural forest ecosystems in terms of foraging and nesting places. Jungle rubber is considered a complex agroforestry system because it has the structure and biodiversity of a secondary forest. As a result, the carbon stock is estimated to be between 30% and 100% higher than rubber monoculture and between 55% and 130% higher than oil palm monoculture.

Outgrower schemes & impact investors
In Cameroon, Corrie MacColl, a Halcyon agri-company, has been operating two large-scale rubber plantations. They are launching an out-grower program for rubber smallholders to cover up to 27,000 hectares in 12 years. The purpose of the program is to improve the economic well-being of its smallholder partners by offering a combination of farming loans and critical farm management education. One feature that is truly innovative in this smallholder replanting programme is the staggered replanting scheme, which offers investors the opportunity to spread the investment (and risk) in tranches over a longer period of time and not invest a large amount upfront.

In the rubber sector, one possible type of alternative collateral is to secure the loan not only with land titles but also with the trees (wood) grown on the land. According to the International Financial Reporting Standards ("IFRS") Foundation – International Accounting Standard ("IAS") 41, biological assets are accounted for in Indonesian plantation companies' financial statements. However, the financial sector, especially Bank Indonesia, does not see them as legitimate collateral.

Certification programmes
Forest management certification from the Forest Stewardship Council ("FSC") verifies that forests are managed in a way that protects natural ecosystems while also maintaining sustainable economic viability. Standards, certification schemes, and long-term projects are not widely adopted in Indonesia. As of 2021, there are no natural rubber plantations in Indonesia that have been certified by FSC.

The low uptake of certification schemes is due to the lack of consumer demand for certification, low natural rubber market prices, low rubber yield, and the high cost of certification. Plantation owners will struggle to breakeven due to a lack of demand for certified sustainable natural rubber, particularly large-scale plantations, even though the premium for FSC-certified rubber is higher than the cost of certification.

The demand for certified sustainable or organic natural rubber is currently low around the world. Despite their intentions to use sustainable rubber, no major tyre company has committed to paying a premium for natural rubber that is sustainable. Patagonia, IKEA, and Under Armour are among a small group of corporations that have pledged to buy certified natural rubber.

There has been a renewed push for sustainable natural rubber with the formation of the Global Platform for Sustainable Natural Rubber ("GPSNR") in 2018. Given the relatively low uptake of certification schemes for other commodities (palm oil, cocoa, and coffee) in Indonesia, there is no indication in the market whether certification schemes or best practices and guidelines are the best way forward.

The Way Forward

Enabling finance for rubber tree replanting and technical assistance for smallholders to achieve sustainable production is expected to have a positive impact on various levels. Adopting innovative combinations of the options identified in this article can facilitate increased funding in blended finance sources to smallholders, which can be channelled through local financial institutions. Exploring options for smallholder farmers to be better organized and more integrated in the rubber value chain through linkages with larger organizations and established project structures is another essential step in attracting funding.

Indeed, smallholders will benefit from improved market access (collective selling) and negotiating power (bulk input purchases) by means of farmer organizations or cooperatives. Through traceability schemes and offtake agreements, a more organized rubber supply chain might also potentially facilitate the implementation of a sustainable natural rubber policy and with it the attraction of sustainable financing. The GPSNR network and the Equity Working Group are examples of private sector involvement that can raise awareness of the natural rubber value chain and improve its socioeconomic and environmental performance.

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