Fashion DIET

Transparency in Fashion Business

Hochschule Reutlingen
Reutlingen University

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Learning Objectives

After this lecture students should be able to:

- Describe what transparency is
- Discuss why transparency is important in fashion business
- Outline benefits and risks of corporate transparency
- Explain the background and mechanism of non-financial reporting
- Discuss the future of transparency in fashion business

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Transparency

Decision of an organization to reveal all the relevant information regarding its products and internal policies and practices to legitimate partners or stakeholders, so intellectual property rights are not at risk.

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Transparency involves...

"The corporate disclosure of:

(1) the names of the suppliers involved in producing the firm's products;

(2) information about the sustainability conditions within these suppliers' facilities; and

(3) the buying firms' purchasing practices"

(Egels-Zandenet al., 2015, p. 96)

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Consumers want transparency

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How many consumers are interested in learning about…

Fashion Revolution (2020), p.10

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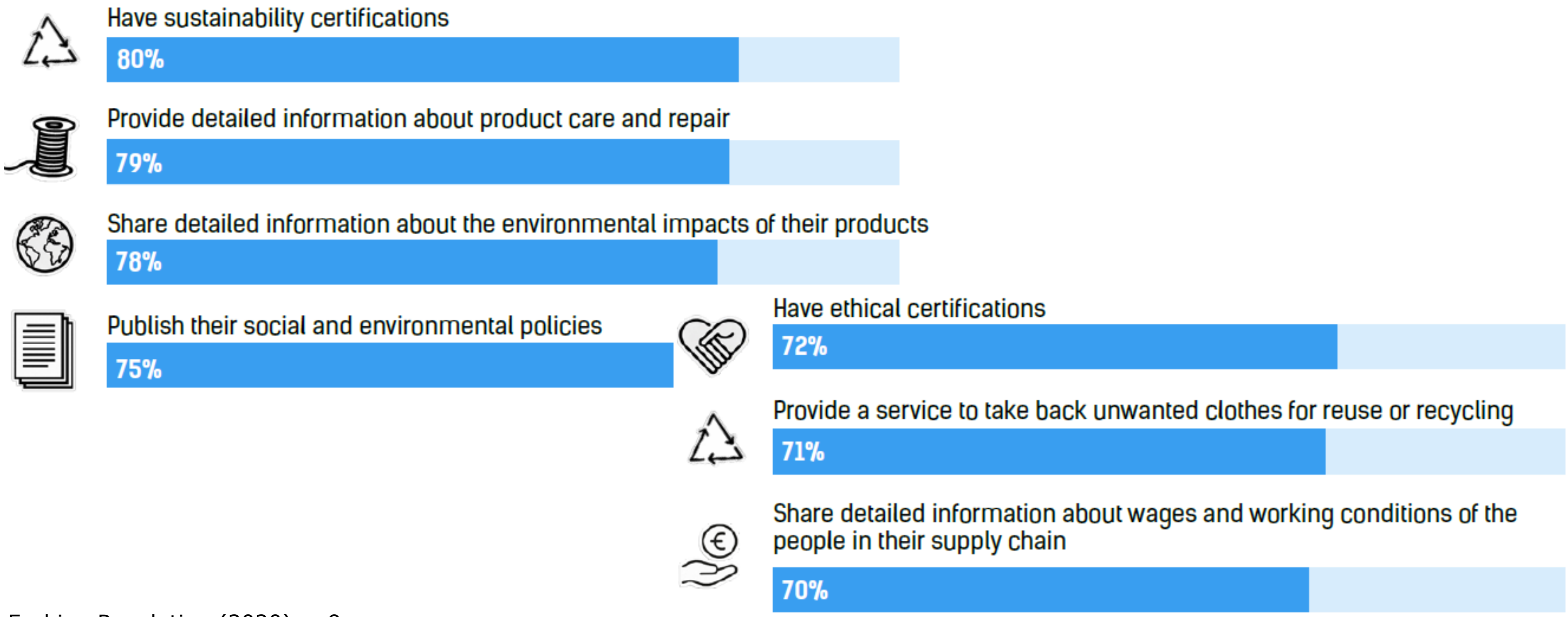
When choosing a clothing brand to buy from, how many consumers agreed that it is important for brands to...



Fashion Revolution (2020), p.9

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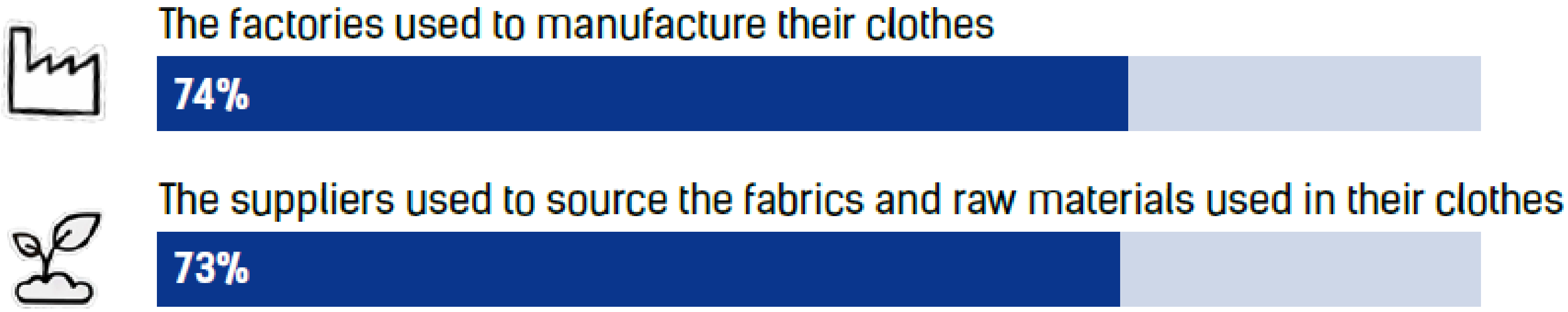
When it comes to supply chain transparency, people agree that fashion brands should publish...



Fashion Revolution (2020), p.10

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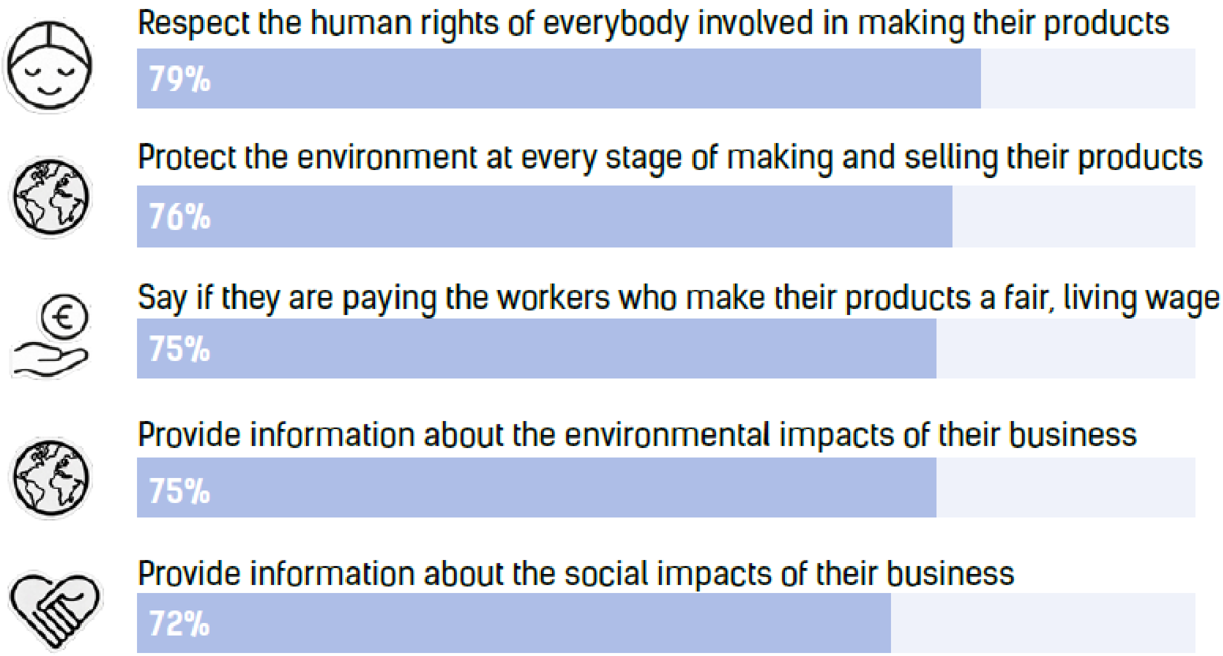
How many people agreed that fashion brands should be required by law to...



Fashion Revolution (2020), p.11

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The Fashion Transparency Index

= The Fashion Transparency Index ranks 250 brands with annual turnover of at least 400 million USD on the information they publicly disclose about sustainability, across 246 categories from animal welfare and biodiversity to purchasing practices, working conditions and recycling.

Fahion Revolution (2022)

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The Fashion Transparency Index

Access the Fashion Transparency Index: https://www.fashionrevolution.org/about/transparency/

Discuss:

- How does your favorite brand score?
- Go through the list of companies - any surprises?
- Discuss how the scores are calculated (see next slides or in the fashion Transparency Index on page 35): Would you weight diffeently or are wightings fine?

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The Fashion Transparency Index - Weighting of the scores

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POLICIES & COMMITMENTS

This section explores brands' social and environmental policies for both their own employees and workers in the supply chain, how these policies are implemented, if it has relevant goals and targets it has in place and if brands are reporting annual progress against these targets. In 2021, available points in this section were halved to place more emphasis on outcomes and impacts. This year, whilst no indicators changed, we developed more stringent guidance on what disclosure is acceptable which may be the reason why some brands score lower in comparison to last year. For example, when evaluating if brands have a supplier policy on Overtime Pay, just stating 'overtime is paid at a premium' is not sufficient. We are looking for disclosure of the percentage above minimum wage. Further, within Section 1.2 we have not accepted points where brands' policies "encourage" or "suggest" that a supplier does something, it must be a requirement. Language, when ambiguous, can be used as a way to deflect responsibility and our aim was to more closely scrutinise language used.

13.2%

GOVERNANCE

Here, we look at who on the executive board has responsibility for social and environmental performance, how this is implemented, how social and environmental improvements are linked to employee, CEO and supplier performance,whether the relevant department can be easily contacted by the public and whether there is worker representation on the board. This year, we also looked to see if the brands are publishing a responsible tax strategy and whether there is worker representation on the executive board.

4.4%

Fahion Revolution (2022), p.35

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The Fashion Transparency Index - Weighting of the scores

TRACEABILITY

In this section we expect brands to publish supplier lists at three levels: manufacturing, processing facilities and mills, and raw materials. We also look for extra details such as supplier address, number of workers, gender breakdown, number of migrant workers, union representation and when the list was last updated. New for this year, we looked to see if brands' lists are publicly available and in alignment with the Open Data Standard for the Apparel Sector in order to make information easy to use for trade unions and NGOs. We also checked whether or not brands are active contributors to the Open Apparel Registry to enable collaboration and efficient access of data for impacted stakeholders.

29.2%

KNOW, SHOW & FIX

In Know, Show & Fix we review what brands disclose about their human rights and environmental due diligence processes, how they assess suppliers against their policies, what are the results of these audits and assessments, what brands do when problems are found, how workers can file complaints and how these are addressed. This year, for the first time, we have separated human rights and environmental due diligence into different subsections in order to illuminate potential gaps in environmental due diligence disclosure. Based on previous Indices, disclosure often focused on human rights due diligence.

20%

Fahion Revolution (2022), p.35

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The Fashion Transparency Index - Weighting of the scores

SPOTLIGHT ISSUES

In 2021, we increased the weighting of Spotlight Issues significantly compared to previous editions (up from 19.6% in 2020). This is part of our efforts to push harder for disclosure on the most urgent and difficult problems facing the industry. For 2022, no change has been made in the weighting of this section. In this section, we look at what brands disclose on a number of issues, including: forced labour, living wages, purchasing practices, unionisation, racial and gender equality, overproduction, waste and circularity, sustainable materials, water and chemicals, climate and deforestation.

33.2%

Fahion Revolution (2022), p.35

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The Fashion Transparency Index – Key Issues in 2022

- Progress on transparency in the global fashion industry is still slow among 250 of the world's largest fashion brands and retailers, with brands achieving an overall average score of just 24% (= up 1% from 2021)
- More brands than ever (48%) are disclosing their first tier suppliers, however, half still disclose nothing
- Less than a third of major brands disclose a decarbonization target covering their entire supply chain

Fahion Revolution (2022)

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The Fashion Transparency Index – Key Issues in 2022

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- Most (85%) major brands still do not disclose their annual production volumes despite mounting evidence of overproduction and clothing waste
- Most retailer take-back programs simply divert clothing from local communities and ship it off to secondhand markets in the Global South, where we know much of the clothing ends up in landfills, burnt or swept out to sea
- Only 11% of brands publish their supplier wastewater test results, despite the textile industry being a leading contributor to water pollution

Fahion Revolution (2022)

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The Fashion Transparency Index – Key Issues in 2022

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- As new and proposed legislation focuses on greenwashing claims, almost half of major brands (46%) publish targets on sustainable materials yet only 37% provide information on what constitutes a sustainable material
- Only 24% of brands disclose how they minimize the impacts of microfibres despite textiles being the largest source of microplastics in the ocean
- Just 12% of brands publish a purchasing code of conduct indicating that most are still reluctant to disclose how their purchasing practices could be affecting suppliers and workers

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The Fashion Transparency Index – Key Issues in 2022

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- The vast majority of major brands and retailers (94%) do not disclose the number of workers in their supply chains paying recruitment fees → paints an unclear picture of the risks of forced labor
- Only 13% of brands disclose how many of their supplier facilities have trade unions
- The industry's reliance on low-wage female labour continues yet most brands (94%) neglect to disclose the key issue of how prevalent gender-based labor violations are
- Most major brands and retailers (96%) do not publish the number of workers in their supply chain paid a living wage, nor do they disclose if they isolate labor costs in their pricing

Fahion Revolution (2022)

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Let`s work!

- Do some research and list scandals that fashion brands were involved:
  - What brands were involved?
  - Which countries were involved?
  - What kind was the mistreat (human rights, environmental…)?

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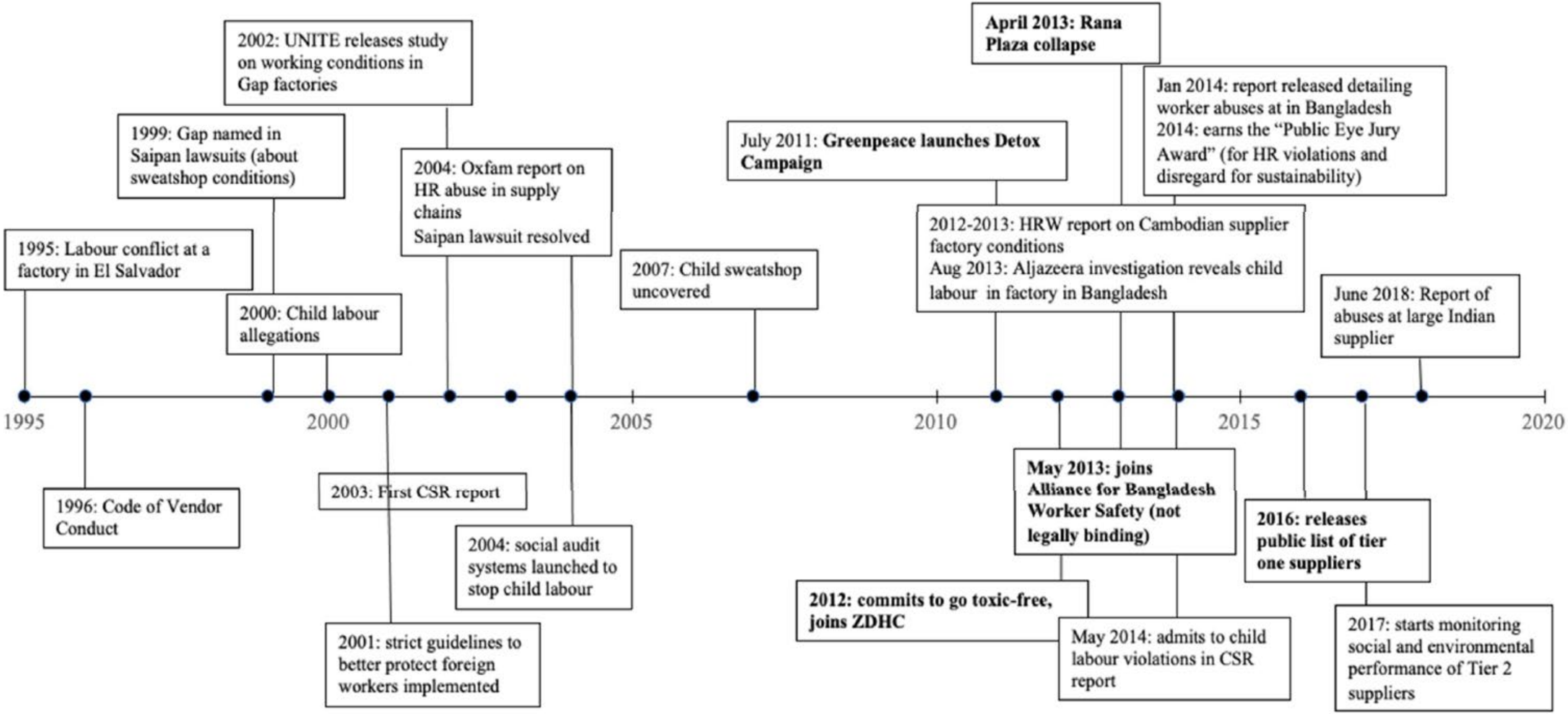
Inditex scandal and CSR timeline



Fraser & van der Ven (2022), p.17

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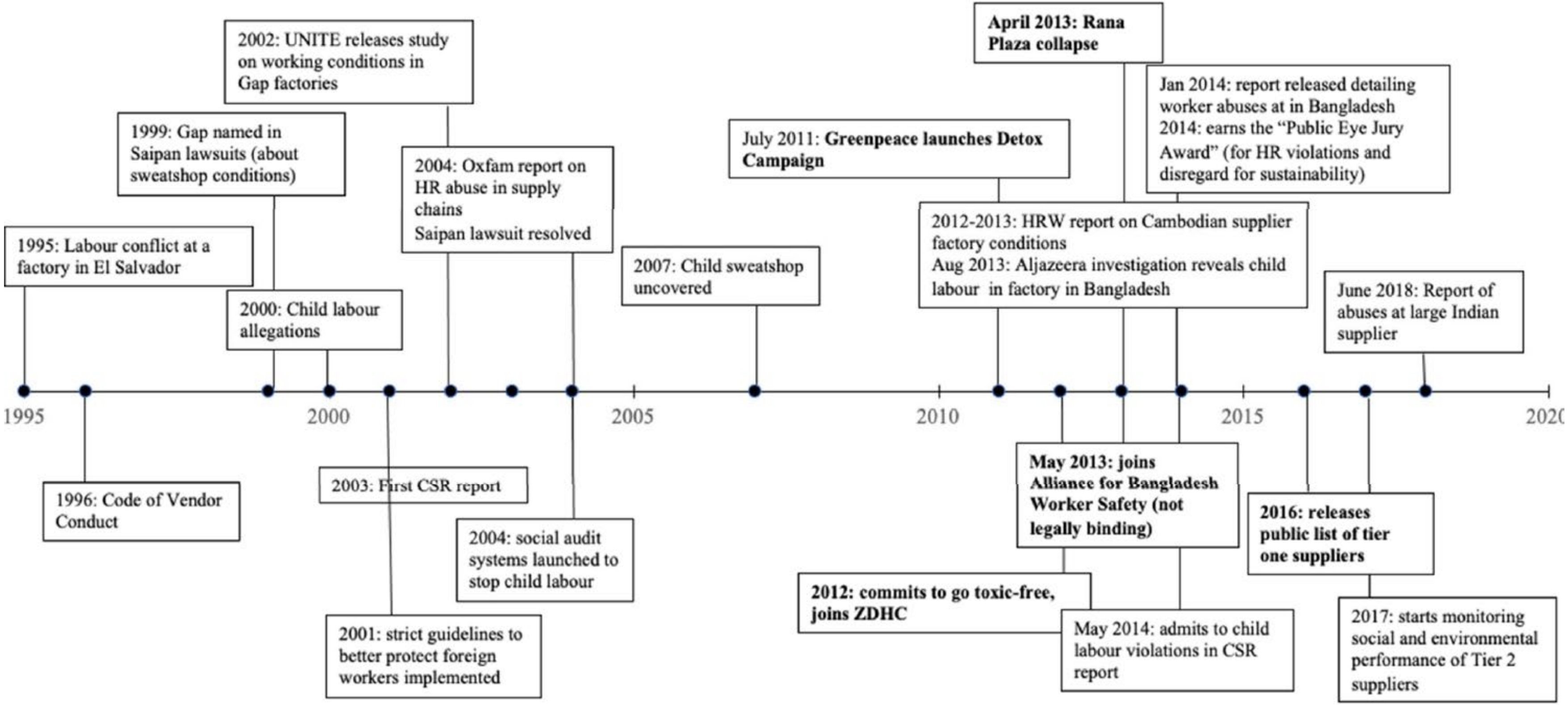
GAP scandal and CSR timeline



Fraser & van der Ven (2022), p.18

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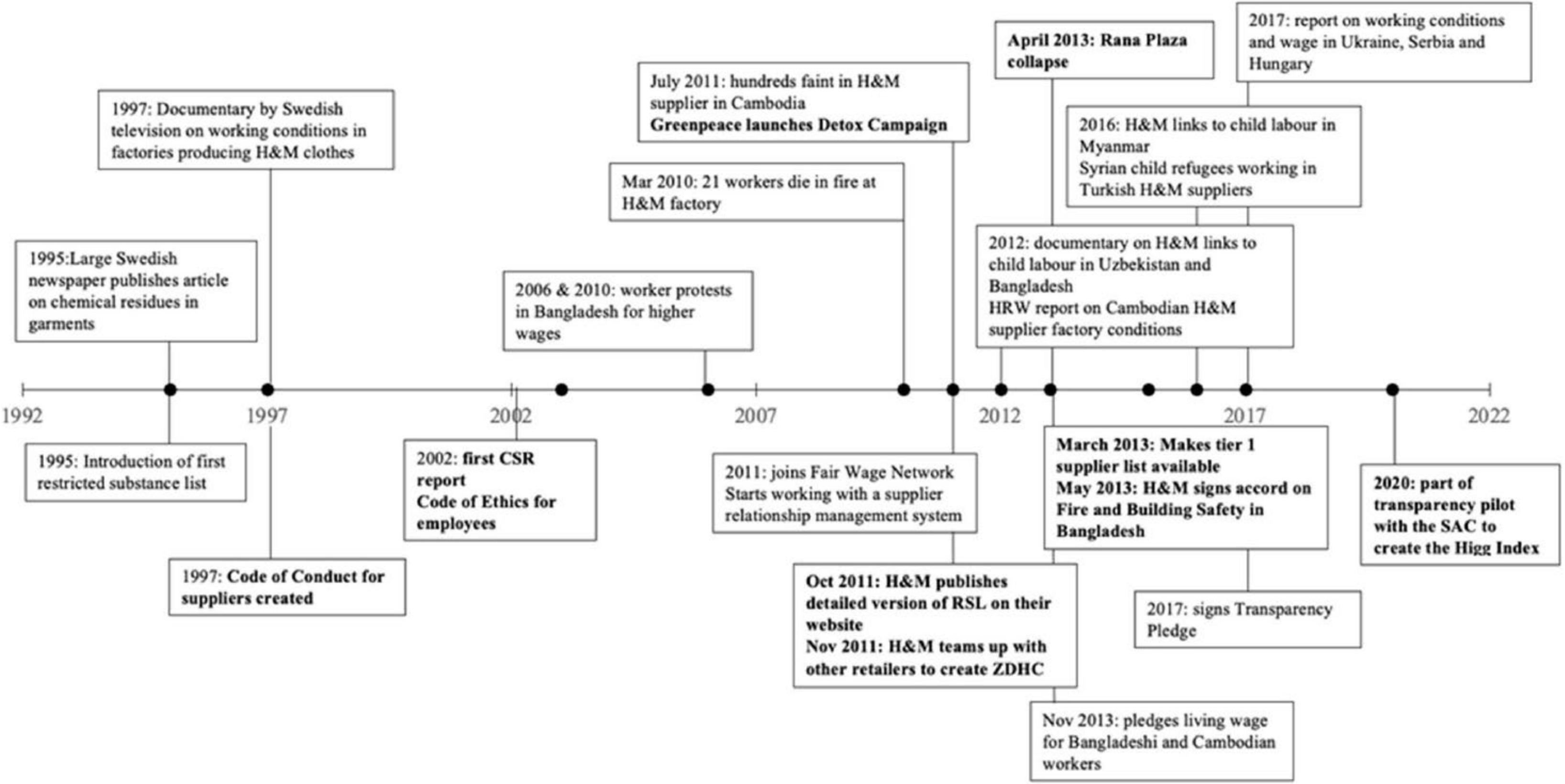
H&M scandal and CSR timeline



Fraser & van der Ven (2022), p.17

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Benefits of transparency

- Reducing or preventing negative market signals regarding environmental and social impacts and building trust
- Facilitating the assessment of regulatory and voluntary compliance
- Enhancing the efficiency and quality of SSCM
- Being associated with attitudes towards purchase intention

Garcia-Torres et al. (2021)

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Risks of transparency

- Increased exposure to name and shame campaigns
- Risk of innovation lifespan reduction
- Distrust derived from certificates not backed up by a government agency

Garcia-Torres et al. (2021)

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Requirements on corporate reporting

- Within in the EU, legislation for corporate reporting differentiates between companies which are of public interest (PIEs) and those who are not (non-PIEs):

→ In general, **non-PIEs** need to fulfill the **requirements set by the respective member s**tate they are located in *)

*) Still, harmonization on EU level has been applied since the contract of Lissabon.

→ Def. as credit institutes, insurers and **capital market-oriented companies**

→ **PIEs** need to follow the requirements steming from Regulation (EC) No 1606/2002 which among others asks for **application of the International Financial Reporting Standards (IFRS)** as endorsed by the EU

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Legal background and requirements

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International Financial Reporting Standards (IFRS)

- Issued by the International Accounting Standards Board (IASB), the standard setting body of the IFRS Foundation
- Required by approx. 170 jurisdictions worldwide
- Objective is to provide users of financial statements information that is **useful for decision-making**
- Companies should present a **true and fair view** of their financial position, its performance and the cash flows; means for this are
  - Statement of financial position
  - Statement of comprehensive income
  - Statement of cash flows

Discuss: How do the IFRS contribute to the concept of accountability?

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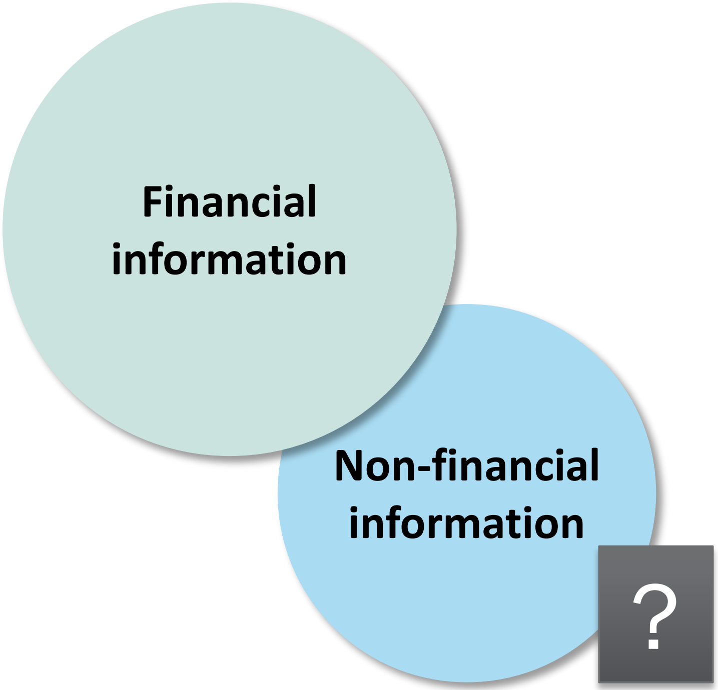
Brief reflection of reporting requirements

- Financial statements comprise information linked to the past
- Decision usefulness might be limited in relation to forecasts

→General necessity of further requirements regarding non-financial information



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Further aspects on potential relevance of non-financial information

Changes in economic and geopolitical realities after the pandemic

Acceleration of digitization

Changes due to the virtualization of the working world (New Work)

Conversion to sustainable and climate-neutral economic processes

Future reporting will need to include non-financial information more comprehensively to reflect these developments.

Source: *KPMG* (2021)

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Non-financial reporting

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- Under IFRS companies might provide a management commentary which is **not compulsory**
- On national level, EU members already require economic outlooks by the management, e.g. the German Lagebericht (§289 HGB)

Opportunities and RIsks

Risk management objectives and methods	Presentation of hedges of important types of transactions
Dealing with price change, default and liquidity risks, etc.	Non-financial performance indicators, such as information on **environmental and employee issues**

Obligation only for corporations with over 500 employees

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Implementation of the current requirements by the companies (headlight Germany)

- Compliance with §289 of the German Commercial Code (HGB) in conjunction with the concretization by GAS 20 by medium-sized companies

	2013	2018	2013	2018
Finanzwirtschaftliche Risiken	61	77	32,97%	29,17%
Umfeld und Branchenrisiken	43	69	23,24%	26,14%
Operative Risiken	23	36	12,43%	13,64%
Risiken aus der Entwicklung des Gesamtmarkts	18	29	9,73%	10,98%
Rechtliche Risiken	14	21	7,57%	7,95%
Personalrisiken	9	12	4,86%	4,55%
IT-Risiken	12	15	6,49%	5,68%
Strategierisiken	5	5	2,70%	1,89%

Source: *Müller/Seebeck/Weeger* (2021), n=100

Despite legal requirement, low level of risk assessment

Assessments of current megatrends (environmental protection, digitization, globalization) are hardly to be found in the companies' management reports

Discuss: What could be the reasons here?

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Critical view on current requirements

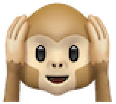
→Information is not relevant, not reliable, rarely comparable (critics were investors and other stakeholders).

→How should non-financial information then be considered, e.g., for investments?

→Also, too few companies committed.

→Summary:

Corporates



Investors

Public

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Importance of sustainable reporting

- Study by *Baumgartner/Ernst/Fischer* (2020) points out the comparatively low significance of sustainable reporting for various groups of addressees

Table 13 Relevance of the information provided in the experimental groups' disclosure vignettes (studies 2 and 3)

Rank	Study 2 (*N*=225): investment decision			Study 3 (*N*=228): employment decision		
	Information category	Mean	SD	Information category	Mean	SD
1	Financial situation	6.28	0.99	Employees and workplace**	5.97	1.22
2	Firm strategy**	5.60	1.27	**Development of corporate reputation***	**5.49**	**1.21**
3	Products and innovations**	5.56	1.19	Financial situation	5.44	1.32
4	**Development of corporate reputation***	**5.40**	**1.27**	Firm strategy**	5.42	1.30
5	Sustainability**	5.08	1.61	Products and innovations**	5.28	1.17
6	Social commitment**	4.55	1.63	Sustainability**	5.26	1.51
7	Employees and workplace**	4.48	1.47	Social commitment**	4.96	1.44

*Direct reputation information; **indirect reputation information

Discuss: What is your perception of the importance of this information?

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Voluntary sustainability reporting

Nonwithstanding current legal requirements, companies may develop their own sustainability requirements and report about it

economic necessities + own beliefs

→ Positive effects on financial parameters (sales/profit) may not occur until much later!

Two important currencies: **Credibility and trust!**

Topic: What can the company do for society?

Discuss: What could be the downside of voluntary reporting in terms of sustainable aspects?

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Excursus: No consistent source for sustainable reporting, but…

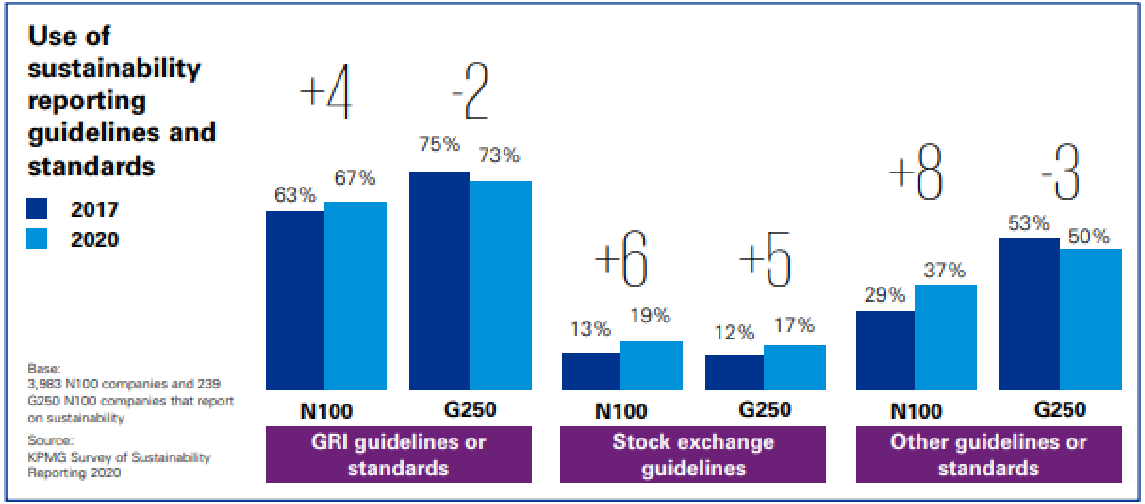
Examples:

GRI Empowering Sustainable Decisions

Deutscher NACHHALTIGKEITS Kodex

ISO 9001

→ Larger companies most commonly use GRI:



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Würth MODYF GmbH & Co. KG

Company	Products	Workwear and safety footwear manufacturer
	Place, Age	Künzelsau, 1997 as a subsidiary of Adolf Würth GmbH & Co. KG
	Size	Employees: 144 / Sales: 56 million euros / Balance sheet total:
Reporting	Type	Voluntary reporting according to GRI standards, separate report, since 2020
	Scope	84 pages

	Contect	• Linking the five focus topics with the company's strategic orientation
		    • Products
		    • Supply chain
		    • Resources
		    • Climate protection
		    • Employees
		• ISO 9001, ISO 14001
		• GRI Index

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Wolford AG

Company	Products	Luxury skinwear (legwear, bodywear, lingerie)
	Place, Age	Bregenz (Austria), founded 1950
	Size	Employees: 1,243 / Sales: 119 million euros / Balance sheet total: 162 million euros
Reporting	Type	Separate sustainability report since 2017/18 (obligated qua legal from (AG))
	Scope	44 pages

	Contect	• Responsible corporate governance and compliance
		• Sustainability issues and stakeholders involved
		• Consequences for the sustainability strategy (concrete KPIs)
		• Areas of responsibility (environment, employees, supply chain)
		    • Energy consumption, CO_2 emissions, wastewater, waste, water
		    • Working hours, fluctuation, occupational safety, diversity
		    • Certification, materials
		• GRI index

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Further examples of good practise

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Analytical considerations	Good or leading reporting practice examples
Business model reporting	
Business model reporting: clarity and comprehensiveness of value creation description	• Neste (Energy) • Stora Enso (Forest products and paper) • Schneider (Electronic component and equipment) • FMO (Development banking)
Business model reporting: potential across time horizons	• Allianz (Insurance) • Schneider Electric (Electronic component and equipment) • Orsted (Energy)
Business model reporting: dependencies and impacts	• SGS (Business support services) • EnBW (Electric and gas utilities) • ABN Amro (Diversified banking) • DSM (Chemicals)
Reporting sustainability matters linkage to business model, strategy	
Sustainability matters effects on company performance	• EnBW (Electric and gas utilities) • Arcadis (Consulting engineering and construction) • ABN Amro (Diversified banking) • SGS (Business support services) • Norsk Hydro (Aluminium and renewable energy)
Sustainability risks	• Enel (Energy) • Schneider (Electronic component and equipment) • AB Volvo (Automotive) • Novozymes (Pharmaceutical and biotechnology) • BNP Paribas (Diversified banking)
Sustainability opportunities	• Enel (Energy) • Schneider (Electronic component and equipment) • CH Hansen (Bioscience) • Acciona (Energy and infrastructure) • Signify (Industrial products-electrical equipment)
Sustainability strategy, targets, KPIs, and progress	• Acciona (Energy and infrastructure) • Peugeot (Automotive) • Lenzing (Chemicals) • GlaxoSmithKline-GSK (Pharmaceutical)

** the listing of companies within each category of Table 2 does not indicate a ranking. It is the order of presentation in the Supplementary Document: Good reporting practices*

Die Bank für eine Welt im Wandel

Innovative by nature

Source: report of the EFRAG Task Force

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The big BUT…

- To map sustainable developments in the companies is one thing
- In order to implement actual sustainable developments it is necessary:

CAPITAL	UNDERSTANDING OF THE CAPITAL PROVIDERS	WORKING BUSINESS CASES

Discuss the following statement:
"Regulation, and be it via reporting standards, will help along the way."

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Where we go to?

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Necessity of sustainability reporting requirements

Contrary to the study by Baumgartner et al.

Stakeholders of companies with **increasing interest** in information about the **consideration of sustainability in corporate activities**

Sustainability reporting recognized by **politicians**
→ Instrument in the context of **combating climate change** as well as increasing importance of ecological and social aspects

Decision-making by companies in the interest of a more ecological and social world, first of all transparency about these aspects of decisions

Discuss: Is the dominance of financial aspects eroding?

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Reporting standards to be used and place of reporting

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From no consistent source so far to the Vision of the EU Commission

EU-wide single source:

To be defined

- ➔ Publication of sustainability information in the **management report** of the companies.
- ➔ Format: annual financial statements and management reports electronically in xhtml format.
- ➔ Aspects of sustainability reporting are to be digitally identified (tagging)

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Revision of the CSR Directive by the EU

- EU Green Deal: climate-neutral continent by 2050
- Small building block to this:
  Complete revision of the existing CSR Directive.
- Publication of the draft in April 2021, with the objectives:
  - More transparency on sustainable aspects
  - Eye-to-eye with financial reporting
  - Ending the "two-tier society" of financial and non-financial information
  - Regulation of clear responsibilities
  - Alignment with the EU Action Plan on Sustainable Finance/EU Green Deal

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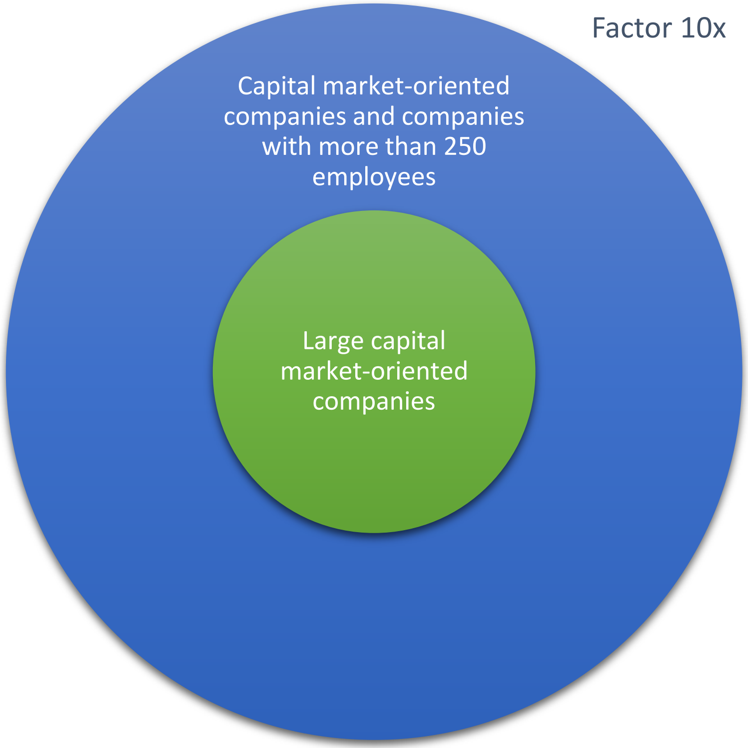
Extension of the scope of application



- Previous obligation for approx. 500 companies in Germany alone
- New regulation affects approx. 5,000 companies in Germany
- Larger corporates obligated as of 01.01.2023 (=elimination of capital market and employee criteria)
- Capital market-oriented small and medium-sized enterprises (SMEs) as of 01.01.2026

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Expansion and specification of reportable information

- Regulatory content expanded and specified
- Focus on environmental, social and employee issues
- Corporate governance aspects added (e.g. role of management board and supervisory board)
- Furthermore reporting on:

Inclusion of the supply chain

Requirement that reporting is retrospective and forward-looking (in the short, medium and long term), qualitative and quantitative

Disclosures on intangible assets, such as "human capital" or "social capital

Reporting on measures taken to prevent, mitigate or eliminate negative impacts

Targets and target achievement in relation to sustainability aspects

Consideration of stakeholder interests and sustainability aspects within the framework of the business model and corporate strategy

Compatibility of corporate planning with the Paris climate target (1.5 degree target)

Resilience of the business model and corporate strategy

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As of today: Questions remain unanswered...

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Solutions

No generally accepted imaging system	• So far only little regulated • Many proposals, concepts, approaches discussed and tried out • Standardization is missing (also key figures)!	new EU standards ? (Relevance, Reliability, Comparability)
Depiction horizon of sustainability aspects >> Period of other reporting	• NBE deals with the entire value chain and should refer to the entire product life cycle • Consideration of all modes of impact required	Double materiality - environment on company and company on environment ?
Time frame for implementation	• New directive will not apply to the majority of companies until 2026 at the earliest • Agenda to achieve climate neutrality by 2050 on the one hand, critical points by 2030 on the other hand	Previous commitment or self-commitment after all

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Appreciation of the EU Directive

1. **Reconsider timetable for introduction**
   Bring commitment forward, but reduce audit rigor in first few years after implementation

2. **Take better account of findings from risk and opportunity reporting**
   esp. with regard to already identified/known needs for action and potential for improvement:
   E.g.: assessment/categorization of risks, information regarding gross vs. net view.

3. **Binding specifications for key figures to be reported across all industries**

4. **Digitalization in accounting must generally advance**
   Systems only as good as the data they contain
   Need for knowledge carriers

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A spark of hope?

- It is not only the EU Commission that has taken up the issue of sustainability reporting:
  - IFRS Foundation - responsible for the internationally recognized accounting standards IFRS - has founded a new entity, the International Sustainability Standards Board (ISSB), which is to develop global basic standards (Global Baseline) in the area of sustainability reporting in the future.
  - The ISSB was already joined by a number of voluntary initiatives when it was founded.
  - With the founding of the ISSB, two prototypes were published on the topics:
    - Climate reporting and
    - general requirements for the disclosure of sustainability-related financial information.
  - The ISSB is based in Frankfurt am Main

→"Competition" stimulates business.

→Plus tendencies to align among ISSB, GRI and EFRAG.

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