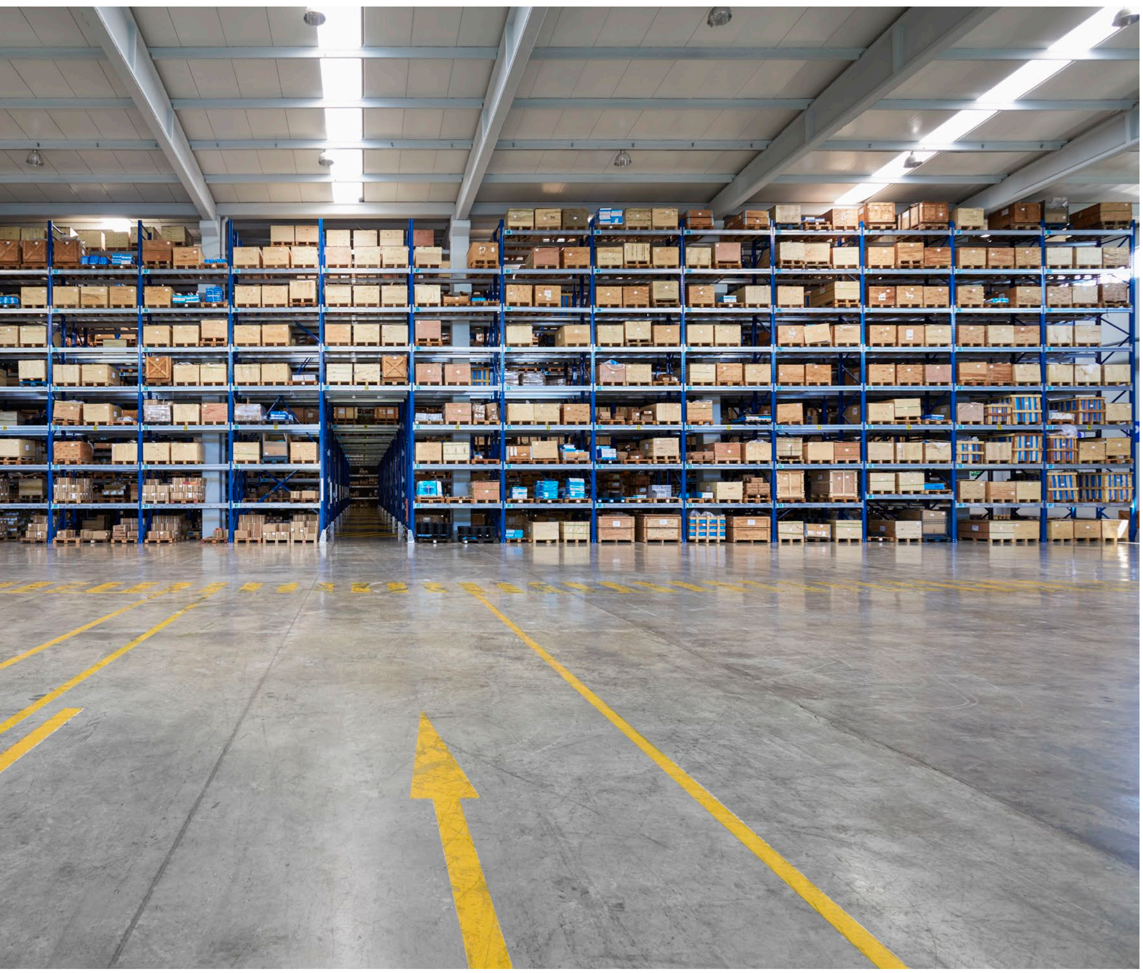
ESG Research

ESG Materiality Map
Consumer Products - Nonfood

Dec. 13, 2022

Environmental and social factors, most notably working conditions, waste and recycling, and responsible marketing and labeling, are material for stakeholders and increasingly material for credit.

This report does not constitute a rating action



Sustainable Finance

Anna Liubachyna
London
anna.liubachyna
@spglobal.com

Bruce Thomson
New York
bruce.thomson
@spglobal.com

Credit Ratings

Raam Ratnam
London
raam.ratnam
@spglobal.com

Sarah Wyeth
New York
sarah.wyeth
@spglobal.com

S&P Global
Ratings

ESG Materiality Map
Consumer Products - Nonfood

In line with the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, S&P Global Ratings is publishing research on the ESG materiality map for the consumer products - nonfood sector. We provide an illustration of our current view of the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. The materiality map does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis.

Consumer Products - Nonfood Sector

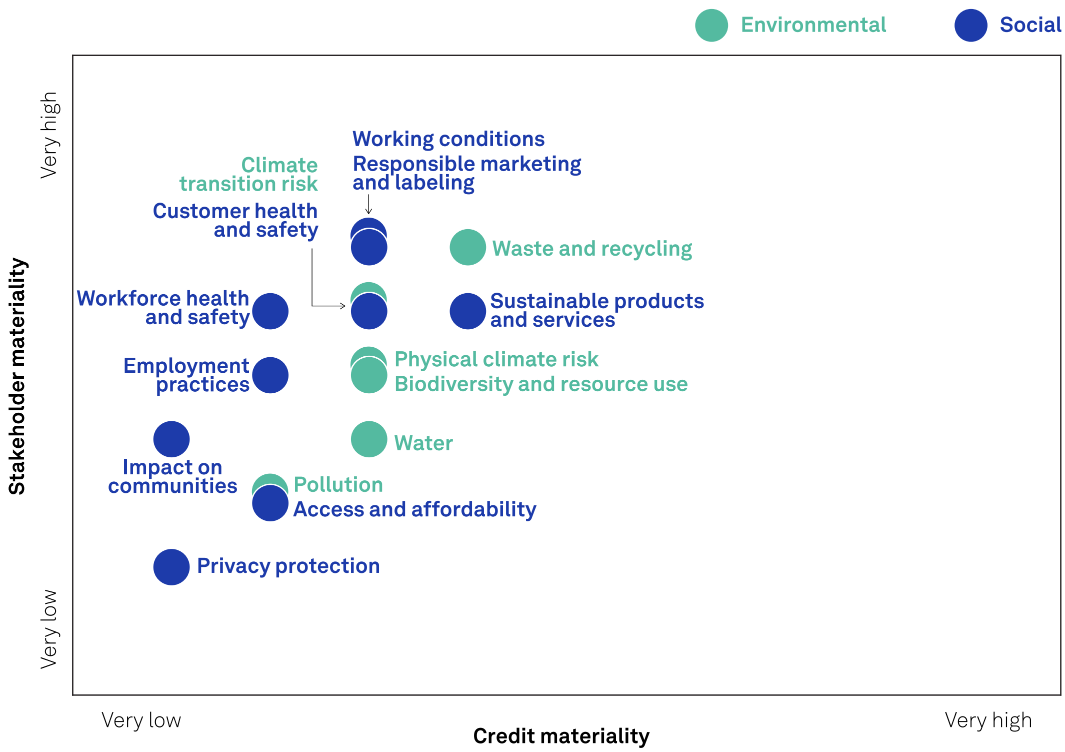
The consumer nonfood sector covers a wide variety of companies in the consumer goods segments, both branded and private labels, and includes personal luxury, apparel, household, beauty and personal care, and white-goods products.

Key Takeaways

- Waste & Recycling and Climate Transition have high stakeholder materiality given the contribution of consumer nonfood products to different types of waste and pollution (e.g., plastic, electronic, textile) and emissions across their value chains, which potentially have broad-reaching consequences and could be subject to further regulation.
- Working Conditions are material for stakeholders as consumer nonfood companies typically rely on labor-intensive production within complex global supply chains in which workers may be vulnerable to worker and human rights risks. This has been generally less material to credit historically, but new legislation on due diligence and responsibility across the supply chain may impact materiality going forward.
- Sustainable Products and Services and Responsible Marketing and Labeling are increasingly material from stakeholders' perspective and are seen as both an opportunity and a risk for credit. Consumer preference and new regulation are likely to further influence how companies develop, market, and label products, impacting competitive positioning and regulatory exposure.

See materiality map on the following page.

ESG Materiality Map For The Consumer Products - Nonfood Sector



The materiality map provides an illustration at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. It does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG Criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis. Source: S&P Global Ratings.

How To Read The ESG Materiality Map

The stakeholder materiality (Y axis) reflects our assessment of the relative level of impacts and dependencies of the sector on the environment, society, and economy.

The credit materiality (X axis) reflects our assessment of the relative level of potential and actual credit impact for the sector. The credit implications for the factors positioned on the left side to the middle of the X-axis would be more limited and absorbable. On the right side, there is higher potential for these implications to be more disruptive. We assess credit implications for an entity based on its individual characteristics.

Assessing E&S factors' materiality: We consider both the likelihood of the impact from a given factor, as well as the magnitude of the impact. The materiality of the factors varies depending on the perspective (stakeholder or credit) as well as the evolving and dynamic interactions between these two dimensions.

The main areas of the map:

- The upper-right quadrant displays the most material, on a relative basis, E&S factors identified for the sector from both a stakeholder and credit perspective.
- The upper-left quadrant presents factors that are more material from a stakeholder than credit perspective. These factors have the potential to become more material from a credit perspective.
- The bottom-left quadrant shows factors that are less material for both stakeholders and credit. Their materiality may evolve over time and this dynamic may not be linear.

Examples Of Material Factors

Below we provide the rationale of some of the material factors to illustrate the above findings.

Waste and recycling

We consider waste and recycling to be highly material for stakeholders but less so for credit. Stakeholders, including governments and the public, are pushing for tighter restrictions on electronics, clothing, and plastics waste and end-of-life management, which together contribute to systemic problems including climate change and accumulation of nonrecycled waste. Currently the fashion industry alone is responsible for around 40 million tons of textile waste a year or about 5% of municipal solid waste, most of which is either sent to landfills or incinerated according to the Ellen MacArthur Foundation. In 2022, U.N. member states in Nairobi agreed to develop a new international binding agreement to tackle plastic pollution across the value chain--from oil and gas producers, petrochemical companies, manufacturers, and retailers to consumer use of products and waste collection and management. This global agreement can support upstream solutions such as reducing or replacing plastic in products. We already observe that regulations in some markets--such as the E.U.'s Waste Electrical and Electronic Equipment (WEEE) directive--require electronics and electrical equipment manufacturers to collect and properly treat their products at the end of their useful life. We believe future policy responses, including taxation, could affect margins and volumes for consumer product companies, making credit impacts more material as the industry adapts. Investment will be required to comply with regulations and respond to changing consumer preferences. At the same time, we recognize that near-term investments to limit waste typically mean less raw material is used in the manufacturing and packaging of products, thereby reducing costs in the long-term.

Working conditions

High stakeholder materiality is driven by this sector's heavy reliance on labor-intensive production and manufacturing within the supply chains. Some subsectors, such as white goods, household, and beauty, are increasingly automating their manufacturing process. However, much of the sector--in particular the apparel and textile industries--remains reliant on manual labor, especially during the garment manufacturing, packing, and distribution phases. For example, in Asia, which is the world's largest textile hub accounting for ~55% of global textile exports, the International Labor Organization (ILO) estimates the apparel industry to employ ~60 million workers, most of whom are women, who face challenging working conditions within the context of less-stringent labor standards. While the ILO acknowledges progress in increasing real wages, workers remain vulnerable to abuses of fundamental rights – including child and forced labor, occupational health and safety, and excessive working hours. The sector is further exposed to working conditions related to key inputs, such as cotton and metals/minerals. To date, the reputational issues faced by companies exposed to supply chains with poor labor practices have tended not to translate into declines in demand or revenue that are meaningful enough to weaken creditworthiness. However, as consumers become more aware of and sensitive to supply chain practices and as the regulatory environment evolves (see, for example, supply chain human rights due diligence legislation in the EU, use of Withhold Release Orders, the Uyghur Forced Labor Prevention Act, and the FABRIC Act in the United States), these issues may become more credit material over time.

Sustainable products and services

We see sustainable products and services to be material for the sector from both a credit and stakeholder perspective. In recent years, consumers have increasingly asked for more sustainable products and packaging. This trend has led many companies to engage in product innovation, invest in new technology, and develop new partnerships to optimize their products for sustainability. Sustainable product alternatives include plastic-free packaging, more energy efficient white goods appliances, more environmentally friendly product formulations in beauty and personal care products, and more sustainable materials in apparel. We also note this shift toward more sustainable products is influenced by regulatory pressure. For example, the proposed EU Eco Design of Sustainable Product Regulation would create eco-design requirements for products sold in the EU, and more innovative and proactive companies may be better positioned to meet new requirements as well as consumer preferences. From a credit perspective, developing a sustainable product portfolio could become a competitive edge, whereas failure to offer sustainable products could harm brand reputation, reduce competitiveness, or increase exposure to potential regulatory changes. We recognize that consumers still broadly prioritize value, convenience, and quality, yet we believe sustainable products could help to capture new or expand existing customer markets, and thus drive revenue growth or improve margins in the more-premium segments.

Climate transition risks

Climate transition is currently more material for stakeholders than credit. In this industry, most of the greenhouse gas (GHG) emissions are within the value chain (Scope 3). For some products, the GHG emissions during the manufacturing stage is minimal compared to the raw material production (e.g., oil for plastic products) or in the use phase (e.g. for white goods). For example, the fashion industry, which accounts for between 2% and 4 % of global GHG emissions (according to McKinsey), set up the Fashion Charter that provides a clear pathway for the fashion industry to achieve net-zero emissions by 2050. It means the industry will need to invest in manufacturing technologies, logistics, and supply chains. Other segments could face more regulation, such as increasing energy efficiency standards for white goods. Many brands are adopting decarbonization strategies for their direct operations, their supply chains, and by designing more-efficient products in the face of increased investor and customer awareness. Reducing emissions will likely require investment in manufacturing technologies, logistics, and supply chains. This could affect credit insofar as it affects free cash flow, but will vary depending on the payback time, local market conditions, and companies' ability to pass on the spend to consumers.

Responsible marketing and labeling

The materiality of responsible marketing and labeling is currently higher for stakeholders than for credit. Stakeholders, including government and nongovernmental organizations (NGOs), are increasingly scrutinizing companies' environmental and sustainability claims, and greenwashing accusations can harm companies' reputations and increasingly open them to legal exposure. For example, advertising and marketing campaigns that project outdated views, lack diversity, or misrepresent marginalized groups can mislead or do harm to customers, and in some cases, could cause reputational harm to companies, with financial implications. For some products, such as white goods, regulation has traditionally enforced stringent standards on safety labeling. For example, the EU's energy labeling regulation has driven energy-efficiency labeling standards for refrigerator and washing machine appliances. However, much of the rest of the sector faces increased stakeholder pressure to enhance transparency and communication on environmental impacts. While a series of voluntary labeling initiatives have emerged for brands to improve practices, such as the Higg Index and the EU EcoLabel, we anticipate the introduction of further regulation (for example, the EU Consumer Empowerment Directive and the Eco Design of Sustainable Product Regulation) in an effort to standardize practices across the industry. From a credit perspective, although consumer product manufacturers invest regularly in labeling, packaging, and marketing to attract consumers and remain relevant in the marketplace, new sustainability-related regulatory requirements would lead to incremental costs associated with monitoring and compliance and fines for noncompliance.

What is our approach to research on the ESG materiality map?

Referring to the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, this research is built on the ESG materiality concept that considers ESG issues as material when they could affect stakeholders, potentially leading to material direct or indirect credit impact on entities. It considers that all businesses, through their activities and interactions, impact and depend, directly or indirectly, on stakeholders such as the environment (natural capital), society (human and social capital), and economy (financial capital). Using this ESG materiality concept, S&P Global Ratings has worked toward identifying a common, global, cross-sector set of E&S factors that we believe are material to stakeholders, and either are already, or have the potential to become, credit material for entities. The materiality map we propose provides an illustration at a point in time, of our findings on the relative materiality of those factors, from both the stakeholder and credit perspectives.

How does the sector ESG materiality map relate to credit ratings or ESG evaluations?

The sector materiality map is a visual representation of the factors that we consider impactful to the sector from a stakeholder and credit perspective for the purposes of this research. It does not represent any new analytical approach to the E&S factors in our credit ratings.

The relative materiality of the factors indicated on the materiality maps may inform the E&S Risk Atlas scores and the weights of the E&S factors used in ESG evaluations.

They may also inform our discussions with issuers on those factors' existing or potential credit materiality.

Related Research

- Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors, May 18, 2022
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- ESG Evaluation Analytical Approach, Dec. 15, 2020