ESG Integration: Reflections on Sustainability

Since the inception of the firm, one of the things ingrained in Lindsell Train's philosophy is to seek truly sustainable brands - those which have survived the challenges of the past and have the potential to continue growing, adapting and delighting consumers worldwide. And against this backdrop, one of the things we think about the most these days is the disruptive potential of technology and the impact of increasingly rapid global digitisation on the brands and products we invest in. As investors who are continually seeking to ensure that our portfolio companies' brands are truly top tier and irreplaceable, we are alert to the fact that a key effect of digitisation is that the consumer's relationship with brands has changed, and consumer demand for "sustainability" is growing faster than ever. In the past the flow of information was largely controlled by the brand owner and communicated via mass media advertising, with more detail only accessible by those who knew the company well or who took the time to conduct exhaustive research. But today, a wealth of information on every brand is now just a swipe, tap or click away. As the consumer becomes ever more interested in the provenance and global impact of the brands and products they choose to consume, we consider a company's approach to addressing these concerns and demands directly relevant to the survival and success of the brand – in short, sustainability in the fullest sense of the word. In this piece I'd like to provide a snapshot of how we actively think about issues of sustainability where we consider it an integral part of the investment case, and outline how we have actively engaged with four of our portfolio companies on these questions: fashion houses Prada and Burberry, luxury cosmetics manufacturer Shiseido, and also Unilever, owner of consumer brands across the food, home and personal care categories.

As our newest investment, perhaps Prada is a good place to start. We began buying the shares in 2019 but this was preceded, as with all Lindsell Train investments, by a multi-year period of research. This was work to look at Prada itself and also its luxury peers, as part of a piece of work intended to give an overview of the digital shifts happening within the sector and help us to identify opportunities coming out of those changes. A fashion house's future depends upon reaching and delighting a new generation of consumers, innovating to create trends and stay ahead of the curve whilst always offering the highest quality products. The luxury industry's shift to digital described earlier is a critical trend, prompted by a widespread realisation that the young luxury shopper of today is more digitally connected than any of his or her forebears, and that these changes are permanent. Increased connectivity offers an opportunity for fashion houses - indeed, all brand owners - to communicate with their customers, but as I've said earlier, it also removes some of the mystery and brings with it transparency on a never before seen scale plus much faster dissemination of information. This has led to an increasingly informed luxury shopper with a growing interest in the environmental and social issues applicable to fashion companies – slave labour in supply chains, animal cruelty, water use, climate change and plastic pollution immediately spring to mind.

Various surveys and news articles have very much underlined this need for luxury fashion houses to take these trends seriously – for example, 2019's BCG-Altagamma survey of 12,000 luxury consumers reported that 60% of respondents would opt for the more sustainable brand of a particular item. And there are certainly signs that consumers are, in many cases, willing to pay up for sustainability credentials they believe to be important: a separate survey conducted by HSBC in February of last year indicated that 83% of respondents reported spending more on a product promoted as sustainable in the past 12 months. We are not suggesting that ESG concerns are necessarily going to become the dominant factor in consumer brand choice. But we can't ignore how they influence consumers and colour brand perception, and so Prada taking an informed and constructive approach to these issues is therefore not simply 'nice to have' but in fact essential for the company's success and must be a central piece of the strategy.

With all this in mind we dedicated much of our research to such questions of sustainability and were able to ask the company specifically about them. We were pleased to find Prada alert to consumer demands and implementing multiple initiatives: the first and perhaps the most important is the 'Re-Nylon' project, in which 30% of its iconic nylon handbag collection is now made from fully recycled plastic taken from the ocean. Over time, the entire collection will be made from recycled nylon – and there has already been a very positive consumer response to these products, with several models already sold out. Prada has responded to calls for increased attention to animal cruelty: in May 2019 it pledged that it will stop using fur in its designs or products from spring/summer 2020. We also pay attention to the fact that the company's supply chain is predominantly based in Italy: of the 80% of production that is outsourced, 80% is to partners located in Italy, most with relationships stretching back 30+ years. This means the supply chain is transparent and well established, allowing Prada not only to easily monitor product quality, but also to ensure that conditions are fair and equitable.

We continue to monitor Prada in this context, and in exactly the same way we are alert to Burberry's ESG initiatives. Burberry has been included in our portfolios since 2008, and we believe that the company's groundbreaking early adoption of digital has in many ways gone hand in hand with its sustainability initiatives. Burberry was an early adopter of digital - for example, in 2009 it was the first luxury fashion house to launch its own social platform, "The Art of the Trench", and in 2011 it became the first luxury brand to sell through Twitter's "Buy Now" program - and the phenomenal amount of consumer data this generated influenced its sensitivity to consumer demand for sustainability within the brand. Burberry has had a ESG program in place since 2004 and continues to make changes, for example banning fur from its collections from 2018.

Whilst on a management led tour of Burberry's Regent Street flagship store last year, I saw first hand the growing number of products made from recycled fabrics - Burberry has developed two in-house, firstly an "e-canvas" made from food industry waste products, and secondly a type of recycled nylon called "Econyl". Burberry emphasised that consumers actively desire these kinds of products, so it's a case of supplying what they are calling for rather than needing to educate them about recycled fabrics. I noticed that "Econyl" featured prominently on all such product labels - far from being an addendum, this truly is a key part of branding. Of course, missteps can and do happen - in the same year Burberry was found to have incinerated almost £29m worth of unsold goods as part of its brand protection strategy (i.e. not allowing items to be sold at steep discounts). However, the resulting consumer backlash made it evident that the act of burning goods was far more damaging to the brand - and we were encouraged to see that Burberry immediately recognised this and pledged to end the practice.

More recently, prompted by the discovery of sweatshops in the supply chains of certain fast fashion retailers, we asked Gerry Murphy, the chairman of Burberry, to reassure us about the company's policies and control of its own supply chain. Understandably, these kinds of issues are mainly confined to fast fashion which relies on selling a large volume of product with thin margins, which is not the case with Burberry. In addition, we were encouraged to learn that Burberry has both a robust supplier vetting programme and a tightly controlled supply chain. Mr Murphy was in agreement with us that ESG issues of this nature should be - and are - crucial brand health considerations. The trend towards ethical clothing was firmly in place before the crisis, but more and more people are thinking about the provenance of what they wear, especially if it's a high value, branded piece that people want to wear proudly.

We believe that many of the same themes are relevant to luxury Japanese cosmetics manufacturer Shiseido, held within both our Japan and Global funds. A recent conversation with the company revealed that they are seeing definite growth in consumer awareness of sustainability, both in Western and Asian markets including Japan and China, and that being able to clearly address these kinds of environmental and social issues will be an increasingly important part of "brand health". A key problem facing the company is balancing the growing global demand for cruelty-free products with China's requirement for animal testing on all cosmetics sold in the country. With 19% of revenues coming from China, Shiseido acknowledges that at present the situation is at something of an impasse, but nevertheless its brands not sold in China (Bare Minerals) are PETA certified cruelty free, and overall the company is working to develop alternative testing methods with the aim of eradicating it entirely.

Calls for more variety and diversity within colour cosmetics (such as foundation or lipstick) have grown ever louder in recent years, so we were pleased to learn that Shiseido's Western-market focused brand Nars has a huge 40 shade range, and that in 2019 Naomi Campbell was chosen as the face of the brand - her first cosmetics campaign in a career spanning more than 30 years. We think it makes perfect sense for a cosmetics company to address the widest possible market with a broad range of shades and inclusive advertising. And since the 2014 appointment of the current CEO and the implementation of a long term turnaround plan designed to boost brand value and reposition Shiseido as a global company, we notice that changes have been made to the composition of employees. At the Japanese HQ, the percentage of female managers has grown to 33% as of January this year, a very encouraging development for a beauty business.

Shiseido is also actively increasing its amount of recycled and reusable packaging, with the aim of reaching 100% across all products - but this is hardly a new idea for the company, which first developed refillable product packaging back in 1926! Against this backdrop it's clear that the recent successes in improving packaging composition (in 2008 50% of Shiseido's Japanese skincare products were made with plastic, whereas now over 90% are paper based) are embedded firmly within its history and heritage of efficiency and avoiding wastefulness.

Unilever, the last of our portfolio companies I'd like to look at in this context, has a similarly explicitly stated waste reduction policy with a target of halving the amount of virgin plastic used in packaging, and increasing the recycled plastic material content in packaging to 25% by 2025. As with the introduction of Burberry's Econyl, Unilever believes that little public education is needed, and these measures are simply fulfilling consumers' wishes. (Indeed a 2018 joint survey by waste management firm Veolia and not-for-profit RECOUP backs this up, indicating that 93% of UK consumers believe that all plastic bottles should contain some recycled content - and that consumers are willing to pay an average of 2.5 pence more for recycled packaging). Unilever tells us that progress is slow, in no small part due to the dearth of recycling facilities, but ultimately the shift is underway and will continue. We are pleased to see that other companies in our portfolios are making similar efforts on this front: last year both Diageo and Heineken totally removed all plastic ring carriers and wrapping from beer multipacks, and Pepsico estimates that 89% of its worldwide packaging is already fully recyclable.

At Lindsell Train we often discuss Unilever's pivot from food brands to personal care in response to an increasingly digitally disrupted landscape in which commoditization of brands is accelerating: revenues from food have gone from 54% in 2008 to 38% today, whereas in the same period revenues from beauty and personal care have gone from 28% to 42%. This is the result of a strategy of active acquisitions and disposals, which has brought with it an enhanced understanding of the consumer desire for brand sustainability and social awareness. Eight of the last 15 beauty or personal care brands bought by Unilever have some kind of ethical, social or environmental "brand purpose", whether that is the cruelty-free and vegan luxury cosmetics brand Hourglass or eco-friendly laundry brands Seventh Generation and The Laundress. And across the wider brand portfolio, Unilever's introduction of the concept of "Sustainable Living Brands", i.e. those with an explicit purpose of effecting positive global change, seems to be bearing fruit. These 28 brands (including the seven largest by revenue - Dove, Knorr, Persil/Omo, Rexona, Lipton, Hellmann's and Wall's) delivered 75% of the company's overall revenue growth, and collectively grew 69% faster than the remainder of the brand portfolio. The combination of an irreplaceable brand plus the social and environmental awareness demanded by today's consumer is proving to be a powerful combination.

Truly durable brands - by definition - must change and adapt, always offering the consumer something new and challenging whilst maintaining an impeccable level of quality. Prada's 'Re-Nylon' initiative is, to us, the latest development in a tradition of creativity and innovation which also included the introduction of the wonderfully groundbreaking nylon collection back in the 1950s. A Burberry Econyl trench coat is a playful and modern nod to Thomas Burberry's invention of gabardine fabric and the original trench coat back in 1879. Shiseido's recycled plastic packaging pays homage to its original 1926 refillable bottle. And Unilever's recent acquisitions of eco-friendly laundry brands update its home care portfolio that began with William Lever's Sunlight Soap - itself introduced in 1884 as the first cut and packaged laundry product that offered labour saving benefits to the women who bought it. We view today's re-imagining of all these collections and products with an environmental and social focus as an expression of each company's keen sensitivity to consumer trends, married with creativity and rooted in heritage. True sustainability is brand sustainability, and these initiatives are, we think, a demonstration of the unquantifiable 'spark of innovation' that we believe makes a brand durable over time and very valuable indeed.

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