

WALTER SCOTT

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QUARTERLY COMMENTARY

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COMMENTARY

For an industry that works hard to project an image of health, glamour and wellbeing, fashion is in truth a rather dirty business. Estimated to be responsible for between four and ten percent of all global emissions annually, its impact on climate change is significant.¹ Resource waste, environmental degradation, biodiversity destruction, and supply chain labour abuses further undermine fashion’s aspirational messaging.

None of this is new news, of course. The downsides of the rapid growth in the global apparel industry, particularly fast fashion, have been common knowledge for some time. But there is now a growing sense that the current model is no longer sustainable. Regulation, rising consumer awareness, and pressure from within are forcing fashion to move beyond platitudes and soundbites towards a more fundamental reassessment of how it deals with its environmental and social responsibilities. A welcome development undoubtedly, but also one that has potentially meaningful long-term implications for investors.

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It was with this in mind that Alan Lander, co-Head of Research, travelled to Copenhagen for the 13th edition of the [Global Fashion Summit](#) – not, as the name might suggest, a showcase for the latest trends in *haute couture* but rather a two-day forum for the discussion of the industry’s most pressing sustainability challenges. Bringing together clothing brands, supply chain operators, NGOs, charities and a host of other stakeholders, the event was an opportunity for us to build further on our existing understanding of fashion’s sustainability landscape and how its evolution might not only impact the companies in which we invest today but how it could also shape the opportunities of tomorrow.

While fashion may have stepped up its sustainability efforts in recent years, to date these measures have had only limited impact – the current trajectory of carbon emissions is not aligned with the goals of the Paris agreement, with the gap likely to widen in the years ahead. Given its share of overall emissions, this failure would have material consequences for the success of the Paris agreement. It appears this reality is now hitting home, with speaker after speaker in Copenhagen acknowledging that the industry must act with far greater urgency. This chimes with our research in this area and with the conversations we’ve had with management teams; companies are increasingly focusing on the issue of sustainability and how they address their emissions footprint. As borne out by the data, however, the industry is still in the foothills of this journey. One speaker summed it up neatly when reflecting that the industry “has done a good job of getting to the start line but now the race (to reduce emissions) really starts”.

Collaborating to decarbonise

Given the industry’s current structure, however, doing so effectively and quickly will not be easy. The global apparel industry is a complex ecosystem, a sprawling patchwork of brands, manufacturers, suppliers, retailers, and consumers, with emissions occurring at every stage. More than 70% of these emissions come from upstream activities, such as energy-intensive raw material production, preparation, and processing. To date, this fragmented, highly competitive model, has been ill-suited to the task of overall emissions reduction. For decarbonisation to be successful, greater collaboration, between brands, competitors, and value chain stakeholders, is vital.

For some industry players, an increased focus on working together will mean having to unlearn some long-held competitive behaviours; “letting go of the ego” as one summit speaker

put it. For many brands, it will mean building more equal relationships with suppliers, exploring and incentivizing efforts to decarbonize upstream activities. But while the theme of the summit, “Alliances for a New Era”, suggests that the need for a more collaborative approach is increasingly recognised, we left Copenhagen unconvinced that it is happening at the scale required to make a material difference.

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That should not be taken as despair, however. If warm words can be transformed into concrete action, then real benefits should result. The Head of Sustainability at footwear pioneer and disruptor Allbirds outlined how just effective collaboration can be when done well. The world’s most carbon efficient running shoe, for example, the Adizero x Allbirds 2.94kg CO₂e, is the result of a ground-breaking collaboration between Allbirds and German footwear giant Adidas. Marrying the former’s expertise in sustainable materials with the latter’s proprietary technology, the 2.94kg went from conception to production in just 12 months thanks to the open and free exchange of knowledge and innovation. Describing it as a “call to action for other brands” Adidas believes the project’s success will “encourage others to rethink business as usual”.

Materials matter

Central to the Allbirds-Adidas joint venture was the use of more sustainable materials. Recycled polyester and rubber, natural lyocell and sugarcane-derived textiles delivered a shoe 63% less carbon intensive than the popular Adizero RC3² and more than four times less intensive than the average running shoe.³ Adidas is now applying these learnings in the development of other shoes, helping to accelerate the company’s decarbonisation strategy.

The ability of industry players to scale-up the use of sustainable materials and encourage designers to move away from traditional materials is central to fashion’s push to lower its carbon footprint. In a presentation given by senior representatives of Nike, it was identified as the area where the company can move the needle most on emissions. Some 80% of a Nike shoe’s lifetime emissions come from its materials, so smarter choices at the design stage will have a significant impact. Reflecting this, the company has set a target of 50% sustainable key material use by 2025.

Similarly, Inditex, the world’s largest fast fashion house, has committed to using only organic, recycled or more sustainable cotton by 2023, as well as sustainable and recycled linen and polyester by 2025. The company is also exploring other innovative solutions, having recently announced a commitment to purchase 30% of Finnish startup Infinited Fiber’s annual future production of its textile-waste derived Infinna fibre.

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While there is certainly more that Nike, Adidas and Inditex can do on materials, their progress so far gives cause for optimism. Brands of their size can bring much-needed scale to the drive to more sustainable materials, helping to lower costs relative to traditional alternatives in the process. The recently announced EU Strategy for Sustainable and Circular Textiles, the aims of which were outlined in Copenhagen by Frans Timmermans, the executive vice-president of the European Green Deal, will add further impetus to this trend.

Building on existing eco-design guidelines and voluntary schemes, the strategy will introduce binding product-specific requirements that will ensure that by 2030 all textile products in the EU will be longer-lasting and recyclable, easier to repair and reuse, free of hazardous substances and produced with respect towards social rights and the environment. Features of the legislation include Extended Producer Responsibility, making producers responsible for the waste created by their products, and Digital Product Passports offering information on the sustainability of garments.

From straight line to circle

Seen by some critics and supporters alike as a “declaration of war” on fast fashion, the EU’s strategy has so far received a positive welcome from many in the industry, who view it as a necessary corrective to ‘greenwashing’ and a facilitator of a more level playing field for those brands and suppliers already committed to sustainability. The strategy has its roots in the EU’s Circular Economy Action Plan, which aims to transition the bloc from a linear “take, make, waste” economic model to a more circular model that minimises waste, maximises resource efficiency and extends the life of textiles already in existence.

Circularity, a subject we considered as part of our recent research into the global energy transition, was a prominent theme of many discussions in Copenhagen, reflecting a growing appetite for more fundamental, systemic change rather than simply trying to decarbonise the existing industry structure. The Circular Fashion Partnership (CFP) offers an example of how this might work in practice.

A cross-sectoral project launched in late 2020, the CFP brought together brands, including Inditex, manufacturers, recyclers, and other stakeholders to facilitate a long-term, scalable transition to a circular system in Bangladesh, the world’s second largest garment exporter. As well as identifying significant scope for reducing carbon emissions and water use, the project found that recycling 100% of waste cotton could reduce Bangladesh’s virgin cotton imports by approximately 20%, saving the country US\$750 million annually. Learnings from the initiative have since informed a report from Global Fashion Agenda that outlines how the apparel industry can become 80% circular by 2030 with increased investment in existing recycling technologies and infrastructures.

Copenhagen conclusions

The two days of the Global Fashion Summit generated as many questions as it did answers. It’s clear that as an industry, fashion understands it must do more and do it more quickly. There is also a huge amount of genuinely innovative work going on to try and turn that understanding into action. For now, however, this isn’t happening at the scale required to alter the industry’s current emissions trajectory. For that to happen, more systemic change is needed. It’s encouraging that many of the global brands are recognising this and are starting to work more closely with stakeholders to effect that change, albeit in many cases in a still tentative manner.

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Voluntary change in the apparel industry has, however, proven something of a failure to date, meaning further regulation is now inevitable. The EU’s recent interventions and New York state’s proposed Fashion Act that aims to force brands to improve their sustainability disclosure are reshaping the regulatory landscape in which companies must operate. The best companies should already be ahead of the regulatory curve and working to ensure they remain so. As investors, we’ll be watching closely how this backdrop develops and analysing how it impacts the operating models of our investee companies in this area, while engaging regularly

with management and corporate sustainability teams. Learnings from the summit will inform our conversations with companies as we work with them to support their sustainability efforts, while also enabling us to better interrogate the efficacy and broader consequences of those efforts.

Walter Scott's aim has always been to invest in companies capable of generating wealth for our clients on a sustainable long-term basis. In today's fast evolving fashion industry, sustainability will play an increasingly important role in dictating just how sustainable a company's wealth-generating capabilities really are.

1. <https://www.worldbank.org/en/news/feature/2019/09/23/costo-moda-medio-ambiente>
2. <https://news.adidas.com/running/adidas-and-allbirds-scale-up-releasing-four-new-colorways-of-their-lowest-carbon-running-shoe/s/aa905f1c-d155-44ff-81e9-23bb5f0be43d>
3. <https://www.edie.net/adidas-and-allbirds-unveil-running-shoes-with-lowest-recorded-carbon-footprint/#:~:text=The%20average%20running%20shoe%20has,footprint%20of%20less%20than%203kg.>

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