Sustainable Leather Foundation's pathway to ESG: Impacts and Opportunities for the Leather Industry

Pathway Paper 2 V1.1

Issue Date: 20 March 2023

Sustainable Leather Foundation

Industry Led – Consumer Focused

Sustainable Leather Foundation's Pathway to ESG: Impacts & Opportunities for the Leather Industry

Contents

Introduction

In a world where we are inundated with acronyms and new terms, one of the most important to know and recognise for businesses moving forward is ESG. ESG stands for Environmental, Social, and Governance; the 3 pillars or aspects of a company that represent non-financial metrics and information[1,2].

ESG is an acronym that can be placed in front of many types of root words, such as report, department, or metrics. It is commonly used as an over-arching term to capture all the frameworks in which a company manages its non-financial risks and opportunities[1].

These metrics intend to provide a set of criteria which evaluate the strength of a company's policies and systems surrounding environmental, social and governance impacts[3]. ESG can also be substituted with words or phrases such as Sustainability and Corporate Social Responsibility. While each of these terms were intended for a unique purpose, it is common to find many companies and reporting frameworks utilising them interchangeably. Because of this variability in definition and application, it is critical that companies conduct preliminary research on the proposed ESG requirements or reporting.

The most common way ESG will appear in the leather industry is through the introduction of a framework or rating agency. Frameworks are documents which outline what to measure[4]. These will be similar to standards from the International Standards Organisation (ISO) that depict guidelines for a particular topic and scope. ESG frameworks do not have to outline a particular metric or quantitative benchmark that companies must abide by. The intent is to define a scope and provide a general target in which corporate systems and policies are reviewed and developed against.

It is important to note that many of these frameworks cover a very broad scope and are not specific to the leather industry. In fact, much of the ESG frameworks are built to stretch across multi-industry applications[2]. This provides an advantage where the guidelines are broad enough for each company to fit within, but conversely, can minimise the nuance required to explain an important aspect or metric of an industry not represented properly.

Rating agencies create scales to measure the effectiveness of an application of an ESG framework[4]. Scales can be made from the same originator of a framework or can be a separate scoring mechanism. The purpose of these scales at a global level is to rank corporations against their ESG robustness and commitment[5].

Most of the leather industry does not directly partake in the widespread ESG evaluations, as it targets the largest corporations, brands, and retailers. We in the leather industry are most commonly evaluated in ESG reporting as a function of a wider supply chain. Currently, universally recognised ESG frameworks and rating agencies do not exist for the leather industry. However, leather specific ESG audit standards and certifications do exist, such as SLF's. The existing audits and certifications within the leather industry have the advantage of being built specifically for our product, but typically focus on one area of ESG. This contrasts with the ESG frameworks that are comprehensive in nature, but lack the specificity required to accurately represent the leather industry. SLF's audit is the first in our industry that evaluates and audits ESG in its entirety without compromising the unique needs of the leather industry.

Links to the most acknowledged frameworks (as researched by SLF) are listed at the end of this article.

Evolution of ESG

ESG is not a new approach to the measurement of non-financial metrics[5]. We have seen this approach dating back to investment firms in the 19th century, and some can trace back the origin of sustainability to the German Forestry Department in the 18th century[5]. The concept of ESG is simply a holistic approach to evaluating a company. However, over time this has evolved into a complex (but necessary) evaluation tool[2].

In recent history, we can trace much of our present-day knowledge of ESG frameworks back to a few key milestones and events. There are many theories on which events, environmental disasters or technological advancements have led us to our current ESG state, but in general it can be interpreted that the combination of these three major forces have driven a large part of our ESG activity today[6].

Large environmental and social events such as Chernobyl in 1980, the Nike sweatshop labour scandal in 1996 and the 2020 COVID Pandemic, to name a few, have pinpointed critical failures in our corporate systems showcasing a need for stronger ESG investment and management[6]. As a response to these events, ESG indexes and standards were crafted and debated.

In the late 1980s, the most famously referenced introduction of the term "sustainability" was defined within the Brundtland Commission Report[7]. From this, the first ESG Index Fund was established in 1990, called the Domini Social Index (now MSCI LD 400 Social Index)[6] and in 2000 we see the creation of the Carbon Disclosure Project (CDP), which is linked to the Global Reporting Initiative (GRI), one of the most established ESG frameworks today.

These reports and indexes have developed over the last 20 years to a great extent. In 2010 there were over 50 agencies and rating scales, bubbling up to create a great divergence in scope and global targets[5]. To mediate this, global organisations developed focused frameworks such as the United Nations (UN) Principles for Responsible Investment (PRI) (2006), the Sustainability Accounting Standards Board (SASB), and the United Nations Sustainable Development Goals (SDGs) (2015)[6]. It is through these types of uniting standards that we were able to see global ESG coordination, understanding, and consistency evolve.

Leading the global ESG coordination is the European Commission's work with the development of the Corporate Sustainability Reporting Directive (CSRD). The CSRD's initial proposal was completed in April 2021, expanding the scope of non-financial metric reporting in the EU[8]. Organized through the European Financial Reporting Advisory Group (EFRAG), the CSRD is based on global frameworks such as the GRI, focusing on "double materiality", financial and outward (environmental and social) materiality[8]. In this context, materiality references an ESG issue that a company has an impact on or may be impacted by[9]. For example, water scarcity would generally be considered a material (environmental) issue for the leather industry as it largely relies on water to manufacture its product.

EFRAG published its first set of European Sustainability Reporting Standards in April 2022, outlining that ESG reporting for comparison, and auditing will be mandatory for applicable companies[8]. Approximately 50,000 companies will be affected in the EU, even some that are non-EU based[10]. By January 2023 it is anticipated that the first set of standards will be deployed, with formal reporting starting in 2024.

As auditing will be a requirement of the CSRD, we at SLF can support under this new directive, as independent auditors can assure sustainability accuracy within this directive[11]. SLF's Transparency Dashboard™ and digital framework is uniquely set up to support the new digital tag requirement that is within this directive. While the EU's CSRD is the first of its kind globally, we at SLF are keeping a close eye on legislation to support the growth of ESG reporting in all regions. To learn more about the specifics of the EU's CSRD timeline and which companies will be affected, please reference the links at the bottom of the article.

Outside of the creation of the frameworks and rating scales from governments and agencies themselves, we have also seen third-party institutions quantitatively evaluate the effectiveness of these newly created tools. The Aggregate Confusion Project, led by a team at the Massachusetts Institute of Technology Sloan School of Management focuses on the creation of "more rigorous and coherent methods for ESG integration", minimising the noise and confusion surrounding the existing methodologies[12].

Additionally, the World Economic Forum, led by global banking and investment leaders, has published a report focused on developing a common set of metrics for investors and stakeholders to define "sustainable value creation"[2]. We are now not only seeing the creation of tools, but the harmonisation of ideologies, metrics, and standards. This is a crucial part in ESG's evolution, and it is through this next phase that we will likely begin to see metrics that have concrete impact on the leather industry and our supply chain.

Key Performance Indicators

The critical components to ESG frameworks and rating scales are the Key Performance Indicators (KPIs). KPIs can be broken down into two main categories, general and sector-specific[13]. General KPIs are those that measure topical areas applicable to all industries[13]. An example would be "energy efficiency", as all industries require energy to do some level of business. Sector-specific KPIs apply to certain industries only[13]. A sector-specific example would be "quantity of hazardous waste".

While this differentiation of KPIs is relatively intuitive in nature, the application is where the complexity begins. For example, a KPI needs to be applied within a specific scope (raw hide to wet blue) and measured against a functional unit (e.g., 1 square metre of leather) for it to have context and provide value. For those familiar with life cycle analyses, this is the same ideology for measuring environmental impact within a specified facility and scope.

To learn more about ESG KPIs that are specifically built for the leather industry, reference SLF's Audit Standard Report. We outline specific metrics in environmental, social, and governance audit reports for facility improvement. SLF is working to build these KPIs specific to the entire supply chain, developing an understanding of ESG at a level that provides tangible, cost-effective solutions.

How to Effectively Manage ESG

ESG can be an overwhelming topic to address as it is so broad in scope and contains a multitude of new concepts, standards, and metrics. The simplest way to kick-off ESG measurement and engagement is to evaluate your current state. Establishing a committee or team with representatives from each department or a cross-functional liaison can help maintain focus and drive solutions.

Utilise this team and/or leader to outline the problem statement(s) affecting the business objectives and prioritise them with a resource versus impact analysis. This can be done with a basic pareto chart or bar graph. Following that, collect and identify the current state of corporate policy, standards, and corporate ethos. This is important because the company may contain ESG characteristics in its management principles and strategy. Look everywhere within your company to identify where ESG may affect you.

If ESG categories are new to your team, utilise SLF's Standard Audit Report and Standards & Benchmarks to help pinpoint important topics in each section. These can be compared against other industry-specific Standards.

Finally, a gap-analysis can be conducted between current state and the target problem(s) or drivers for ESG. Once these gaps are identified, corporations can work with organisations, such as SLF, to identify improvement activities to create a culture of continuous improvement. It is important to truly understand each of these activities with regards to the KPIs as well as metrics outlining financial performance. For example, if the team can improve workers' hours by removing wasted activity, the team should think about how to measure this in terms of workers' satisfaction, workers' safety, and financial savings. This links the ESG metric to the profitability of the company and thus provides continuous value for all.

Working Together as One Industry

Embracing ESG is not simply about continuous improvement, it is about engaging in a concept that bridges the gap across the entire leather industry. We all have a responsibility to ensure leather's future as a sustainable product and this begins with simple, consistent improvements on the factory floor, design studio, and R&D laboratory. If we as tanners, chemists, innovators, technologists and leaders can integrate ESG improvement into our product and design before it hits the floor, imagine the marketability, profitability, and longevity that will result.

Our consumer base is changing rapidly, but with embracing concepts such as ESG we can showcase how leather is linked to global aspirations and the UN SDGs such as responsible consumption, zero hunger, and reduced carbon emissions. We already have an excellent product; we now must embrace ESG at our core and design leather for a new sustainable future.

Link to acknowledged ESG frameworks:

Top 5 ESG Frameworks – by Measurabl

Link to European Financial Reporting Advisory Group:

CSRD Draft Sustainability Reporting Standards

Link to Deloitte Summary of EU CSRD*:

**Reference pgs. 3, 8 and 11 for summary tables*

EU Corporate Sustainability Reporting Directive

References

1. Deloitte. (2022) #1 What is ESG? ESG Explained – Article series exploring ESG from the very basics [online] https://www2.deloitte.com/hu/en/pages/energy-and-resources/articles/esg-explained-1-what-is-esg.html. Accessed 20 Jun. 2022.

2. *"Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation."* World Economic Forum in collaboration with Deloitte, EY, KPMG and PwC. White Paper, 2020, pp. 1-96. https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf. Accessed 20 Jun. 2022.

3. Gartner, Inc. (2022) Finance: Gartner Glossary [online] https://www.gartner.com/en/finance/glossary/environmental-social-and-governance-esg-. Accessed 20 Jun. 2022.

4. Atkins, Betsy. "Demystifying ESG: Its History & Current Status". *Forbes Magazine – Markets.* https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=71d7395b2cdd. Accessed 20 Jun. 2022.

5. Nagel, Sebastian, et al. "Between Efficiency and Resilience: The Classification of Companies According to Their Sustainability Performance." *Historical Social Research / Historische Sozialforschung*, vol. 42, no. 1 (159), 2017, pp. 189–210. *JSTOR*, http://www.jstor.org/stable/44176029. Accessed 20 Jun. 2022.

6. Dun & Bradstreet, Inc. (2022) The ESG Explainer: Why ESG Data Is Valuable for Supply Management [online]. Available from: https://www.dnb.co.uk/perspectives/supply-chain/esg-data-valuable-for-supply-management-procurement.html. Accessed 20 Jun. 2022.

7. Sheth, Jagdish N., and Atul Parvatiyar. *Sustainable Marketing: Market-Driving, Not Market-Driven.* Journal of Macromarketing, SAGE Publication, 2021. pp. 150-165. https://doi.org/10.1177/0276146720961836. Accessed 20 Jun. 2022.

8. Global Reporting Initiative. (2021) GRI backs mandatory EU reporting on sustainability impacts [online] https://www.globalreporting.org/news/news-center/gri-backs-mandatory-eu-reporting-on-sustainability-impacts/. Accessed 14 Jul. 2022.

9. New York University Stern School of Business – Center for Sustainable Business. (2019) Sustainability Materiality Matrices Explained. [online] https://www.stern.nyu.edu/sites/default/files/assets/documents/NYUSternCSBSustainabilityMateriality_2019_0.pdf. Accessed 13 Jul. 2022.

10. Deloitte. (2021) Corporate Sustainability Reporting Directive – The Future Landscape of Sustainability Reporting. [online] https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/sustainability/Corporate-Sustainability-Reporting-Directive.pdf. Accessed 18 Jul. 2022.

11. European Commission. (2022) Questions and Answers: Corporate Sustainability Reporting Directive Proposal. [online] https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1806. Accessed 18 Jul. 2022.

12. Massachusetts Institute of Technology Sloan School of Management. (2022) The Aggregate Confusion Project [online] https://mitsloan.mit.edu/sustainability-initiative/aggregate-confusion-project. Accessed 20 Jun. 2022.

13. European Federation of Financial Analysts Societies. *KPIs for ESG: A Guideline for Integration of ESG into Financial Analysis and Corporate Valuation. Version 1.2.* DVFA, 2009. pp. 1-70. file:///C:/Users/kthud/Downloads/kpis_for%20esg%20-%20european%20federation%20of%20financial%20analysts%20societies_5314%20(2).pdf. Accessed 20 Jun. 2022.

14. Ertl, Veronika, and Martin Schebesta. *Sustainability in Global Supply Chains: Arguments For and Against a Legal Obligation for Compliance with Human Rights and Environmental Standards*. Konrad Adenauer Stiftung, 2020. *JSTOR*, http://www.jstor.org/stable/resrep25299. Accessed 20 Jun. 2022.

15. Holmes, Ingrid, and Sam Maule. "RESPONSIBLE INVESTMENT: ADDRESSING SUSTAINABILITY CHALLENGES THROUGH FINANCIAL REFORM." *A SUSTAINABLE FINANCE PLAN FOR THE EUROPEAN UNION*, E3G, 2016, pp. 17–27. *JSTOR*, http://www.jstor.org/stable/resrep17700.8. Accessed 20 Jun. 2022.

16. Light, Sarah E., and Christina P. Skinner. "BANKS AND CLIMATE GOVERNANCE." *Columbia Law Review*, vol. 121, no. 6, 2021, pp. 1895–956. *JSTOR*, https://www.jstor.org/stable/27075597. Accessed 20 Jun. 2022.

17. Measurabl. (2022) The Top 5 Sustainability Reporting Frameworks You Should Know [online] https://www.measurabl.com/the-top-five-sustainability-reporting-frameworks-you-should-know/. Accessed 20 Jun. 2022.

18. Moliterni, Fabio. *Sustainable Investing and Green Finance: Boosting Markets by Solving Ambiguities*. Edited by Stefano Pareglio, Fondazione Eni Enrico Mattei (FEEM), 2018. *JSTOR*, http://www.jstor.org/stable/resrep16403. Accessed 20 Jun. 2022.

19. Ritz, Robert A. *Climate Targets, Executive Compensation, and Corporate Strategy*. Energy Policy Research Group, University of Cambridge, 2020. *JSTOR*, http://www.jstor.org/stable/resrep30320. Accessed 20 Jun. 2022.

20. United Nations. (2022) Department of Economic and Social Affairs: Sustainable Development [online] https://sdgs.un.org/goals. Accessed 20 Jun. 2022.

21. European Financial Advisory Group. (2022) Public Consultation on the first set of Draft ESRS. [online] https://www.efrag.org/lab3. Accessed 19 Jul. 2022.

Original Document:
Version 1.0 created 20 July 2022.
Version 1.1 revised 20 March 2023.

Authored by:
Katie Kutskill, Technical Director - Sustainable Leather Foundation

Peer Reviewed by:
Alexandra Pelka, ESG & SDG Consultant - AP Projects
Anne Lama, Senior Lecturer - The University of Northampton