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Yellow Light: ESG Investing, A Caution to Fast Fashion Brands

Ka’myia Gunn
Emory University School of Law, ka'myia.gunn@emory.edu

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YELLOW LIGHT: ESG INVESTING, A CAUTION TO FAST FASHION BRANDS

It is no secret that risk management is integral to investment decision-making. Since 2005, environmental, social, and governance ("ESG") factors have been recognized by the investor community as important determinants of a company's financial performance.[1] ESG encompasses a broad list of factors related to a company's business practices. Environmental factors examine the environmental effects of a company, including carbon emissions from production, water use, and waste.[2] Social factors assess the treatment of employees and suppliers and corporate community engagement, and governance concerns all things company management, from board diversity and structure to executive pay.[3] Over the years, ESG has grown to capture the attention of companies across varied sectors, consumers, state legislatures, and the U.S. Securities and Exchange Commission ("SEC"). Given the increased focus on ESG and sustainability, apparel and internet retail companies engaging in fast fashion ("fast fashion brands") will be forced to consider and change their impact on the environment—or risk going out of style.

The fashion industry consists of "textile and apparel brands, wholesalers, importers, and retailers."[4] Globally, the industry is "valued at nearly three *trillion* dollars," and "one in six people [work] a job directly or indirectly related to fashion."[5] These figures alone denote the industry's significant potential impact on social and environmental issues. Fast fashion refers to low-priced, trendy clothing inspired by high-end designers, runway styles, and celebrities,[6] and it serves as a shorthand for both the kind of clothing produced and production processes. Under the traditional model of production, companies would release collection launches every few months to the tune of the four

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1 Environmental, Social, and Governance (ESG): Overview, Lexis Practical Law Practice Note w-034-7942.

2 *Id.*

3 *Id.*

4 Carolyn B. Maloney, *The Economic Impact of the Fashion Industry*, (Feb. 2019), https://www.jec.senate.gov/public/_cache/files/39201d61-aec8-4458-80e8-2fe26ee8a31e/economic-impact-of-the-fashion-industry.pdf. (Carolyn Maloney is the Chairwoman of the House Committee on Oversight and Reform).

5 *Scaling ESG Solutions in Fashion*, Accenture, (2022), https://www.accenture.com/_acnmedia/PDF-176/Accenture-Retail-Scaling-ESG-Solution-2022-Edition-Full-Report.pdf#zoom=40.

6 *See What is Fast Fashion*, Investopedia (last updated Sept. 16, 2022), https://www.investopedia.com/terms/f/fast-fashion.asp.

seasons.[7] Today, fast fashion brands push out collections every few weeks.[8] Shein, a leading industry giant, "can supposedly produce a dress within a week—from design to packaging."[9] Other popular fast fashion brands include Zara, Boohoo, and H&M Group ("H&M").[10] The rapidity of production by virtue of technology, globalization, and social media has transformed the industry and birthed new challenges for stakeholders.[11]

Fashion is not as appealing under the lens of ESG, especially given the extreme costs to the environment and to society. The industry accounts for up to ten percent of annual global carbon emissions,[12] "more than all international flights and maritime shipping combined,"[13] and "[one] fifth of the three hundred million tons of plastic produced globally each year."[14] Other reports spotlight the industry's significant water consumption and "impact on stressed agricultural lands."[15] According to a 2019 World Bank Report, the number of garments made annually has doubled since 2000 to about 100 billion garments.[16]

Fast fashion is unmistakably associated with environmental harm and worker mistreatment. Many fast fashion companies have established production sites in developing countries to mitigate costs and legal risk,[17] giving rise to increased issues of unlivable wages, violence against women workers, and unrealistic

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7 *See* Shannon Whitehead Lohr, *5 Truths the Fast Fashion Industry Doesn't Want You to Know*, HuffPost (Oct. 19, 2014), https://www.huffpost.com/entry/5-truths-the-fast-fashion_b_5690575.

8 *See* Press Release, Public Eye, 75-hour weeks for Shein: Public Eye looks behind the Chinese online fashion giant's glitzy front, (Nov. 12, 2021) https://www.publiceye.ch/en/media-corner/press-releases/detail/75-hour-weeks-for-shein-public-eye-looks-behind-the-chinese-online-fashion-giants-glitzy-front.

9 *Id*.

10 *See* Alexander Davis, *ESG's Big Test: Fast Fashion, and a $100B Fashion Juggernaut*, Pitchbook (Apr. 14, 2022), https://pitchbook.com/news/articles/esg-investor-test-fast-fashion-100b-shein.

11 *See* Maloney, *supra* note 4, at 1.

12 *See* Jill Standish, *Can Fashion Finally Move the Needle on Sustainability*, Forbes (May 29, 2022), https://www.forbes.com/sites/jillstandish/2022/05/29/can-fashion-finally-move-the-needle-on-sustainability/?sh=3633fb036a80; *See also* Rachael Dottle & Jackie Gu, *The Global Glut of Clothing Is an Environmental Crisis*, Bloomberg (Feb. 23, 2022), https://www.bloomberg.com/graphics/2022-fashion-industry-environmental-impact/?leadSource=uverify%20wall.

13 *How Much do Our Wardrobes Cost to the Environment*, The World Bank (Sept. 23, 2019), https://www.worldbank.org/en/news/feature/2019/09/23/costo-moda-medio-ambiente.

14 Dottle & Gu, *supra* note 12.

15 Andrews Brooks, Clothing Poverty: The Hidden World of Fast Fashion and Second-Hand Clothes xii (2d ed. 2019).

16 *How Much do Our Wardrobes Cost to the Environment*, *supra* note 13.

17 Emma Ross, *Fast Fashion Getting Faster: A Look at The Unethical Labor Practices Sustained A Growing Industry*, GW Law International Law and Policy Brief (Oct. 28, 2021), https://studentbriefs.law.gwu.edu/ilpb/2021/10/28/fast-fashion-getting-faster-a-look-at-the-unethical-labor-practices-sustaining-a-growing-industry/.

workload requirements.[18] Factory and warehouse workers have reported working 12 hours a day[19] and even 24-hour shifts.[20] UK brand Boohoo faced heavy backlash in 2017 after audit reports and an investigation by the Guardian newspaper revealed that factory workers in one of its largest suppliers experienced poor working conditions.[21] The reporting of such incidents has led to greater oversight in the supply chain and more regulations focusing on worker health and safety.[22] Also concerning is the promotion of the throwaway consumer culture.[23] Consumers expect to wear fast fashion items only a handful of times, in part because of the lesser quality production standards, which help to explain increased textile waste.

In response to the call for socially responsible practices, many fast fashion brands have strived to improve their sustainability efforts. For example, "Zara committed that fifty percent of items it sells in 2022 will be made with recycled materials and ecologically grown cotton."[24] H&M partnered with the Better Cotton Initiative[25] and continues to launch Conscious Choice to promote the use of sustainable materials.[26] Other sustainability efforts include recycling programs, clothing repair services, and digital traceability, which permits brands to ensure compliance in the supply chain.[27] Despite good intentions, much of what is produced is either destroyed or ends up in a landfill.[28] In fact, "less than 1% of used clothing is recycled into new garments."[29]

This introduces a new problem: greenwashing. Greenwashing can mislead consumers into buying items that work against their hopes for increased sustainability.[30] Boohoo and H&M have faced major public scrutiny over claims

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[18] *See* Andrews Brooks, Clothing Poverty: The Hidden World of Fast Fashion and Second-Hand Clothes xii (2d ed. 2019).

[19] Public Eye, *supra* note 8.

[20] Archie Bland et al., *Boohoo Selling Clothes Made by Pakistani Workers 'Who Earned 29p An Hour'*, The Guardian (Dec. 22, 2020), https://www.theguardian.com/business/2020/dec/22/boohoo-selling-clothes-made-by-pakistani-workers-who-earned-29p-an-hour.

[21] *See id.*

[22] *See* Ross, *supra* note 17.

[23] Davis, *supra* note 10.

[24] Dottle & Gu, *supra* note 12.

[25] Bin Shin, Sustainable Fashion Supply Chain: Lessons from H&M, 6 Sustainability 6236, 6240 (2014).

[26] H&M, Our Commitment, https://www2.hm.com/en_us/sustainability-at-hm/our-products/explained.html (last visited Oct. 30, 2022).

[27] *How ESG Investors are Making Sustainable Fashion on Trend*, Morgan Stanley (May 25, 2022), https://www.morganstanley.com/ideas/sustainable-investing-fashion.

[28] Dottle & Gu, *supra* note 12.

[29] *How Much Do our Wardrobes Cost to the Environment*, *supra* note 13.

[30] *See* Jordan Hart, *Fast-fashion brands Boohoo and Pretty Little Thing Are Getting Slammed For Greenwashing After Critics Call Sustainability Claims Misleading*, Insider (Sept. 17, 2022),

of greenwashing,[31] and H&M was sued this year in federal court for allegedly engaging in greenwashing when selling a product from the Conscious Choice collection.[32] In June, Quartz publication explained that H&M's environmental scorecards, formally known as Higg Index Sustainability Profiles, minimized (and at times misrepresented) the environmental impact of reviewed clothing.[33] These findings highlight the downsides of sustainable marketing and further demonstrate that the industry's harmful effects outpace its corrective measures.

ESG priorities proposed for the fashion industry work to address the issues of resource depletion and waste, poor employee treatment, and suspicious corporate activity.[34] Vogue Business, in its Winter 2021 update, identified several areas of change such as greater emphasis on raw materials, renewable energy in the supply chain, and effective company-supplier relationships.[35] Specific ESG initiatives include reducing "greenhouse gas emissions within textile fiber and material production," "eliminat[ing] manufacturing restricted substances list chemicals," and "pursuing materials that are closed-loop recycled, deforestation free."[36] The biggest change, however, that fast fashion brands can make is to commit to less production.

Fast fashion companies have been slow to implement ESG for three reasons. First, it will require extraordinary efforts on the part of companies such as greater transparency of company action, dedicated funding sources for ESG priorities, and the elimination of well-established, but damaging business practices. Second, with no "overarching laws that regulate ESG," companies can operate in the shadows of the "existing patchwork of federal and state regulation."[37] Said another way, fast fashion companies must be *self-motivated*, to some extent, to address and implement sustainability-focused initiatives. Government actors are

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https://www.businessinsider.com/boohoo-pretty-little-thing-slammed-kourtney-kardashian-greenwashing-sustainability-2022-9#:~:text=The%20partnership%20was%20met%20with,really%20is%2C%22%20as%20defined%20by.

31 *See id.*

32 Alden Wicker, *H&M Is Being Sued for Greenwashing. What Does That Mean For Fashion?*, The Cut (Aug. 19, 2022), https://www.thecut.com/2022/08/h-and-m-greenwashing-fashion.html.

33 Amanda Shendruk, *Quartz Investigation: H&M Showed Bogus Environmental Scores for its Clothing*, Quartz (Jun. 29, 2022), https://qz.com/2180075/hm-showed-bogus-environmental-higg-index-scores-for-its-clothing.

34 Public Eye, *supra* note 8.

35 Rachel Cernansky, *Vogue Business Index: Fashion's top ESG priorities*, Vogue Business (Dec. 23, 2021), https://www.voguebusiness.com/sustainability/vogue-business-index-fashions-top-esg-priorities.

36 *Scaling ESG Solutions in Fashion*, Accenture (2022), https://www.accenture.com/_acnmedia/PDF-176/Accenture-Retail-Scaling-ESG-Solution-2022-Edition-Full-Report.pdf#zoom=40.

37 Environmental, Social, and Governance (ESG): Overview, LexisPractical Law Practice Note, *supra* note 1.

addressing investor-led demands for ESG compliance and reporting. The SEC created a task force to help "proactively identify ESG-related misconduct,"[38] and proposed a rule mandating disclosure by public companies of climate change effects.[39] Finally, and most importantly, fast fashion brands inherently rely on unsustainable practices to turn a profit. Consumer demand for cheap, fast products and goals of expansion prompt companies to continue linking profitability with volume production.[40]

Luckily, ESG has staying power. Global ESG assets are expected to reach over 50 trillion dollars by 2025—a significant jump from the near 20 trillion in 2016.[41] ESG investors evaluate a company's risk according to its ESG risk rating. Poor ESG performance is off-putting to investors because it signals future reputational risk, legal risk, and consumer and employee loss.[42] Socially conscious investors have avoided or divested from fast fashion brands given their relatively higher ESG risk ratings and impact on the environment and workers. For example, in 2020, fund manager Ketan Patel discussed ESG's impact on Boohoo Group PLC and "amid heightened investor concern [of worker exploitation], stock fell as much as 24 percent."[43] In this view, investors can enforce or reinforce good business practices by depriving bad actors of funding.[44] Some ESG investors continue to invest in moderate to high-risk companies, but with the intention of making internal improvements,[45] which has proven a difficult task.[46]

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[38] Press Release, U.S. Securities and Exchange Commission, SEC Announces Enforcement Task Force focused on Climate and ESG Issues (Mar. 4, 2021).

[39] Press Release, U.S. Securities and Exchange Commission, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2021).

[40] *See* Cernansky, *supra* note 35.

[41] ESG Assets May Hit $53 Trillion By 2025, a Third of Global AUM, Bloomberg Intelligence (Feb. 23, 2021), https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.

[42] *See* Environmental, Social, and Governance (ESG): Overview, Lexis Practical Law Practice Note, *supra* note 1.

[43] Bloomberg Markets and Finance, *Boohoo Sparks Fast Fashion Ethics Question for ESG Funds*, https://www.youtube.com/watch?v=CKuOCoWUPZM.

[44] *See* Davis, *supra* note 10.

[45] *Pitchbook Analyst Note: ESG, Impact, and Greenwashing in PE and VC*, Pitchbook (Feb. 14, 2022), https://pitchbook.com/news/reports/q1-2022-pitchbook-analyst-note-esg-impact-and-greenwashing-in-pe-and-vc (complete fillable form to download report).

[46] See *id.*

Moreover, Shein recently reported a $100 billion dollar valuation[47] and is projected to "do an initial public offering (IPO) as soon as 2024."[48] According to a 2022 Bloomberg report, ESG concerns could frustrate Shein's IPO efforts.[49] Shein is not reflective of investor-led demand for ESG because its largest investors – Sequoia Capital China, IDG Capital, and Tiger Global Management – are not "dissuaded" by these concerns.[50] However, that could change with the tide of future investors. Shein has implemented ESG-related measures. In 2022, it established a climate fund and Shein Exchange, a resale platform, and released an ESG report.[51] This signals the growing influence of ESG on the fast fashion industry.

In sum, fast fashion brands must approach their business practices with a firm understanding of their environmental and social impact. Even more, they must be willing to take risks to remedy ill effects and prevent new or further harm. ESG investing and related measures may help to curtail unsound business practices, but it will take seriously, coordinated efforts among investors, companies, consumers, and governmental players to improve the fast fashion industry.

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47 Davis, *supra* note 10.

48 Jack Stebbins, *Chinese Fast-Fashion Company Shein seeks U.S. IPO as soon as 2024*, CNBC (Jul. 14, 2022), https://www.cnbc.com/2022/07/14/chinese-fast-fashion-company-shein-seeks-us-ipo-as-soon-as-2024-report.html.

49 *See id.*

50 *See id.*

51 Maliha Shoaib, *Shein's New Resale Programme Won't Make It Any More Sustainable*, Vogue Business (Oct. 18, 2022), https://www.voguebusiness.com/sustainability/sheins-new-resale-programme-wont-make-it-any-more-sustainable.