Global Counsel

Boohoo’s troubles: ESG cannot be ignored

Blog post by Political Due Diligence Associate Michaela Smart, 05 October 2020

Worker exploitation and poor labour conditions have long been a major problem for the fashion supply chain. Advocates have been campaigning for better conditions for years, but the Boohoo scandal in its UK factories this summer was a salutary reminder that this is not a problem confined to emerging economies.

Boohoo’s very public troubles have highlighted the clear risk to investors of poor ESG performance by corporates – even when they are operating manufacturing ‘at home’. In the days following a damning coverage of the company’s supply chain abuses, Boohoo’s share price fell significantly and one of its largest shareholders, Standard Life Aberdeen, divested the majority of its stake. While an independent report has absolved Boohoo of criminality, the company has clearly violated good social and corporate governance standards.

Before the covid-19 outbreak, rising interest in ESG was already defining the direction of travel for corporate governance and redefining the field of corporate social responsibility. The pandemic has accelerated this trend revealing vulnerabilities in societies, economies, and supply chains.

Many companies have responded by recommitting to environmental and social goals, forcing them to consider the corporate governance architecture required to achieve them. Many investors are clearly re-evaluating and strengthening their commitment to ESG principles in the context of increasing scrutiny of their societal role. This is likely to accelerate what is already a growing trend of investors holding portfolio firms more accountable for any negative impact on a growing list of ESG areas.

Cynics might point out that the Boohoo crisis has not dented sales. But that is probably short sighted. Boohoo’s reputational damage with investors and capital markets may be harder to measure and its credit with local political stakeholders will have taken a huge hit. These are not negligible impacts. Boohoo has emphasised the S and the G in ESG.

Whatever might be true for Boohoo, what does seem fairly clear is that ESG funds have, on the whole, performed better than their conventional counterparts over the last decade. ESG funds been able to largely avoid the fallout from the sharp drops in oil prices – as a result of their low exposure and on average ESG funds have fallen just 12% this year, approximately half of the average percentage decline in the S&P 500 Index.

Private equity managers need to be ready to develop their own response to this evolution. Not least because they own many of the retail companies – like Boohoo – that dominate both high streets and their online counterparts. Consumer discretionary deals worth over $680 bn have been done in Europe and North America since 2010, around 20% of PE deals in the past decade. And PE’s influence in retail will grow as rescue packages for household name companies in distress emerge – with deals already done this year including SCP Private Equity’s buyout of TM Lewin, TowerBrook’s

restructuring deal for the Azzurri Group and a consortium of investors' plan to restructure US clothing brand J Crew.

There is both risk and opportunity here. The risk lies in having a company like Boohoo somewhere in a portfolio. The opportunity comes from the influence of investors: LPs and GPs alike can drive change in corporate practices. Blackrock's campaign on climate is one clear example of where the alternative asset industry can be a force for positive change. The firm announced that they had taken shareholder action against 53 companies - including Chevron, ExxonMobil and Volvo - that they claim have failed to respond quickly enough to the demands of investors on climate change.

Although many investors have existing ESG commitments, it is clear that private equity has a long way to go to deepen and develop practices and processes with enough rigour to assess the full range of ESG issues. Setting clearer investment criteria, introducing action plans for portfolio assets, working with experts and challenging management teams that are failing to meet expectations are all fundamental to getting this right.