



SARASIN

The quest for authenticity – Can luxury brands justify a premium price?

Sustainability report
of the luxury goods industry

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The lure of luxury

Do you sometimes like to treat yourself or your family to something special? People have always been attracted by nice things. Moreover, the desire to mark one's social status through the choice of consumer goods can play a major role in purchasing decisions. In fact, emotional factors are remarkably important for many of our consumer decisions, both large and small.

The fact that emotions have such a big influence on our buying decisions is part of the human condition: the phenomenon exists in nearly all and societies. You can see it everywhere: in Hanoi or Hamburg, Munich or Moscow, London or Lagos. Admittedly, given the differences in purchasing power and culture, consumers in those cities spend their money on different consumer goods. Nevertheless, the mechanism behind the purchasing decisions remains the same – from mobile phones, to fashion goods, to cars. Consumers are willing to pay more for particular goods if those items make them feel a certain “something”. For manufacturers of consumer and luxury goods, this emotional attraction is the most important factor in terms of brand loyalty and pricing. Because virtually the same rules apply all over the world, the demographic and economic growth of emerging-market countries, and also the demographic shifts taking place in the western economies, create enormous new growth opportunities for manufacturers of consumer and luxury goods. This is where experience pays off. Companies that have been selling products with a “premium character” for many years understand the whole process: from sourcing, through production, to marketing and distribution. That is why these long-established, successful companies offer investors such a great opportunity to benefit from the big changes resulting from the new world order. As the oriental economies grow and prosper, luxury goods flow steadily from west to east.

But in an ever more interconnected and densely populated world, society, politicians and consumers become less and less tolerant of companies that use doubtful, or potentially doubtful, methods of sourcing, production and sales. The newly emerging world order obliges us, more than ever, to subject the sustainability of corporate busi-

ness models to a critical analysis. A thorough sustainability analysis is needed to ensure that investments in the highly promising sector of luxury goods will also deliver sustainable investment success. This report is intended to help achieve that goal.

I hope you find this study informative.

Best wishes



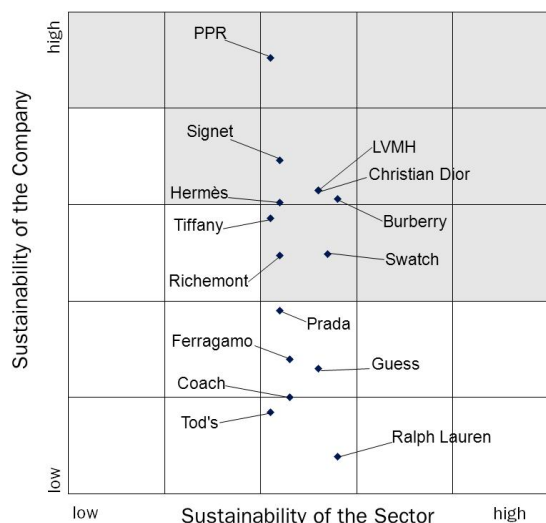
Burkhard P. Varnholt, Chief Investment Officer

Sustainable luxury goods companies

With increasing production capacity and “brand-stretching”, the image of luxury brands is shifting away from the artisan tradition. Increasing reputation risks are the consequence, be it through the loss of exclusivity or negative publicity about environmental and social deficits in the manufacturing of raw materials. Brand reputation is key to the business of luxury goods companies, and hence corporate awareness of sustainability issues is important for protecting brand values. Among luxury brand companies, however, transparency about sustainability lags far behind apparel manufacturers and retailers, for example. Nevertheless, there are a number of luxury goods companies which are eligible for Sarasin’s sustainability funds. All have a sustainable supply chain management system. But the focus of their activities is still on the reduction of reputation risks rather than on the opportunities created by an attractive, sustainable brand image.

The luxury goods sector is very diversified and ranged from luxury cars, yachts, real estate, hotels, tourism, and furniture through to fine gastronomy. This report focuses on 15 leading luxury goods companies in the following industries: leather goods and footwear; watches, jewelry and accessories; clothing; cosmetics and fragrances; fine beverages; and specialist retailers (see Appendix).

Fig. 1: Sustainability ratings of luxury goods companies



Source: Sarasin

Greater awareness of the contents behind the brand names

Luxury goods companies live from the reputation of their brands. Luxury brands are well-known and highly valued names which stand for exclusivity and high quality. In recent decades, however, the luxury goods industry has grown and the business model has shifted towards higher

production volumes with “industrialisation” and subcontracting of manufacturing. Companies have also expanded their product ranges by adding different accessories to their traditional product lines (so-called brand-stretching). As a consequence, the well-known luxury goods brands are gradually losing exclusivity and authenticity. For example, the “Made In” label is in danger of losing its quality image as more and more product components are manufactured in low-cost countries as part of the trend towards volume production. In other words, the actual contents of the brands (in terms of origin and manufacturing of products) are diverging from the brand image.

This divergence, coupled with the loss of exclusivity and authenticity, put the reputation of the brands at risk. Volume growth and brand-stretching are driving luxury brands in the direction of “democratised” products, reducing their attractiveness in terms of exclusivity. With the Internet, social media, and consumer protection organisations, consumers are much better informed about products, including controversial issues in design and manufacturing. Apart from quality tests, this increasingly concerns environmental and social standards in supply chains, especially in the production of raw materials. Consumers do also generally care more about the environmental and social aspects of the products they purchase. Negative publicity about local river contamination from textile and leather factories, poor labour conditions at suppliers’ factories, or “blood diamonds” can damage brand images. Responsible business practices not only enable companies to avoid reputation risks, but also present opportunities by creating attractive “responsible brand” images. It is therefore crucial to integrate sustainability into the quality management system in supply chains.

Results of the sustainability rating

However, many luxury companies are not transparent when it comes to disclosing information on their production and supply chains. That could indicate their lack of awareness of the risks for the reputation of their brands as regards the environmental and social issues in supply chains (see Appendix). The sustainability initiatives of luxury companies are mainly aimed at averting reputation risks, such as avoiding scandals or attacks by NGOs. Only a few companies seek associated opportunities by actively marketing high sustainability standards as part of a “clean” and desirable brand image.

Leading sustainable companies

The three companies with the highest sustainability ratings are PPR (“high”), and LVMH and Burberry (“above average”). The French retailer and luxury goods distributor PPR is the most sustainable company in Sarasin’s sustainable investment universe. PPR owns multi-luxury brands (see Appendix), including Gucci (26% of total revenue), and Puma (25%). PPR is one of the few in the peer group that has a commitment to the development of environmentally friendly products group-wide. The PPR Group’s Code of Business Practice (the Code) covers guidelines for raw material sourcing (leather, exotic skins, fur, diamonds and gold), as well as basic human rights and labour conditions. Sustainability issues are part of the performance measurement of top management, which is rare in the peer group. Under the Code, each brand has its own guidelines addressing specific environmental and social issues associated with their business activities. The flagship brand Gucci (leather goods products) has a supply chain management system based on Social Accountability International’s SA8000 standard. Environmental and social criteria are integrated into the supplier selection. Regular environmental and social audits are conducted at least twice a year at the factories of its direct leather suppliers. The sports goods brand Puma has one of the most advanced environmental and social supply chain management systems of all the apparel and textile manufacturers.

LVMH was the first major luxury goods company to communicate its commitment to the environment. LVMH Environmental Department was created in 1992. LVMH is the most transparent in the peer group. Each brand discloses where and how products are made. LVMH strategically maintains in-house production in the country of origin of the brands (France, Italy, Spain, Switzerland), and secures sources of key raw materials. In 2009, the flagship

brand Louis Vuitton established a joint venture leather tannery that exclusively supplies the brand with hides and leathers tanned with vegetable products (free from heavy metals).

The British clothing company Burberry is one of the few major luxury goods companies to seek collaboration with multi-stakeholders by joining specific groups such as Ethical Trading Initiatives (requiring payment of living wages for suppliers and subcontractors) and the Leather Working Group (developing an assessment tool to evaluate environmental performance of leather tannery operations). The majority of Burberry products are manufactured in the EU member states and Turkey. For example, its iconic trench coats are manufactured in the UK factory, cashmere products in Scotland and jeans in Turkey. A traceability project for raw materials (fur, cotton, leather) was launched in 2010 to promote high ethical standards of animal welfare and labour conditions. Burberry has a list of banned substances and requires suppliers to comply with a range of environmental legislation (EU Directive) and certifications (Oeko-Tex Standard 100, EU Eco label for Footwear and Textiles).

Reputation risks translate into financial risks

Due to the importance of the brand image for the business of luxury goods companies, reputation risks - such as the loss of exclusivity, and NGO criticism against environmental and social deficiencies in the supply chains of the products - ultimately affect the valuation of the companies. This means that awareness and proactive management of sustainability helps to protect brand value at the same time as protecting shareholder value for investors.

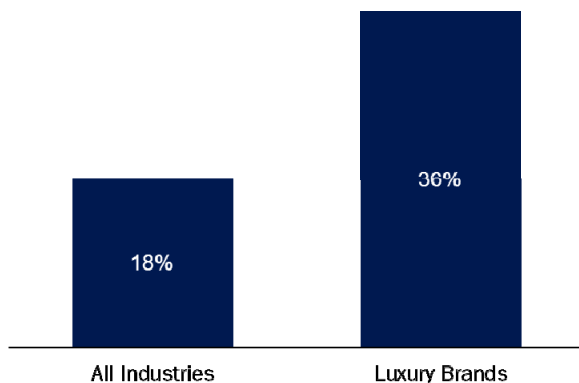
Reputation risks through commoditisation

A brand logo has a major influence on luxury consumers' purchasing decisions. Recently brand reputation is becoming more and more vulnerable, since the gap between the authentic image of luxury brands and their manufacturing reality is widening. Over the last decades, many luxury goods companies have increased production volumes and implemented "brand stretching", while attempting to keep their image of craftsmanship and exclusivity.

Brand value: Key business driver

Brand value is the key driver for the business and the valuation of luxury goods companies. According to the market research firm Interbrand, brand values contributed more than double to the value of luxury goods companies (36%) compared with the average of the top 100 brands (18%) in the last five years (see Fig. 2).

Fig. 2: Average contribution of brand values to market capitalisation¹



Source: Interbrand, Datastream

Luxury brand logos are the symbol of wealth and social status. The more convincing the brand, the more a premium price can be justified to consumers. The brand logo is so powerful that, for example, a diamond engagement ring designed by Cartier (owned by Richemont) could charge up to a 40% premium over an unbranded ring with a stone of identical size and quality.²

The origin of the logo is a seal which was stamped by professional guilds to certify the quality of products made by a member craftsman of the guild in ancient times. Af-

ter the Industrial Revolution, however, products became mass-produced on assembly lines and could no longer be traced back to a single craftsman. It was trademarks and logos that companies started using to guarantee consistent quality. Since the 1950s, trademarks and logos have been actively used as marketing and advertising tools, and then evolved into brand symbols. The emergence of the luxury goods market in Japan in the mid-1970s backed by the culture of homogeneity established the mass luxury brand market. During the last luxury boom period, leading luxury goods companies succeeded in establishing well-known brand logos standing for luxury. People are willing to pay a significant premium for the trust they have in brand, rather than purely for the product itself. Today logos brand people. The logo has become a tool for declaring a certain group we belong to and shares the specific message and ethics of the brand.

Trend: towards mass production and brand stretching

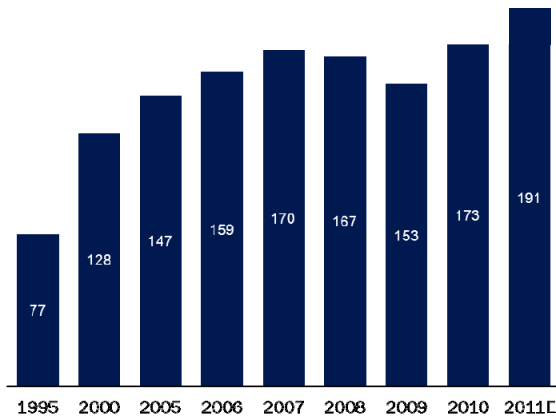
Due to industry trends, brand reputation is becoming more and more vulnerable. The market for luxury consumer goods has grown comparatively fast (see Fig. 3). This is the result of increasing wealth in both industrialised and emerging countries. Newly industrialised economies like China have grown especially, as a result of the emerging middle classes. As a consequence, production has had to keep up with demand and the manufacturing of luxury goods items has shifted from artisanal methods to industrialised production. This has also included subcontracting of raw materials and product components.

This trend is also accompanied by a concentration in the industry. Since the 1990s, companies like LVMH and Richemont have grown by acquiring family-owned luxury boutiques. Today, LVMH owns a large number of luxury brands (see Appendix). A similar story applies to other luxury conglomerates like Richemont and PPR Group.

¹ Average brand values over last five years (2007-2011); luxury brands include: Cartier; Gucci; Hermès; Louis Vuitton; and Tiffany & Co.

² Bain & Co. "The global diamond industry". 2011.

Fig. 3: Global luxury goods market (bn EUR)



Source: Bain & Co., Fondazione Altagamma, Sarasin

Another industry trend is brand stretching. Luxury companies have grown by expanding the product ranges of their brands and adding different product ranges to their traditional product lines. For example, Louis Vuitton Malletier was founded in 1854. The legendary brand "Louis Vuitton" was established around travelling items, notably trunks. Since 1998, the brand has started offering a full range of products such as clothing, shoes and accessories to international luxury consumers. Watches were added in 2002, jewellery in 2004 and an eyewear collection in 2005. To serve the middle-class luxury markets, luxury goods companies have also started offering "affordable" luxury logo-covered products by stretching their brand product lines to lower-priced items such as scarves, perfumes and handbags.

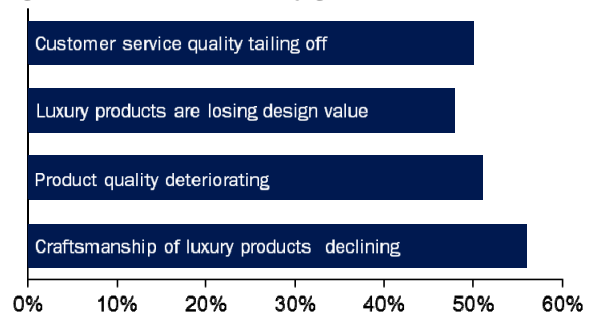
Risks to brand reputation through commoditisation

Changing production models (mass production, subcontracting) and brand stretching enable luxury goods companies to grow their business. However, as a consequence, luxury goods items are no longer exclusively hand-made by artisans, but become identical commodities. Brand stretching can offer more choices for consumers to purchase brand logo-covered products. At the same time, however, luxury brands lose their identity, which used to be valid for just a handful of products. "The country of origin" is still one of the key elements for the purchasing decisions of luxury goods consumers. Especially in the world's largest luxury market Japan, "Made in Italy" and "Made in France" labels are closely associated with admiration for different cultural legacies along with the image of aesthetic design and high quality. Due to the outsourcing of production, manufacturing now

takes place in a number of different countries. Even if products carry the "made in" label, many components may be produced in low-cost countries. There are no stringent "country of origin" rules for luxury goods products under the EU and other international laws, except for "Swiss made" watches. None of the major luxury goods companies have a public policy for defining the "country of origin" for their own products. As a consequence of these trends, many luxury products have become premium commodities. This means that a gap between the brand image and its content (in terms of the actual manufacturing of the products) is widening.

Luxury goods consumers pay significant premiums for the authentic value of luxury goods: high quality (based on craftsmanship), scarcity (made of rare materials), exclusivity (limited by number or distribution) and aesthetic design. With easy access to information via the Internet, social networking sites, as well as independent ratings such as the Luxury Brand Status Index published by the Luxury Institute, consumers are well informed to judge which brand product is worth paying a premium for. The market power once wielded by the luxury goods companies has reverted to consumers as they become increasingly aware of the gap between brand image and intrinsic value. As a consequence, the reputation of the brands, the key business driver for the luxury goods industry, is in danger. The relevance of this risk is confirmed by recent surveys showing that many consumers are no longer satisfied with luxury brands (see Fig. 4).

Fig. 4: Satisfaction of luxury goods consumers



Source: Luxury Institute

Reputation risks in globalised supply chains

With higher production volumes and greater consumer awareness of the environmental and social impacts of products, the conditions under which luxury products and their raw materials are manufactured are becoming critical, similar to the situation in the apparel industry. The challenge for luxury brands is to establish sustainable supply chain management systems, especially to ensure the traceability of materials used in their products. Various initiatives by individual companies along with joint industry initiatives have been started in an attempt to reduce reputation risks by avoiding negative publicity such as “blood diamonds”, “dirty gold” or child labour.

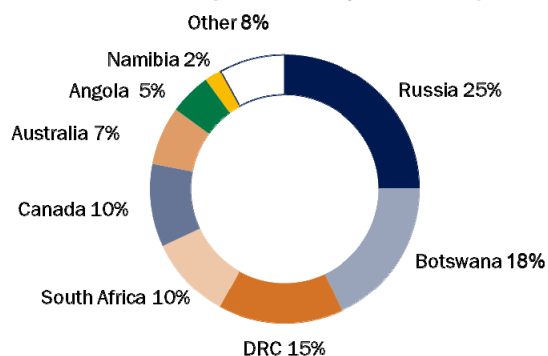
Brand reputation risk associated with environmental and social impacts in supply chains

Another aspect of the actual content behind the brand logo is the conditions under which luxury products, especially their raw materials, are produced. Consumers are not only getting concerned about the loss of authenticity and exclusivity, but also increasing their awareness of environmental and social standards in supply chains located in low-cost countries. In this respect the challenges the luxury goods industry is facing are getting similar to other fashion and sports goods companies which have experienced frequent NGO campaigns targeting child labour, human rights violations or industrial pollution. The relevant challenges for luxury goods companies are mainly linked to their raw materials.

Gemstones and precious metals: the image is getting dirty

Gemstones and precious metals are used by the luxury goods companies for jewellery, watches and other accessories. Natural diamonds satisfy luxury consumers' aspirations through their authentic, symbolic and status value. “A diamond is forever” is one of the most well-known slogans, first created in 1947 by De Beers. De Beers controlled the rough diamond trade in the 20th century. It was so successful that the share of brides receiving diamond engagement rings grew from 10% in 1939 to 80% by the end of the twentieth century in the U.S., the world's largest jewellery market.³ Contrary to their shiny appearance, their mining operations cause a range of environmental and social problems. Diamonds are sourced from developing and emerging countries. Russia and African countries account for 70% of the world's diamond production (see Fig. 5).

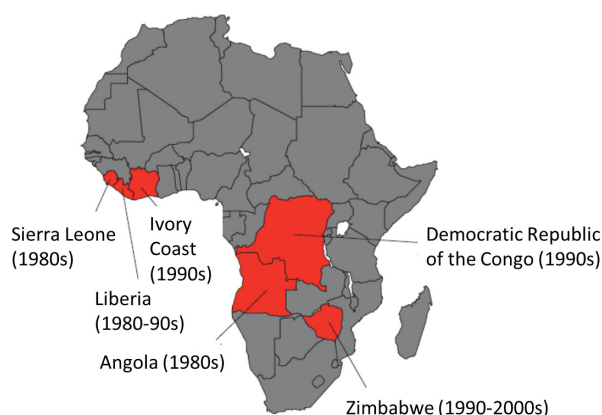
Fig. 5: World diamond production by countries (volume)



Source: Bain & Co.

In the 1990s the aspirational image of diamonds was threatened by the media coverage of “conflict” or “blood” diamonds which are used to finance civil wars in Africa (see Fig. 6). Luxury consumers indirectly finance violent conflicts and human rights abuses happening far from home.

Fig. 6: Countries of conflict diamonds



Source: Bain & Co.

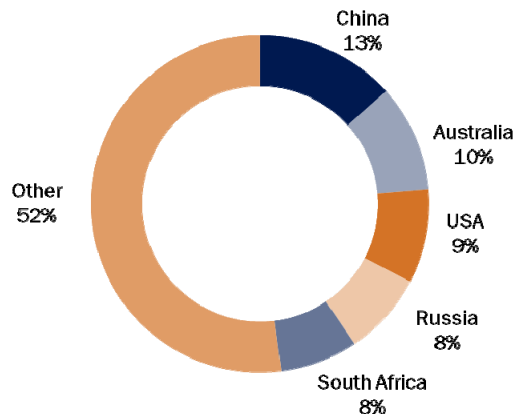
In 2003, the Kimberley Process Certification Scheme (KPCS) entered into force aiming to end the trade in

³ Bain & Co. “The global diamond industry”. 2011.

rough diamonds which funds civil wars and criminals. KPCS prohibits participants from trading with non-participants. Today the KPCS member countries represent 99.8% of the global production of rough diamonds. However, it is estimated that there are still 4% of rough diamonds traded in the world that by-pass the KPCS.⁴

Gold is another key material for jewellery. Major producers of gold are China, Australia and the U.S. (see Fig. 7). Like diamonds, part of the gold originates from African conflict regions. Therefore, gold is classified as one of the four “conflict minerals” defined by the “Dodd Frank Act” in the U.S. that requires companies to disclose the sources of the minerals they use from the conflict regions in the Democratic Republic of Congo or adjoining territories.⁵

Fig. 7: World gold production by countries (volume)



Source: National Environment Research Council

There are other concerns associated with gold mining operations that can cause financial risks such as compensation claims, security of supply, and legal fines, apart from reputation risks. The destruction of the natural landscape, together with the relocation of local communities and poor working conditions (health and safety, excessive working hours, child and forced labour, etc.) are rife in some mining operations. The "No Dirty Gold" campaign launched in 2004 by Earthworks and Oxfam America has criticised environmental problems in gold mining operations. Highly toxic substances such as cyanide and mercury have polluted water, harmed the health of work-

ers, local communities, and their farmland. Open-mining of gold generates more waste per unit extracted than any other metal.⁶ The production of one gold ring generates 20 tons of waste.

Fig. 8: Major environmental and social concerns associated with gemstones and precious metals

Materials	Major Concerns
Diamonds	financing civil wars and crimes; poor labour conditions
Gold	use of toxic substances; water use; water contamination; hazardous waste generation; health risks for workers and local communities; financing civil wars and crimes
Platinum	water use ; waste generation
Silver	water contamination; use of toxic substances; health risks for workers and local communities

Source: No Dirty Gold, Sarasin

The leading jewellery brand Tiffany can trace back the origin of over 80% of diamonds used in the brand's products to individual mines, through a subsidiary that vertically integrates the supply chain from mining, processing, and refining to the final supply of finished diamonds. A “Social Accountability Program” is implemented in the diamond supply chain that covers issues such as fair wages, health and safety, and training programs for workers. Another jewellery brand Cartier (owned by Richemont) is helping to establish higher environmental and social standards at the Eurocantera gold mine in Honduras. The mine does not use hazardous chemicals such as cyanide or mercury, mining waste is fully recycled and reforestation programs have been initiated. Although the portion of gold supplied from the mine is presumably very limited, this case shows the effectiveness of purchasing commitments to promote more responsible operations. However, these approaches require purchasing power that most other jewellery brands do not have, so multilateral collaboration is important.

The Responsible Jewellery Council (RJC) was established in 2005 aiming to end "conflict minerals", as well as environmental and social problems in the whole jewellery supply chain (diamonds, gold and platinum). RJC mem-

⁴ http://www.diamondfacts.org/index.php?option=com_content&view=article&id=128&Itemid=134&lang=en
⁵ The U.S. Government Printing Office. 2010. “Dodd-Frank Wall Street Reform and Consumer Protection Act”.

⁶ The Economist. “The Price of glitz: all that glitters is not green”. 27 July 2009.

bers represent USD 45 billion in annual sales of the entire jewellery supply chain. It is compulsory for the members to be certified within the first two years of their membership by RJC-accredited auditors for compliance with the RJC Code of Practice. A voluntary Chain-of-Custody Standard (CoC) for refiners was launched in March 2012 to enhance the traceability of gold and other precious metals. The CoC certification supports the “OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas” as well as the US “Dodd-Frank Act” by guaranteeing CoC gold is “conflict-free”, wherever the country of origin.⁷ In November 2011, a collaboration with the Alliance for Responsible Mining (ARM) was established to improve environmental and social practices in mining operations by promoting dialogue between large mining corporations and artisanal and small-scale mining (ASM) communities. ARM focuses on ASM and encourages the phasing out of mercury from mining operations. In 2010 ARM established a collaboration with the Fairtrade Labeling Organisation International (FLO), and the first Fairtrade-certified gold was launched in 2011.

Compared to diamonds and gold, the traceability of other gemstones is surprisingly low, indicating a lack of awareness of the associated reputation risks among luxury goods companies. Some gemstones have controversial origins. For example, 90% of rubies are sourced from Burma and 60% of emeralds from Columbia,⁸ the former being ranked as the 3rd and the latter as 26th in the “2011 Oppressive Regime List” by the “Ethical Consumer”.

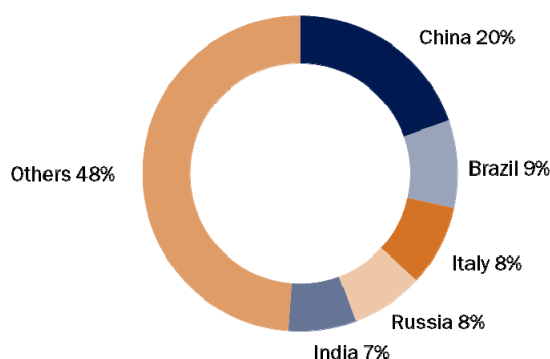
Leather

Leather is used by the luxury goods companies mainly for shoes, leather goods (luggage, bags, and belts, etc.) and accessories (organisers, watch bands, etc.). Cow hide is the most common leather source, accounting for two-thirds of world leather production. The major leather producers are located in developing countries (see Fig. 9).

In leather tanning hazardous chemicals are often used. Commonly used substances such as chromium (for tanning) and azo dyes (for dyeing) are listed by the EU REACH (Registration, Evaluation, Authorisation and Restriction of

Chemicals) system as restricted substances. Chromium leather tanning also involves intensive use of water. 700 litres of water are required per ton of tanned skin,⁹ resulting also in considerable amounts of wastewater. In some countries, environmental regulation is weak and wastewater discharges caused by poor effluent treatment contaminate water sources (rivers and groundwater). What's more, residual quantities of hazardous substances in the final leather products may cause health risks through direct contact with the skin.

Fig. 9: World light leather production (volume)



Source: FAO

Some companies have started initiatives for environmentally friendly leather. In 2009 the Louis Vuitton brand (owned by LVMH) established a joint venture with its leather supplier Tannerie Masure to secure sourcing of hides and leather tanned with vegetal extracts rather than chemicals. The Gucci brand (owned by PPR) has fully integrated environmental assessments in the leather material selection process. Nearly all Hermès leather goods are made free from solvent-based adhesives by replacing them with water-based. The industry initiative Leather Working Group (LWG) has developed an assessment tool to evaluate the environmental performance of tannery operations (e.g. energy efficiency, waste recycling). Since its establishment in 2005, over 10% of the global leather production has been verified by LWG-accredited auditors. LWG tannery members can voluntarily disclose their auditing results based on the LWG scoring system for environmental performance (gold, silver and bronze). In 2010 hide traceability was integrated into the LWG environmental stewardship audit process in response to criticism by Greenpeace¹⁰ and other environmental NGOs against leather sourced from cattle farming that contributes to

⁷ The Responsible Jewellery Council and London Bullion Market Association. “Do you know where your gold comes from? – getting to know your gold refiner”. The Baselworld, 18 March 2012.

⁸ Cheuvreux. „Luxury goods: sustainability sector profile“. March 2012.

⁹ Ibid.

¹⁰ Greenpeace. “Slaughtering the Amazon”. 2009.

the deforestation of Amazon forest. However, LWG requirements are not comprehensive. The standard does not require compulsory auditing of tanners, or chrome-free leather tanning processes. Until today, none of the luxury brands has published public targets for sourcing exclusively from leather tanners with the highest LWG score.

The traceability of exotic skin is another challenge for luxury goods brands. Trade of endangered species is banned or restricted by the CITES (Convention on International Trade in Endangered Species of Wild Fauna and Flora). In 2011, the Louis Vuitton brand acquired the Singapore-based exotic leather tannery Heng Long International (specialising in crocodile skin) to enhance the traceability and secure sourcing of exotic skin from compliant sources.

Cotton

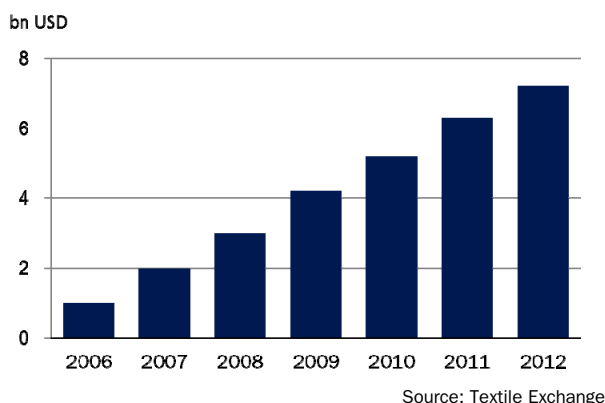
Cotton is one of the major raw materials for textile and clothing. Cotton farming, which mostly takes place in emerging countries like China, India, Pakistan and Brazil, has been criticised by NGO campaigns for child labour and poor labour conditions. Cotton farming also requires large amounts of water and hazardous substances (pesticides, insecticides and fungicides), some of which are banned in the EU member states. It not only causes environmental damage, but also health risks for farmers and consumers. Further down the textile supply chain, the manufacturing of clothes causes environmental pollution (e.g. water pollution from dyeing mills), health risks by using hazardous substances, and has been criticized for poor labour standards over many years now. The recent Greenpeace “Dirty Laundry” report highlighted inadequate control of wastewater discharges in the supply chain. Burberry is one of the few luxury brands that discloses a list of banned substances and requires suppliers to comply with a range of environmental legislation (EU Directives) and certifications (Oeko-Tex Standard 100, EU Eco

label for Footwear and Textiles). Some brands have introduced organic cotton items. However, none of the major luxury goods companies have a specific strategy for developing organic cotton products.

Companies have started to tackle reputation risks

Environmental and social issues related to the production of raw materials and the supply chain contrast with the aspirational image of luxury brands. This divergence is another cause of reputation risks. The different initiatives mentioned show that leading luxury goods companies have started to work on improving environmental and social standards. However, most activities are focused more on avoiding scandals and negative publicity. Sustainability has not yet been recognised as an opportunity which derives from the fact that consumers increasingly demand “ethical” products with a guarantee of high environmental and social standards in supply chains. Markets for these products are increasing fast (see Fig. 10).

Fig. 10: Global retail sales of organic cotton products



Sustainability helps to protect brand values

In order to protect and enhance the value of their brands, leading luxury goods companies have started to improve the traceability of their raw materials and supply chains as a strategy for avoiding the reputation risks related to environmental and social problems. Few companies have developed the traditional artisanal manufacturing model, thus avoiding risks related to volume production from the beginning. Strategies to enhance brand images by adding sustainability features have barely been implemented, but they may enable luxury goods companies to benefit from the opportunities resulting from consumers' increasing demand for “ethical” products.

As the brand value is key to their business, luxury goods companies are more exposed to reputation risk than any other industries. Recent changes in the business models are widening the gap between the authentic brand images and their contents. Consideration of the different environmental and social aspects in business strategies and operational management can enable luxury companies to create “more content behind the brands” and thereby improve brand reputation. There are three main strategies for this.

Reducing reputation risks

The first strategy is merely “reactive”, aiming mainly at avoiding reputation risks associated with poor environmental and social standards in supply chains by introducing standards and controls for suppliers in general and raw materials in particular. As mentioned in the previous chapter, this is the most commonly applied strategy of leading luxury brands up to now.

Back to artisanal roots

A second strategy is to “return to its ancestral roots”. Wealthy luxury goods consumers seek to differentiate themselves from the “nouveau-riche” luxury consumers. Some leading “high-end” luxury brands are enhancing cultural heritage and exclusivity by offering expensive hand-crafted items made of rare materials in small editions. For example, Cartier (owned by Richemont) recently introduced a watch that features a horse’s face made from a mosaic of semi-precious stones priced at EUR 90,000 (Wall Street Journal, 18 March 2012). Other luxury goods companies have increased production capacity by multiplying traditional artisanal manufacturing. Hermès has consistently manufactured around 75% of all production volumes in house between 2002 and 2010. This proportion is considerably higher if one takes into account the

fact that revenue has nearly doubled in that period. In 2010, 43% of employees were production workers, the highest proportion among the major luxury goods companies. This strategy not only enhances the brand image but also helps to avoid supply chain risks associated with manufacturing in low-cost countries.

Adding sustainability to the brand image

The third and most proactive sustainability strategy is to build an authentic brand image associated with sustainability features. Only few companies have implemented this strategy. Luxury brands need creativity beyond the inherited authentic image. Authentic luxury items in the 21st century will be made in a sustainable way, along with aesthetic design and high quality based on craftsmanship. Today consumers are more aware of the environmental and social impacts related to the products they purchase than before, and demand for “ethical” products is increasing. The idea of taking care of the environment and society also appeals to the ethical sub-conscious, a sort of ethical obligation of being rich, successful or famous. For example, the “(Oscar) Green Carpet Challenge” was launched in 2009 by Livia Firth, eco-fashion campaigner and wife of actor Colin Firth. The word “upcycling” coined by Livia means articles not only made with recycled materials but high-end garments fashioned from ethical materials that do not compromise on desirability.¹¹ A sustainable luxury brand is becoming a hard-to-resist tool to support their statement. It is sustainable luxury that today’s luxury consumers are looking for.

¹¹ Financial Times. “On the green carpet”. 24 February 2012.

List of large luxury goods companies

Company	Divisions (% of sales)	Sales (€ bn)	Workforce	Brands
Burberry	Leather goods, footwear and accessories 40%, clothing 60%	1.7	6,700	Burberry Prorsum (design inspiration), Burberry London (ready-to-wear), Burberry Brit and Burberry Sport (casual wear)
Christian Dior	Fashion and leather goods 27%, services retailing 37%, wines and spirits 6%, perfumes and cosmetics 18%, watches and jewellery 7%, Christian Dior Couture 4%, others 1%	24.6	101'200	Christian Dior, brands of LVMH (see below)
Coach	Handbags 63%, accessories 27%, others 10%	2.9	15,000	Coach
Ferragamo ^{a)}	Footwear 41%, leather goods 31%, clothing 12%, accessories 9%, fragrances 6%, and others 2%	0.8	2,800	Salvatore Ferragamo, Emanuel Ungaro
Guess?	Clothing, watches, leather apparel, handbags, fragrance, jewellery, and others	1.8	15,000	GUESS?, GUESS, Triangle Design, Marciano, Question Mark, etc
Hermès ^{a)}	Leather Goods 50%, ready-to-wear and accessories 19%, silk & textiles 12%, perfumes 6%, watches 5%, others 8%	2.4	8,400	Hermès, Les Christalleries de Saint-Louis, Puiforcat (tableware); John Lobb Bootmaker (leather shoes); Shang Xia (Hermès Chinese brand).
LVMH	Fashion and leather 37%, selective retailing 27%, wines and spirits 15%, perfumes and cosmetics 13%, watches and jewellery 8%	23.7	97,600	1. Fashion and leather goods: Louis Vuitton; Fendi; and others (Donna Karan, Marc Jacobs, Céline, Kenzo, Givenchy, Thomas Pink, Pucci, Berluti). 2. Selective retailing: DFS; Miami Cruiseline; Sephora; Le Bon Marché. 3. Wines and spirits: Champagne and wines (Moët & Chandon, Dom Pérignon, Ruinart, Mercier, Veuve Clicquot, Krug, Estates & Wine, Chateau d'Yquem); Cognac and spirits (Hennessy, Glenmorangie, Ardbeg, Velvedere, Wanjun). 4. Perfumes and cosmetics: Perfumes Christian Dior; Guerlain; and others (Parfums Givenchy, Parfums Kenzo, Fendi, Parfums Emilio Pucci, Benefit, Make Up For Ever, Fresh, Parfums Loewe, Acqua di Parma). 5. Watches and jewelry: TAG Heuer; Hublot; Zenith; other brands (Chaumet, De Beers, Fred).
PPR	Leather Goods 20%, home electronics 18%, footwear 17%, clothing 13%, watches and jewellery 2%, and others	12.2	38,400	1. Luxury goods: Gucci; Bottega Veneta; YSL; Alexander McQueen; Balenciaga; Boucheron; Sergio Rossi; Sowind (Girard-Perregaux, JeanRichard); Stella McCartney. 2. Fnac, and 3. Sport & lifestyle (Puma, Volcom).
Prada	Leather Goods 50%, footwear 25%, ready-to-wear 24%, others 1%	2.1	7,900	Prada, Miu Miu (leather goods, ready-to-wear and footwear); Church's, Car Shoe (leather footwear).
Ralph Lauren	Clothing, accessories, footwear, fragrances, and home furnishings	4.0	24,000	Ralph Lauren, Polo, Lauren
Richemont	Jewellery 50%, watches 26%, writing instruments 10%, others 14%	6.9	21,400	1. Jewellery: Cartier; Van Cleef & Arpels. 2. Special watchmakers: IWC; Jaeger-LeCoultre; Piaget; Vacheron Constantin; Officine Panerai; Baume & Mercier; A. Lange & Söhne; Roger Dubuis; Ralph Lauren Watches. 3. Writing instruments: Montblanc. 4. Others: Alfred Dunhill; Chloé; Lancel; Shanghai Tang; Azzedine Alaïa (leather goods, clothing); Purdey (sports gun manufacturer); online luxury retailer Net-A-Porter.com
Signet ^{b)}	Diamonds jewellery, gold and silver jewellery, watches	2.8	16,600	Kay Jewelers, Jared The Galleria Of Jewelry, 16 regional brands (for the US market); H.Samuel, Ernest Jones, Leslie Davis, Forever Diamonds; Perfect Partner (for the UK market).
Swatch	Watches and Jewellery 88%, production 7%, electronics systems 5%	5.9	28,000	Swatch, Omega, Brequet, Blancpain, Glashütte, Jaquet Droz, Tiffany & Co. (watches), Léon Hatot, Longines, Rado, Tissot, Calvin Klein (watches), Balmain, Certina, Mido, Hamilton, Flik Flak, Endura, Tourbillon
Tiffany ^{a)}	Silver and gold jewellery 35%, engagement jewellery and wedding bands 30%, fine jewellery, 17%, designer jewellery 17%	2.3	9,200	Tiffany & Co.
Tod's	Footwear 72%, leather goods 13%, and clothing 1%, and others 1%	0.9	3,500	Tod's, Hogan, Fay, Roger Vivier

a) Financial year 2010

b) Financial year 2012

Source: Company data

Sustainability criteria

Criteria	Weighting	Key indicators
Environmental criteria:		
Strategy and management	8%	Strength in phasing out critical substances in the product life cycle
Pre-production	16%	- Sourcing and traceability - Environmental performance in the supply chain
Production	8%	Environmental performance in own production processes
Products and services	8%	Strength in phasing out & replacing critical substances in products
Social criteria:		
Strategy and management	12%	Social & ethical management
General public	9%	Exposure to oppressive regimes & controversial business activities
Investors	3%	Corporate Governance
Suppliers	18%	Quality of labour conditions and human rights in the supply chain
Employees	6%	- Occupational health & safety - Training and development
Customers	9%	Misleading and unfair marketing
Competitors	3%	Violation of antitrust laws

Source: Bank Sarasin

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