



**Accounting for a
Sustainable Future™**

HOUSEHOLD & PERSONAL PRODUCTS

Research Brief

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HOUSEHOLD & PERSONAL PRODUCTS

Research Brief

SASB's Industry Brief provides evidence for the disclosure topics in the Household & Personal Products industry. The brief opens with a summary of the industry, including relevant legislative and regulatory trends and sustainability risks and opportunities. Following this, evidence for each disclosure topic (in the categories of Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance) is presented. SASB's Industry Brief can be used to understand the data underlying SASB Sustainability Accounting Standards. For accounting metrics and disclosure guidance, please see SASB's Sustainability Accounting Standards. For information about the legal basis for SASB and SASB's standards development process, please see the Conceptual Framework.

SASB identifies the minimum set of disclosure topics likely to constitute material information for companies within a given industry. However, the final determination of materiality is the onus of the company.

Related Documents

- [Household & Personal Products Sustainability Accounting Standards](#)
- [Industry Working Group Participants](#)
- [SASB Conceptual Framework](#)

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SUSTAINABILITY DISCLOSURE TOPICS

ENVIRONMENT

- Water Management

BUSINESS MODEL AND INNOVATION

- Packaging Lifecycle Management
- Product Environmental, Health, and Safety Performance

LEADERSHIP AND GOVERNANCE

- Environmental & Social Impacts of Palm Oil Supply Chain

INTRODUCTION

Most companies in the Household & Personal Products industry sell consumer staples—goods that consumers use daily, typically or around the house. The industry is highly competitive and consumer facing, with brand reputation making up a significant part of companies' value. A growing number of consumers are pushing for greater transparency and stricter standards regarding the social and environmental impact of many of the industry's products. Companies also have to plan for future shifts in water pricing and availability, as water is vital to many of the industry's products. Because this is a highly consumer-facing industry, household and personal products companies face a significant amount of scrutiny and reputational pressure to deal publicly with these issues.

Traditionally, product formulations and supply chain management have been self-regulated in this industry, with relatively loose federal or state oversight. For many products, the causal health and environmental effects of different chemical inputs are difficult to isolate and

understand. This creates regulatory uncertainty and market risks as the health and environmental impacts of household and personal products become more apparent. In this context, management (or mismanagement) of material sustainability issues has the potential to affect company valuation through impacts on profits, assets, liabilities, and cost of capital.

Investors will obtain a more holistic and comparable view of performance if companies in the Household & Personal Products industry report metrics on the material sustainability risks and opportunities that could affect value in the near and long term in their regulatory filings. This would include both positive and negative externalities and the non-financial forms of capital that the industry relies upon for value creation. Specifically, performance on the following sustainability issues will drive competitiveness within the Household & Personal Products industry:

- Minimizing the risk associated with water scarcity;
- Reducing packaging waste and implementing cost-effective product recycling strategies;
- Mitigating the environmental, health, and safety impacts of products; and
- Managing brand equity through responsible sourcing of materials.

INDUSTRY SUMMARY

The Household & Personal Products industry is comprised of companies that manufacture a wide range of goods for personal and commercial consumption, including cosmetics, household and industrial cleaning supplies,

soaps and detergents, sanitary paper products, household batteries, razors, and kitchen utensils.¹

Household and personal products companies operate globally, serving both international and domestic customers. Companies in this industry typically sell their products to mass merchants, grocery stores, membership club stores, drug stores, high-frequency stores, distributors, and e-commerce retailers.¹ Some companies, notably Avon Products, sells products through independent representatives rather than third-party retail establishments.² Other companies have used this direct distribution method to gain access to logistically hard-to-reach customers in emerging markets.³ The fastest-growing segment of the industry in 2014 was e-commerce, with 18 percent year-on-year revenue growth.⁴ In 2014, the total revenue from household and personal products companies listed on global exchanges and traded over-the-counter was approximately \$522 billion for the fiscal years reported as of May 26, 2015.⁵ Companies in this industry compete against each other with their branded products, as well as against retailers' private label products.⁶ Competition is high and based on product quality, innovation, advertising, brand recognition, brand loyalty, and retail price.⁷

Domestically, the two largest sub-segments of the industry, soap and cleaning compound manufacturing and cosmetics manufacturing, grew between 3 and 3.5 percent annually between 2010 and 2014 and are expected to continue growing at the same rate over the next five years.⁸ International expansion is

greatly important to the industry, and the largest growth is coming from the Asia Pacific market, which now represents 28 percent of the global market.⁹ Between 2004 and 2013, the beauty and personal care segment grew 40 percent while the home care segment grew by 34.5 percent.¹⁰

In the U.S., the soap and cleaning compound sub-segment has a medium level of market concentration. Procter & Gamble (P&G) has the largest market share in the soap and cosmetics segments, capturing 19 percent of both product categories. P&G is followed by L'Oreal and SC Johnson & Sons, which have a 12 percent and 9 percent domestic market share, respectively.¹¹ In the U.S. cosmetics industry there is a low level of industry concentration, with the top three companies, P&G, L'Oreal, and Estée Lauder, capturing 11.9 percent, 10.3 percent, and 7.5 percent of revenue, respectively.¹²

The purchase of raw materials accounts for a substantial portion of costs in this industry.¹³ Fluctuations in the prices of critical inputs such as cellulose fiber and industrial chemicals are a major factor in industry profitability, and recently, these prices have been trending upward.¹⁴ This has led to vertical integration. For example, manufacturers of soaps and cleaning compounds are buying some of the chemical companies they source from.¹⁵ The price of oil is also a key factor, as it is used as an input in manufacturing, packaging, and distribution, which are all major expenses for companies in the industry.¹⁶

¹ Industry composition is based on the mapping of the Sustainable Industry Classification System (SICS™) to the

Bloomberg Industry Classification System (BICS). A list of representative companies appears in Appendix I.

Barriers to entry are generally high for companies in the industry as input costs are a substantial portion of revenue. With economies of scale, well-established companies can operate with much lower marginal costs. New entrants find opportunities in smaller niche markets for specialized, high-profit-margin products that are generally aimed at consumers with higher levels of disposable income.¹⁷

The Household & Personal Products industry is global. Manufacturing operations are located all over the world, with cheaper products generally being manufactured in developing markets like China and India due to low labor costs, while premium products tend to be manufactured in more developed countries such as France or Italy. The U.S. is also a major producer of household and personal products.¹⁸

In 2014, the median net income margin for U.S.-listed companies was 7.5 percent.¹⁹ The industry is moving toward “premiumization”—a strategy to market products with the highest possible profit margins—as low population growth in the U.S. and other developed markets is limiting the market size for non-discretionary, non-premium goods. This trend has been growing in tandem with rising per capita disposable income after the recession.²⁰ A low level of population growth in developed countries is also a major factor in expansion into the Asia Pacific market.

Household and personal products companies often depend on very large retailers to market their products. For example, P&G, the largest U.S.-listed company, earned 14 percent of its revenue in 2014 from sales to Walmart.²¹ Other major customers of P&G include Walgreens Co., Target Corp, Costco Wholesale, and

Amazon.com.²² This relationship gives large retailers great bargaining power, and often the ability to influence the pricing and characteristics of products.

In developing economies, high-frequency stores, when considered in aggregate, account for a major portion of sales of household and personal products. These stores are generally independent and community-based and sell limited merchandise. To compete in these markets, companies create lower-cost single- or limited-use versions of their products and negotiate for critical product placement on crowded shelves of sales kiosks. While these products often cost only a fraction of a dollar, they can be sold for much higher margins than a more traditional product size, especially by large companies that benefit from economies of scale. Companies seeking growth in emerging markets have been competing fiercely to gain loyalty from this consumer base.²³

Household and personal products companies are increasingly offering eco-friendly products in response to rising consumer demand. The marketing of cosmetics as “organic” has grown substantially, although the U.S. Food and Drug Administration (FDA) currently has no definition for this labeling.²⁴ There is also a general movement toward more sustainable packaging, which is expected to raise companies’ revenue as consumer demand for sustainable products continues to rise.²⁵

As the worldwide Muslim population grows, halal personal products are becoming a large market. These products are formulated to follow Islamic law (e.g., by excluding certain unapproved animal ingredients) and are projected to grow by a compound annual

growth rate (CAGR) of about 11 percent between 2013-2018, making this an attractive market to companies seeking to grow their customer base.²⁶

Company valuation in this industry is typically based on year-over-year sales growth, EBITDAⁱⁱ margin, and price-earnings (P/E) ratio. Current and potential new customer growth rate is also a key valuation factor. As a significant portion of growth in this market is coming from markets outside the U.S., a company's currency exposure is also an important consideration.²⁷

As many products in this industry are difficult to differentiate, branding and reputation are very important. Companies in this industry generally list high value for intangible assets, and analysts can model differing levels of appreciation or depreciation of this value based on newly public information about a company or its products.

LEGISLATIVE AND REGULATORY TRENDS IN THE HOUSEHOLD & PERSONAL PRODUCTS INDUSTRY

Regulation in the U.S. and abroad represent the formal boundaries of companies' operations, and are often designed to address the social and environmental externalities that businesses can create. Beyond formal regulation, industry practices and self-regulatory efforts act as quasi-regulation and also form part of the social contract between business and society. This section provides a brief summary of key regulations and legislative efforts related to this industry, focusing on social and environmental

factors. It also describes industry self-regulatory efforts, which often serve to pre-empt further regulation.ⁱⁱⁱ

The Household & Personal Products industry is subject to multiple regulatory standards related to health impacts, marketing, and labeling. These regulations are often implemented at the federal level in the U.S., but both state and local governments intervene if an issue is perceived to be a threat to public safety.

At the federal level, the cosmetics industry is subject to the 1938 Federal Food, Drug, and Cosmetics Act (FD&C) and the 1967 Fair Packaging and Labeling Act (FP&L). The latter requires the clear labeling of the ingredients in any cosmetic product, although there are some exceptions made to protect certain trade secrets.²⁸ Currently, the FDA only approves color additives in cosmetics products themselves, but no other components.²⁹ While testing of these other inputs is not required, the FDA strongly recommends self-imposed safety tests.³⁰

The regulation of cosmetics has changed little since the FD&C was introduced nearly eight decades ago.³¹ The FD&C currently only grants the FDA the power to attempt to ban a chemical after it is on the market. Of the roughly 85,000 industrial chemicals available for use, the FDA has banned only eight and placed restrictions on the use of three.³² However, responding to consumer demands companies will sometimes reformulate products without regulatory pressure.

ⁱⁱ Earnings before interest, taxes, depreciation, and amortization.

ⁱⁱⁱ This section does not purport to contain a comprehensive review of all regulations related to this industry, but is

intended to highlight some ways in which regulatory trends are impacting the industry.

However, in 2013, a new, stricter regulation was proposed to grant the FDA a greater authority to create new chemical testing processes, reduce barriers to banning chemicals, and order product recalls.³³ In March 2014, negotiations about this law between the FDA and industry groups—the Personal Care Products Council and the Independent Cosmetics Manufacturers and Distributors—fell apart, and the FDA expressed “profound disappointment”³⁴ with the industry’s counter-proposal. While this specific piece of legislation is not likely to be enacted,³⁵ it is evidence of growing scrutiny of this industry. If similar regulation eventually passed, it would result in large additional costs to the industry.

There is precedent for this level of regulation. The E.U. Cosmetics Directive and REACH (Registration, Evaluation, Authorization and Restriction of Chemicals) legislation have banned more than 1,000 chemicals and require the registration of each chemical in a product prior to its placement on the market if the annual amount exported into the E.U. exceeds one metric ton.³⁶ In July 2013, the E.U. further strengthened its cosmetics regulations, requiring the disclosure of all products and the raw materials in each in a public database. In order to be eligible for sale, chemicals must also pass safety tests.³⁷ Most major U.S. household and personal products companies derive a substantial portion of their revenue from sales in the E.U. and therefore are subject to more stringent chemical regulations in those segments of their operations, which sets a benchmark for advocates for stricter policy in the U.S.

If cosmetic or personal care products claim a specific medical benefit, they are regulated like drugs and held to higher regulatory standards.

The manufacturer has to demonstrate product safety and efficacy to the FDA, which has the power to regulate how a company can advertise the product.³⁸

Specific laws at the state level can also affect industry profitability. The California Safe Cosmetics Act of 2005 requires that companies report to the state the use of all cosmetic ingredients “known or suspected to cause cancer, birth defects, or damage to the reproductive system.”³⁹ In 2014, California created an online public database that lists products that contain any of these harmful chemicals, as designated by the state. Companies are required to add their products to this database if they sell their products in California and make more than one million dollars in annual aggregate sales.⁴⁰ As California is the eighth largest economy in the world,⁴¹ many companies in this industry are highly impacted by this regulation. This increased transparency could put companies that continue to use potentially dangerous chemicals at a risk of losing market share to companies that have found safer alternatives.

The FDA also oversees most soaps and detergents. Synthetic soaps, which constitute the majority of the market,⁴² are governed as cosmetics. If a product is solely labeled as a soap (i.e., the bulk of the nonvolatile matter in the product consists of an alkali salt of fatty acid) then it is instead lightly regulated by the Consumer Product Safety Commission.⁴³

In the U.S., extended producer responsibility (EPR) laws are mostly handled on the local or state level. These laws move some of the responsibility for recycling a good to the producer of the good rather than consumers and governmental agencies. Currently, these

laws are significantly more common in the E.U.⁴⁴ and Canada,⁴⁵ but there have been increasing calls for strengthening of this type legislation in the U.S.⁴⁶ If passed, these laws could have widespread impacts on cost in the Household & Personal Products industry.

The production of palm oil, a relatively cheap vegetable oil used in a myriad of cosmetic and personal care items, has come under scrutiny as it is linked to massive amounts of deforestation, greenhouse gas (GHG) emissions, and serious health issues.⁴⁷ The potential for regulation in the rapidly growing industry prompted the 2004 founding of the Roundtable on Sustainable Palm Oil (RSPO). This industry-led initiative worked in partnership with the non-governmental organization (NGO) the World Wildlife Foundation (WWF) to come up with sustainable standards for palm oil sourcing.⁴⁸ While the initiative was instrumental in establishing sustainable palm oil certification, it has come under criticism for not having created strict enough measures against deforestation and the destruction of peat lands.⁴⁹ In 2012, the RSPO was publicly challenged by a coalition of more than 200 scientists to increase the strictness of its standards, specifically on GHGs.⁵⁰ Palm oil regulation is discussed in greater detail in the Environmental & Social Impacts of Palm Oil Supply Chain section later in this brief.

SUSTAINABILITY-RELATED RISKS AND OPPORTUNITIES

Industry drivers and recent regulations suggest that traditional value drivers will continue to impact financial performance. However, intangible assets such as social, human, and environmental capitals, company leadership

and governance, and the company's ability to innovate to address these issues are likely to increasingly contribute to financial and business value.

Broad industry trends and characteristics are driving the importance of sustainability performance in the Household & Personal Products industry:

- **Regulatory uncertainty:** Companies in this industry face risk from potential bans of key product ingredients. While these bans are relatively rare, they can create significant costs for the industry. Self-regulatory measures can help companies either avoid regulation or be first to market following a ban, helping them gain market share.
- **Consumer trends:** This is a consumer-facing industry, and increasing consumer awareness of hazardous and/or environmentally damaging materials and company practices, as well as a growing desire for more eco-friendly products, means companies can gain a financial advantage by being able to respond quickly and efficiently to these interests and demands.
- **Increased packaging and distribution efficiency:** Many companies in this industry have invested in measures to decrease the cost and environmental burden of packaging materials, in tandem with more efficient distribution methods, in an effort to drive down marginal cost as well as gain market share, as mentioned above.

As described above, the regulatory and legislative environment surrounding the

Household & Personal Products industry emphasizes the importance of sustainability management and performance. Specifically, recent trends suggest a regulatory emphasis on customer protection, which will serve to align the interests of society with those of investors.

The following section provides a brief description of each sustainability issue that is likely to have material implications for companies in the Household & Personal Products industry. This includes an explanation of how the issue could impact valuation and evidence of actual financial impact. Further information on the nature of the value impact, based on SASB's research and analysis, is provided in Appendix IIA and IIB.

Appendix IIA also provides a summary of the evidence of investor interest in the issues. This is based on a systematic analysis of companies' 10-K and 20-F filings, shareholder resolutions, and other public documents, which highlights the frequency with which each topic is discussed in these documents. The evidence of interest is also based on the results of consultation with experts participating in an industry working group (IWG) convened by SASB. The IWG results represent the perspective of a balanced group of stakeholders, including corporations, investors or market participants, and public interest intermediaries.

The industry-specific sustainability disclosure topics and metrics identified in this brief are the result of a year-long standards development process, which takes into account the aforementioned evidence of interest, evidence of financial impact discussed in detail in this brief, inputs from a 90-day public comment

period, and additional inputs from conversations with industry or issue experts.

A summary of the recommended disclosure framework and accounting metrics appears in Appendix III. The complete SASB standards for the industry, including technical protocols, can be downloaded from www.sasb.org. Finally, Appendix IV provides an analysis of the quality of current disclosure on these issues in SEC filings by the leading companies in the industry.

ENVIRONMENT

The environmental dimension of sustainability includes corporate impact on the environment, either through the use of non-renewable natural resources as input to the factors of production (e.g., water, energy) or through environmental externalities or other harmful releases in the environment, such as air and water pollution, waste disposal, and GHG emissions.

The Household & Personal Products industry faces risks and opportunities related to environmental factors, particularly water use in operations. The industry must also navigate water scarcity and ecological impacts resulting from the operations and land use practices of suppliers.

Water Management

Water is vital to this industry, both as a coolant in the manufacturing process and as a main input for many goods. Shampoo, for example, is generally 70 to 80 percent water.⁵¹ Water is becoming a scarce resource around the world, due to increasing consumption as a result of population growth, rapid urbanization, and reduced supplies due to climate change.

Furthermore, water pollution in many emerging markets makes available water supplies unusable or expensive to treat. Many important river basins can already be considered “stressed.” Water scarcity can result in higher supply costs, supply disruptions, and social tensions.⁵²

Many companies in this industry have operations in regions of the world that are facing water scarcity.⁵³ Without careful planning, companies could face increased costs, or worse, lose access to water in these regions. Having rigorous checks in place to ensure a steady supply of water to all their factories, as well as investing in technology to increase the efficient use of water, including recycling, will help companies in this industry keep a lower risk profile as water scarcity inevitably becomes a more pressing international issue.

Company performance in this area can be analyzed in a cost-beneficial way through the following metric (see Appendix III for a full list of metrics):

- Total water withdrawn and total water consumed, percentage of each in regions with High or Extremely High Baseline Water Stress; and
- Discussion of water management risks and description of strategies and practices to mitigate those risks.

Evidence

All four of the household and personal products companies that are listed in the Fortune Global 500 answered “yes” to a 2012 CDP questionnaire that asked if they had operations located in water-stressed regions.⁵⁴ Colgate-Palmolive disclosed that 67.5 percent

of its operations were in water-stressed regions, the highest percentage among the four companies. Colgate-Palmolive also answered “yes” to the question, “Is your company exposed to water-related risks (current or future) that have the potential to generate a substantive change in your business operation, revenue or expenditure?”⁵⁵ In a 2013 survey, Unilever answered “yes” to the same question.⁵⁶

Colgate-Palmolive spends \$9.5 million annually on water for its operation in India, a country facing high water stress,⁵⁷ and believes that if water was priced correctly (accounting for energy, materials, and treatment costs) that cost could double.⁵⁸ Based on recent trends, it is estimated that by 2025, important river basins in the U.S., Mexico, Western Europe, China, India, and Africa will face severe water problems as demand overtakes renewable supplies. Many research groups, like the 2030 Water Resources Group, believe that rising water costs in the coming decades are nearly inevitable.⁵⁹

In 2010, Kimberly-Clark, a large sanitary paper products company, suffered a production stoppage due to an unexpected drought in Kluang, Malaysia, which cost the company \$2 million, as it responded by installing wastewater treatment equipment and other technologies to ensure reliable water supplies.⁶⁰ In a survey conducted by the CDP, a disclosure initiative focusing on water, Kimberly-Clark stated that it was “concerned about the availability of natural resources, such as water... to make [its] products.”⁶¹ With increasing water scarcity, production disruptions will likely become more common and companies that invest in water-efficiency and recycling technologies to reduce this risk

will likely benefit from lower operational costs and lower cost of capital.

In its 2012 Corporate Responsibility Report, Estée-Lauder describes the risk water price volatility poses to both the company and its customers: “Fresh water availability is a growing concern worldwide. Poor management of the world’s fresh water could have significant impacts on our business and the communities in which we operate.”⁶² In its Sustainable Living 2014 report, Unilever notes that it is investing in water efficiency for its operations in water-scarce regions because roughly 30 percent, or 12 million m³, of the water it extracts is from regions that the company has deemed water scarce. In response, Unilever has formed a water-reduction plan that focuses heavily on water-scarce regions in order to lower the company’s future risk profile.⁶³

At one of its sites in Oxnard, California, P&G reduced water use by nearly 25 percent in 2012, generating annual cost savings of more than \$900,000.⁶⁴ As part of its \$2.2 billion investment in new manufacturing capabilities, Unilever built eco-friendly factories in water-stressed regions that are capable of harvesting and reusing rainwater.⁶⁵ A new cleaning process at a Colgate-Palmolive manufacturing plant in South Africa saves the company 103,000 gallons of water a year while increasing product output by two tons a day through reduced downtime.⁶⁶ This demonstrates that higher initial capital expenditures on such initiatives could allow for lower marginal costs for producing goods in the future and could limit output volatility.

At Unilever’s factory in Goa, India, long periods of drought necessitate the expensive process of

importing water by road tanker to continue production. In response, the company developed a rainwater collection system that will harvest 70,000 m³ of water every year. This infrastructure—a model for other factories in water-scarce regions—is expected to pay for itself within 18 months.⁶⁷

Value Impact

Companies with operations in water-scarce and -stressed regions may face significant disruptions that could force them to curb or cease production, which would impact market share and revenue growth. Evidence shows that by undertaking capital expenditures around water conservation, companies can reduce their water use and dependency and improve operational efficiency.

The probability and magnitude of these effects are expected to increase over time. Water costs will likely rise gradually across the globe. Companies with greater exposure to this risk could see an increase in their cost of capital.

Investors can compare data on the percentage of water consumed in water-stressed regions to understand the relative operational risks companies face.

BUSINESS MODEL AND INNOVATION

This dimension of sustainability is concerned with the impact of environmental and social factors on innovation and business models. It addresses the integration of environmental and social factors in the value creation process of companies, including resource efficiency and other innovation in the production process. It also includes product innovation and efficiency,

and responsibility in the design, use-phase, and disposal of products. It includes management of environmental and social impacts on tangible and financial assets—either a company’s own or those it manages as the fiduciary for others.

Emerging environmental and social trends are creating new innovation and business opportunities for companies in the Household & Personal Products industry. This is a highly competitive and consumer-facing industry that depends heavily on the ability to charge a premium for differentiated products. As consumer interest in sustainability grows, companies that can implement and advertise sustainable products are likely to improve profit margins and expand market share. In addition, the logistical operations of this industry are massive, and companies that can make logistical operations more efficient gain a competitive advantage by reducing both marginal costs and environmental externalities.

Packaging Lifecycle Management

Nearly all household and personal products are packaged, therefore, packaging often constitutes a significant portion of expenses. In addition, packaging design has a direct impact on transportation expenses, which are also significant in this industry. Packaging innovations such as light-weighting can reduce production and transportation costs by reducing the amount of materials and energy needed to make and transport products. Light-weighting can also reduce environmental externalities, as transportation of many of these products represents a major source of GHG emissions.⁶⁸

As the Household & Personal Products industry is consumer facing, companies in the industry face public scrutiny over environmental externalities, even if these are not directly tied to their operations. For example, consumers are demanding more sustainable packaging from these companies because the companies have considerable buying power to influence packaging manufacturers.⁶⁹ General trends in sustainable packaging involve the light-weighting of existing packaging, increasing levels of recycling and use of recycled content, the use of sustainably sourced materials, and greater logistical efficiency.⁷⁰

While the sustainability performance of packaging depends largely on the type, use, and ultimate disposal of materials, companies that effectively manage the sustainability characteristics of their product packaging may be better positioned to capture shifting consumer demand, while also potentially reducing input and transport costs.

Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Total weight of packaging, percentage made from recycled or renewable materials, percentage that is recyclable or compostable; and
- Description of strategies to reduce the environmental impact of packaging throughout its lifecycle.

Evidence

The global demand for personal care packaging was valued at \$19 billion in 2012, which translated into 130 billion packaging units.

Demand is expected to reach nearly \$26 billion by 2019.⁷¹ Packaging is a substantial cost in this industry. In the soap and cleaning compounds segment of the industry, for example, packaging represents an average of 20 percent of total costs.⁷²

Packaging efficiencies can result in significant savings for companies. P&G launched a subsidiary in 2013 to develop a thinner and more sustainable plastic and a more streamlined package-creation process, which is projected to save \$150 million in annual costs, reduce time to market for package development by up to 50 percent, and reduce annual capital expenditures by \$50 million.⁷³ Furthermore, the technology makes it easier to include both recycled and bioplastic inputs in the manufacturing process. Unilever, for example, used nearly four thousand tons of recycled plastic in its packaging in 2014.⁷⁴ Kimberly-Clark was able to save nearly \$1 million in material and transport costs in FY2012 by reducing the weight of its Kleenex facial tissues packaging.⁷⁵ As more than 90 percent of transport uses logistics networks that rely on fossil fuels,⁷⁶ companies in this industry are sensitive to rising or volatile oil prices and can cut costs through light-weighting practices. Company-wide, these incremental savings are critical in order to maintain competitive pricing in an industry with heavy price-based competition.

Walmart instituted a sustainability scorecard in 2007 for the packaging of products sold in its stores.⁷⁷ The purpose was both to encourage suppliers to create more sustainable packaging and to serve as a framework for buyers to make packaging sustainability an important component of their decision to purchase a good.⁷⁸ This initiative demonstrates the

importance of creating of sustainable packaging, as Walmart's business is important to the market share of every major company in this industry.⁷⁹

The sustainability of packaging also has an impact at the level of the individual consumer. A recent survey conducted by OCR, a research company, found that 56 percent of Americans surveyed wanted more sustainable packaging options and that 52 percent of millennials were willing to pay more for sustainable packaging.⁸⁰ Using sustainable packaging to develop a positive brand association can therefore help a company increase its market share.

Maine, in 2010, was the first U.S. state to set up framework legislation granting the state authority to create EPR legislation across any feasible industry.⁸¹ Iowa, Massachusetts, New York, Vermont, and Rhode Island have since introduced similar framework legislation.⁸² This momentum may soon bring nationwide EPR regulations—along with compliance costs—and give a competitive advantage to companies that find the most innovative ways to promote the recycling of their products. At the same time, widespread success of industry initiatives around consumer recycling rates could preempt further regulation, as was the case for the rechargeable battery industry in the mid-1990s.⁸³ For example, Unilever's Recycling and Recovery Index tracks recycling rates associated with its products, and the company aims to increase recycling and recovery rates by 15 percent by 2020 in its top 14 countries.⁸⁴

Value Impact

Growing demand for sustainably packaged products is likely to open more opportunities for companies that improve and account for their environmental impacts, and it may have a

positive long-term impact on these companies' revenue and market share growth. At the same time, by investing in R&D to manage physical qualities of packaging, companies may achieve substantial cost savings and improve their operational efficiency. Increasing consumer and legislative interest in packaging issues suggests that the probability and magnitude of these impacts will increase in the future.

A higher percentage of products made from recycled and recyclable materials indicates that a company is proactively addressing consumer environmental concerns as well as mitigating risk of cost and compliance impacts from EPR regulation.

Product Environmental, Health, and Safety Performance

The chemicals used in this industry's products can sometimes have unintended negative environmental and health issues. Isolating and determining causal channels for negative health and environmental impacts is difficult, which means there is often a significant lag between a product's introduction to the market and the point at which regulation and/or public opinion causes companies in the industry to reformulate. The occasional use of product ingredients with negative health consequences, such as potentially carcinogenic chemicals, has placed the industry under increased threat of legislation. This is especially true in the cosmetics segment, where the FDA is seeking increased regulatory power. Companies that are able to anticipate the changing regulatory landscape and implement stricter processes and testing will have a competitive advantage.

If the FDA succeeds in securing greater regulatory oversight of the cosmetics industry,

it is very likely that industry costs will rise.⁸⁵ Companies that are unable to replace some of the chemicals that could be banned, such as phthalates, a type of plastic softener already banned in other industries because of its status as a potential carcinogen, will be at a competitive disadvantage.⁸⁶ The E.U. REACH legislation, as previously mentioned, has banned a significant number of chemicals, as well as well as implementing strict disclosure and safety testing requirements.⁸⁷ Increasing chemical regulation in California will potentially raise company costs if products need to be reformulated and relabeled.⁸⁸

Company performance in this area can be analyzed in a cost-beneficial way though the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Revenue from products that contain REACH substances of very high concern (SVHC);
- Revenue from products that contain substances on the California DTSC Candidate Chemicals List;
- Discussion of process to identify and manage emerging materials and chemicals of concern; and
- Revenue from products designed with green chemistry principles.

Evidence

The cost of product reformulation in order to comply with legislation can be significant. For example, Colgate-Palmolive, in its FY2014 10-K, acknowledges that a ban on triclosan, an anti-bacterial chemical found in cleaning agents, could "adversely affect [its] business."⁸⁹ Triclosan is currently considered safe by the FDA, but some research and special interest

groups have suggested that triclosan can alter hormone activity and potentially aid in the creation of antibiotic-resistant bacteria, causing greater regulatory scrutiny.⁹⁰ Minnesota has passed a law requiring the phasing out of triclosan from all consumer soaps by 2017, and Chicago is currently considering a ban.⁹¹ The E.U. has also proposed a ban.⁹² According to an FDA analysis, manufacturers will likely have to spend between \$112 million and \$369 million to reformulate and re-label affected products.⁹³ Early movers in this space can gain an advantage. For example, a major traditional toothpaste brand that contains triclosan lost two percent of its market share in 2013, while Colgate's Tom's of Maine product line, which doesn't contain triclosan, grew 14 percent.⁹⁴

Consumer demand is shifting toward products with fewer potential negative health effects. In 2009, a consumer advocacy group identified a preservative that emits formaldehyde, as well as 1,4-dioxane, a suspected carcinogen, in some of Johnson & Johnson's baby products. In China alone the company's market share for baby products rapidly dropped 10 percent.⁹⁵ Johnson & Johnson has since phased these ingredients out of its products.⁹⁶ Indeed, the "safer chemistry" market for cleaning products had a CAGR of 20 percent between 2007 and 2011, while conventional products only had a 1.5 percent CAGR over the same period.⁹⁷ Unilever has stated that its "sustainable living brands," accounted for half of the company's growth in 2014, growing at double the rate of the company's more conventional offerings.⁹⁸

Clorox, in its FY2014 10-K, highlights the consumer trends that it is attempting to capitalize on: "Clorox will continue to reshape its portfolio toward businesses aligned with the four consumer megatrends of health and

wellness, sustainability, consumer fragmentation and affordability/value."⁹⁹ Furthermore, as Clorox highlights later in the same document: "The Company devotes significant time and resources to programs designed to protect and preserve the Company's reputation and the reputation of its brands. These programs include ethics and compliance, sustainability and product safety and quality initiatives. Despite these efforts, negative publicity about the Company, including product safety or similar concerns, whether real or perceived, could occur, and the Company's products could face withdrawal, recall or other quality issues."¹⁰⁰ Similarly, Procter & Gamble, in its FY2014 10-K, discloses: "If we are unable to effectively manage real or perceived issues, including concerns about safety, quality, efficacy or similar matters, sentiments toward the Company or our products could be negatively impacted; our ability to operate freely could be impaired and our financial results could suffer."¹⁰¹

California passed the Safer Consumer Products Law in 2013, which established a list of candidate chemicals that the state believes have safer alternatives and that the state could potentially ban in the future. While bans are not yet in effect, the California regulatory environment is increasingly incentivizing companies to proactively eliminate harmful substances.¹⁰²

Walmart—an important retail platform for this industry—introduced a list of substances that it will require to be phased out of its product offerings in Q1 2016. Other key retailers, such as Target and Bed Bath & Beyond, have announced similar programs that will require household and personal products companies to

quickly adapt their product in order to maintain and increase market share.¹⁰³ Jeff Rice, Walmart's Director of Sustainability, has said that the company's "new purchasing framework opens the door for suppliers with commitment to sustainability.... It's one of the criteria we use to make buying decisions now."¹⁰⁴ Walmart's business is crucial for companies in this industry, and companies that are most prepared to offer products without the phased-out ingredients will stand to profit. Given the buying power of Walmart and other large retailers, these directives can be as impactful as regulation.

Companies that actively invest in alternative chemicals will be in a position to anticipate and mitigate the impact of regulation. For example P&G, Johnson & Johnson, and Avon all announced the phasing out of chemicals such as triclosan, phthalates, and some formaldehyde-releasing compounds from their products, responding to consumer pressure and preempting potential regulation.¹⁰⁵

Value Impact

Companies that can adeptly respond to changes in the regulatory landscape and procurement standards will have a competitive advantage and likely increase their market share. Evolving regulations and standards may require companies to increase investment in research and development (R&D) to replace banned or restricted chemicals. Companies' intangible assets can be significantly affected by how they respond to these health and environmental concerns, as they can have significant impact on a company's reputation. The current legislative environment suggests that the probability and magnitude of these impacts will increase in the future.

Analysts could use revenue from products that contain REACH substances of very high concern and products that contain substances on the California DTSC Candidate Chemicals list to understand companies' downside regulatory risk. Greater revenue from green chemistry products indicates a company's potential to gain further market share in a growing consumer segment.

LEADERSHIP AND GOVERNANCE

As applied to sustainability, governance involves the management of issues that are inherent to the business model or common practice in the industry and are in potential conflict with the interest of broader stakeholder groups (government, community, customers, and employees). They therefore create a potential liability, or worse, a limitation or removal of license to operate. This includes regulatory compliance, lobbying, and political contributions. It also includes risk management, safety management, and supply chain and resource management.

Companies that actively and publicly work with their vast networks of suppliers to ensure that inputs are environmentally and socially sound will garner goodwill from consumers and investors, as well as keep public and political opinion from pushing for regulation that could harm the industry.

Environmental & Social Impacts of Palm Oil Supply Chain

Household and personal products companies are exposed to a number of risks associated with their supply chains, including disruptions, input price increases, regulatory compliance

costs, and reputational damage. Proper sourcing of palm oil, a widely used input, is the main supply chain issue for companies in this industry. Companies face pressure to track and responsibly source palm oil. Additionally, they face pressure to ensure minimum standards for working conditions in the supply chain, as the production of palm oil is often associated with fair labor issues.

Palm oil has rapidly risen in popularity over the last two decades as a cheap input for a wide range of goods in this industry, including cleaning products, candles, and cosmetics. As a result, sustainable sourcing has recently become a prevalent issue of governmental and public discourse that some companies have begun to address.

Household and personal products companies with strong materials sourcing practices and the ability to adapt to increasing resource scarcity will be better positioned to protect shareholder value. Innovations at the product-design phase to reduce dependence on controversial materials can also contribute to reducing risks. Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Amount of palm oil sourced, percentage certified through RSPO Book & Claim and Mass Balance systems, and RSPO Identify Preserved and Segregated systems.

Evidence

Palm oil is used in a large variety of goods in the Household & Personal Products industry. For example, it is used as an input in 70

percent of all cosmetics.¹⁰⁶ Since 2000, annual production of palm oil has more than doubled,¹⁰⁷ reaching roughly 60 million metric tons in 2014.¹⁰⁸ Eighty-five percent of worldwide palm oil production comes from tropical forests in Indonesia and Malaysia.¹⁰⁹ The rapid scaling of this industry has created the need for large amounts of new plantation land. This need has largely been met by clear-cutting rain forests and burning peat-lands. The latter causes the release of massive amounts of carbon stored in the peat into the atmosphere.¹¹⁰ If plantation expansion continues at the projected rate, it will release more than 558 million metric tons of carbon dioxide into the atmosphere by 2020. For reference, this is more carbon dioxide than Canada's fossil fuel emissions in 2012.¹¹¹ The mass burning techniques used to create new farmland for palm oil have caused record levels of air pollution in Indonesia and the surrounding countries, causing respiratory issues for people in areas reaching as far as Singapore.¹¹² However, even with increased public awareness and initial industry response, a 2014 report by the Union of Concerned Scientists found that only two of the ten largest personal care companies in the study met the union's standards for a full commitment to sustainably sourced palm oil.¹¹³

Shareholders of Colgate-Palmolive, Avon, and Church & Dwight have filed resolutions asking the companies to move to 100 percent sustainable palm oil, which were all withdrawn as the companies planned to address them.¹¹⁴ There is concern that increased consumer awareness of the environmental degradation caused by palm oil production, along with regulatory measures such as required labeling of all vegetable oils, which the E.U. approved starting at the end of 2014, could bring

consumer boycotts¹¹⁵ and/or punitive regulatory measures. In response, Unilever created an explicit tie between executive compensation and supply chain issues, making bonuses contingent upon making specific progress toward the company's sustainable palm oil commitment.¹¹⁶

There are a myriad of certifications to demonstrate that palm oil is harvested sustainably, although the one most accepted by the industry (though not without some criticism by certain advocacy groups)¹¹⁷ is the RSPO standard.¹¹⁸ Within this certification, there are different levels of assurance, and accordingly, there are different levels of potential risk for companies. The difference between certification types relates to the level of traceability of the specific oil a company buys. Companies that opt for less stringent certifications may still face reputational risk if their inputs are found to be connected to unsustainable palm oil practices.¹¹⁹

Sales of sustainable palm oil were up roughly 50 percent, to 506,586 metric tons, in the first quarter of 2014 compared to the first quarter of 2013.¹²⁰ This is likely a result of companies responding to increasing consumer awareness of, and willingness to pay a premium for, goods marketed as containing sustainably sourced palm oil.¹²¹ A 2014 study by Morgan Stanley Capital International calculated the price of completing stringent palm oil sustainability standards by 2020, and found that it averaged 0.15 percent of revenue for the top 10 national buyers of palm oil. For no company in its study did it cost more than 0.5 percent of total revenue. The highest cost was for Unilever, at 0.46 percent, or roughly \$309 million, by 2020.¹²²

However, all types of palm oil are susceptible to price increase and volatility due to changing weather patterns exacerbated by climate change. In the last six years, prices have shown great volatility, with a standard deviation of roughly \$240, which is 41 percent of the value of palm oil in May 2015 (\$591/metric ton).¹²³ The weather pattern known as "El Niño" has direct consequences on the production of palm oil. With the threat of El Niño in 2014, palm oil producers were concerned about production capabilities. The CEO of IOI Corp, a major Malaysian producer, stated that El Niño could reduce IOI Corp's production by up to 12 percent, driving up prices.¹²⁴ This threat is becoming even more acute, as scientists have forecasted that, due to global warming, El Niño may occur once a decade over the next 100 years. This is twice as often as previously recorded.¹²⁵

Recognizing the environmental risks from unsustainable palm oil production, the Indonesian government is introducing new laws to help mitigate negative effects. In October 2013, Indonesia limited non-state-owned companies to only 100,000 hectares of land for palm oil production. This raised questions as to whether production goals will be met in the future.¹²⁶ This, coupled with the previous evidence, indicates that although palm oil was initially prized for being inexpensive, its future price could rise and become more volatile.

Companies can also protect themselves against these price fluctuations and reputational damages by investing in alternatives. Unilever is investing heavily in Algal oil, made from algae, a potentially competitive and more environmentally sustainable alternative to palm oil.¹²⁷ Ecover has invested in similar technology for its laundry detergents.¹²⁸

Value Impact

Consumer and special interest groups have been raising awareness of environmental and social issues related to palm oil in companies' supply chains. This increasing scrutiny around the sustainable sourcing of palm oil is likely to affect availability of this key material, which may increase household and personal products companies' risk profiles and cost of capital. It could also cause boycotts and reduce the market share of companies that do not address the issue. It also suggests that the probability and magnitude of these impacts will increase in the future. Furthermore, there are potential negative reputational effects that could result from continuing to use unsustainably harvested palm oil, which could result in lower intangible asset value.

Comparing the percentage of a company's palm oil that has been certified to RSPO standards, as well as how verifiable this information is, to the amount that is uncertified can allow analysts to compare companies' relative operational and reputational risk related to palm oil.

APPENDIX I

FIVE REPRESENTATIVE HOUSEHOLD & PERSONAL PRODUCTS COMPANIES^{IV}

COMPANY NAME (TICKER SYMBOL)
Procter & Gamble (PG)
Unilever (UL)
Colgate-Palmolive (CL)
Kimberly Clark (KMB)
Clorox (CLX)

^{IV} This list includes five companies representative of the Household & Personal Products industry and its activities. This includes only companies for which the Household & Personal Products industry is the primary industry, companies that are U.S.-listed but are not primarily traded over the counter, and for which at least 20 percent of revenue is generated by activities in this industry, according to the latest information available on Bloomberg Professional Services. Retrieved on April 15th, 2015.

APPENDIX IIA

EVIDENCE FOR SUSTAINABILITY DISCLOSURE TOPICS

Sustainability Disclosure Topics	EVIDENCE OF INTEREST				EVIDENCE OF FINANCIAL IMPACT				FORWARD-LOOKING IMPACT		
	HM (1-100)	IWGs		EI	Revenues & Costs	Assets & Liabilities	Cost of Capital	EFI	Probability & Magnitude	Externalities	FLI
		%	Priority								
Water Management	33	86	3	Medium	•		•	High	•		Yes
Packaging Lifecycle Management	33	79	4	Medium	•			Medium	•		Yes
Product Environmental, Health, and Safety Performance	100*	75	1	High	•	•		High		•	Yes
Environmental & Social Impacts of Palm Oil Supply Chain	56	86	2	Medium	•	•	•	High		•	Yes

HM: Heat Map, a score out of 100 indicating the relative importance of the topic among SASB's initial list of 43 generic sustainability issues. Asterisks indicate "top issues." The score is based on the frequency of relevant keywords in documents (i.e., 10-Ks, 20-Fs, shareholder resolutions, legal news, news articles, and corporate sustainability reports) that are available on the Bloomberg terminal for the industry's publicly listed companies. Issues for which keyword frequency is in the top quartile are "top issues."

IWGs: SASB Industry Working Groups.

%: The percentage of IWG participants that found the disclosure topic likely to constitute material information for companies in the industry. (-) denotes that the issue was added after the IWG was convened.

Priority: Average ranking of the issue in terms of importance. 1 denotes the most important issue. (-) denotes that the issue was added after the IWG was convened.

EI: Evidence of Interest, a subjective assessment based on quantitative and qualitative findings.

EFI: Evidence of Financial Impact, a subjective assessment based on quantitative and qualitative findings.

FLI: Forward-looking Impact, a subjective assessment of the presence of a material forward-looking impact.

APPENDIX IIB

EVIDENCE OF FINANCIAL IMPACT FOR SUSTAINABILITY DISCLOSURE TOPICS

Evidence of Financial Impact	REVENUE & EXPENSES							ASSETS & LIABILITIES				RISK PROFILE	
	Revenue			Operating Expenses		Non-operating Expenses		Assets		Liabilities		Cost of Capital	Industry Divestment Risk
	Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extra-ordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities		
Water Management	•			•		•						•	
Packaging Lifecycle Management	•			•	•								
Product Environmental, Health, and Safety Performance	•	•	•	•	•				•				
Environmental & Social Impacts of Palm Oil Supply Chain	•			•					•			•	

MEDIUM IMPACT
 HIGH IMPACT

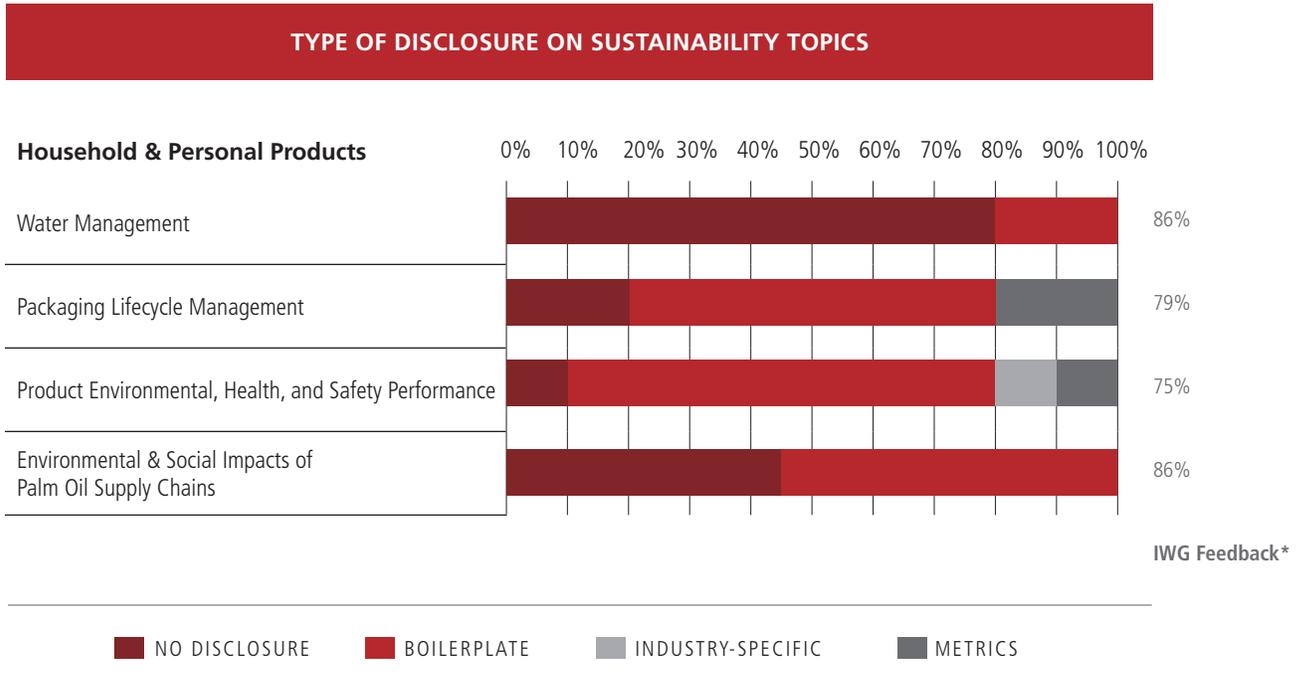
APPENDIX III

SUSTAINABILITY ACCOUNTING METRICS | HOUSEHOLD & PERSONAL PRODUCTS

TOPIC	ACCOUNTING METRIC	CATEGORY	UNIT OF MEASURE	CODE
Water Management	(1) Total water withdrawn and (2) total water consumed, percentage of each in regions with High or Extremely High Baseline Water Stress	Quantitative	Cubic meters (m ³), Percentage (%)	CN0602-01
	Discussion of water management risks and description of strategies and practices to mitigate those risks	Discussion and Analysis	n/a	CN0602-02
Packaging Lifecycle Management	(1) Total weight of packaging, (2) percentage made from recycled or renewable materials, and (3) percentage that is recyclable or compostable	Quantitative	Metric tons (t), Percentage (%)	CN0602-03
	Description of strategies to reduce the environmental impact of packaging throughout its lifecycle	Discussion and Analysis	n/a	CN0602-04
Product Environmental, Health, and Safety Performance	Revenue from products that contain REACH substances of very high concern (SVHC)	Quantitative	U.S. Dollars (\$)	CN0602-05
	Revenue from products that contain substances on the California DTSC Candidate Chemicals List	Quantitative	U.S. Dollars (\$)	CN0602-06
	Discussion of process to identify and manage emerging materials and chemicals of concern	Discussion and Analysis	n/a	CN0602-07
	Revenue from products designed with green chemistry principles	Quantitative	U.S. Dollars (\$)	CN0602-08
Environmental & Social Impacts of Palm Oil Supply Chain	Amount of palm oil sourced, percentage certified through (1) Roundtable on Sustainable Palm Oil (RSPO) Book & Claim and Mass Balance systems and (2) RSPO Identity Preserved and Segregated systems	Quantitative	Metric tons (t), Percentage (%)	CN0602-09

APPENDIX IV: Analysis of SEC Disclosures | Household & Personal Products

The following graph demonstrates an aggregate assessment of how representative U.S.-listed Household & Personal Products companies are currently reporting on sustainability topics in their SEC annual filings.



*Percentage of IWG participants that agreed topic was likely to constitute material information for companies in the industry.

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