

## Environmental, Social, And Governance Evaluation

# Adidas AG

### Summary

Germany-based Adidas AG is one of the leading sportswear players globally, owning about 2,500 retail stores in 160 countries. The company, with a global workforce of about 62,000, designs, develops, distributes, and markets athletic and sports lifestyle products worldwide under the adidas brand. It holds a No. 2 global position in the sporting goods market behind Nike. Adidas generated €19.8 billion in sales in 2020, a 16% decrease compared with 2019, following widespread store closures due to the COVID-19 pandemic. In 2020, the group generated 56% of its revenue in footwear, 39% in apparel, and 5% in accessories and gear. Geographically, the brand has a well-balanced presence in Europe (27% of net sales in 2020); North America (24%); Asia Pacific (35%); Latin America (6%); and the rest of the world (8%).

Our ESG Evaluation of 85 reflects our view that Adidas has a strong emphasis on innovation, supply chain management, and customer engagement. This allows the company to deliver a strong ESG performance and set industry standards. It has developed its sustainability strategy earlier than many industry peers. Adidas is committed to reducing and ultimately ending plastic waste, a goal it plans to realize through its innovative solutions and collaborations with industry stakeholders. The company minimizes its high exposure to supply chain risks by strong and long-lasting partnership with its suppliers, compliance with its supply chain code of conduct, regular assessments, and improvement measures in case of non-compliance. We view Adidas' preparedness as strong. The company is well positioned to navigate disruptions and capitalize on opportunities, which its strategic objectives reflect. Its focus on innovation and partnerships supports its long-term sustainability agenda.

#### PRIMARY ANALYST

**Anna Liubachyna**  
London  
+44 79 71 362 293  
anna.liubachyna@spglobal.com

#### SECONDARY ANALYSTS

**Salvio Cascarino**  
Milan  
+39 02 72 111 303  
salvio.cascarino@spglobal.com

#### María Ortiz de Mendivil

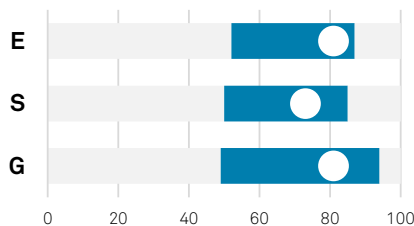
Madrid  
+34 68 62 141 86  
maria.omendivil@spglobal.com

#### RESEARCH CONTRIBUTOR

**Monal Jain**  
CRISIL Ltd.,  
an S&P Affiliate

### ESG Profile Score

**79/100**



Company-specific attainable and actual scores

### Preparedness Opinion (Scoring Impact)
















**Strong (+6)**

### ESG Evaluation



A higher score indicates better sustainability

# Component Scores

Environmental Profile			Social Profile			Governance Profile		
<b>Sector/Region Score</b>		<b>37/50</b>	<b>Sector/Region Score</b>		<b>35/50</b>	<b>Sector/Region Score</b>		<b>29/35</b>
	Greenhouse gas emissions	<b>Strong</b>		Workforce and diversity	<b>Strong</b>		Structure and oversight	<b>Strong</b>
	Waste and pollution	<b>Leading</b>		Safety management	<b>Good</b>		Code and values	<b>Strong</b>
	Water use	<b>Strong</b>		Customer engagement	<b>Strong</b>		Transparency and reporting	<b>Strong</b>
	Land use and biodiversity	<b>Strong</b>		Communities	<b>Strong</b>		Financial and operational risks	<b>Neutral</b>
	General factors (optional)	<b>None</b>		General factors (optional)	<b>None</b>		General factors (optional)	<b>0</b>
<b>Entity-Specific Score</b>		<b>44/50</b>	<b>Entity-Specific Score</b>		<b>38/50</b>	<b>Entity-Specific Score</b>		<b>52/65</b>
<b>E-Profile (30%)</b>		<b>81/100</b>	<b>S-Profile (30%)</b>		<b>73/100</b>	<b>G-Profile (40%)</b>		<b>81/100</b>
<b>ESG Profile (including any adjustments)</b>						<b>79/100</b>		

## Preparedness Summary

Adidas is pursuing organic growth and expanding its direct-to-consumer (DTC) business model while keeping sustainability aspects as one of the prominent features of its long-term strategy. We believe the company is prepared to navigate disruptions and take advantage of opportunities arising beyond the 2021-2025 strategy. Adidas identified many structural trends shaping its industry, such as sustainability, premiumization, e-commerce, the increasing role of data, athleisure, and increasing demand from strategic growth markets such as Greater China. It is highly exposed to potential disruption in its value chain. However, we believe the company can manage its upstream risks through its longstanding relationships with suppliers. In addition, we view continuous interaction between the supervisory and executive boards as benefiting the strategy's execution and ensuring it remains relevant.

### Capabilities

Awareness	<b>Excellent</b>
Assessment	<b>Good</b>
Action plan	<b>Excellent</b>

### Embeddedness

Culture	<b>Good</b>
Decision-making	<b>Excellent</b>

## Preparedness Opinion (Scoring Impact)

**Strong (+ 6)**

## ESG Evaluation

**85**<sub>/100</sub>

Note: Figures are subject to rounding.

# Environmental Profile

81/100

## Sector/Region Score (37/50)

Consumer goods companies face moderate exposure to environmental risks across their value chain. Environmental impacts of apparel companies include waste generation from packaging and products' end of life, pollution from the use of chemicals and dyes, and the production of toxic waste during the manufacture of clothing. The apparel sector is also a major water consumer at the different stages of a manufacturing process and in cotton production.

## Entity-Specific Score (44/50)

Note: Figures are subject to rounding.



**Adidas' objective to make nine out of 10 products sustainable by 2025 emphasizes its move toward a more circular economic system.** The company applies innovative solutions to waste management through its "three loops" approach (recycled, circular, and regenerative), which we view favorably compared with peers. For example, Adidas used 71% of recycled polyester in its products in 2020 (100% by 2024); it uses plastic intercepted from beaches and coastal areas as an alternative to virgin plastic in its products; and it presented shoes made from regenerative Mylo (mushroom-based) material replacing leather in 2021. Hence, we view it as a leader in innovation and manufacture of new materials. In line with advanced peers, Adidas is reducing its chemical footprint along the supply chain by providing technical guidance and support, and setting up specific compliance targets in line with Zero Discharge of Hazardous Chemicals (ZDHC) standards. In addition, the company is using DryDye technology that uses fewer chemicals than traditional dyeing methods. It is also collaborating with researchers to develop a standardized process to test and limit microfiber shedding during production and use, which we view favorably.

**Adidas' strong greenhouse gas (GHG) profile is sustained through its solid performance and reduction targets.** We believe the company is on track to meet its science-based target (consistent with the 1.5°C warming scenario) to reduce absolute GHG emissions--including the most material scope 3 emissions--by 30% by 2030 from 2017 levels, in line with advanced peers. The company is encouraging suppliers to adopt less carbon-intensive processes, use on-site renewable power generation (about 80% of its strategic suppliers) and renewable power purchase agreements (PPA; such as suppliers in Vietnam). We believe these actions will allow Adidas to achieve its climate neutrality target by 2050.

**Adidas' well-managed exposure to water risks derives mainly from its supply chain.** To mitigate the risks, the company is expanding its efforts to reduce water consumption for its garment dying suppliers by 40% by 2025 from the 2017 baseline. Adidas has exceeded the previous targets, which in our view showcases its leadership. To accomplish this, Adidas has published a guide for suppliers with more than 350 water-saving initiatives for the most water-intensive processes, including dyeing and finishing of materials, practices we view as stronger than peers.

**Adidas' performance in sustainable raw material sourcing is strong.** In 2018, it became one of the first companies to achieve 100% cotton sourced more sustainably, minimizing impacts on water availability. The company also established traceability in its leather supply chain.

# Social Profile

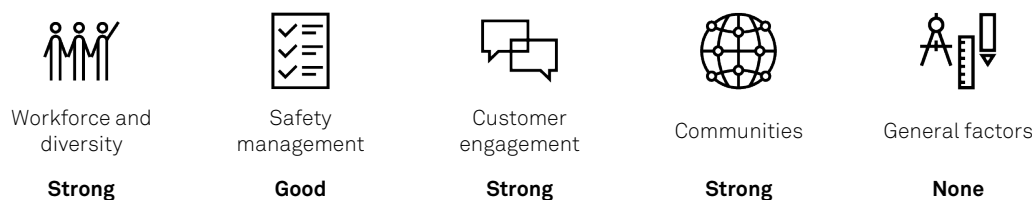
73/100

## Sector/Region Score (35/50)

Consumer goods companies are exposed to social risks across the value chain. Material risks include fast-changing consumer preferences, increasing e-commerce penetration, and growing demand for more sustainable product offerings. Furthermore, they are exposed to social risks such as human rights breaches within their usually complex and global supply chains.

## Entity-Specific Score (38/50)

Note: Figures are subject to rounding.



### Adidas' focus on innovation and transparent product labelling helps it respond to the growing demand for sustainable products and clearly convey its message on sustainability.

The company's most famous sustainable collection is Parley Ocean Plastic range launched in 2015. It is created from plastic intercepted from beaches and coastal areas and received a strong acceptance by consumer reaching 15 million pair of shoes produced in 2020 (roughly 4% of produced footwear). Also, one of the most iconic Adidas' models of shoes--Stan Smith--was redesigned using innovative Mylo material. In addition, the company uses different labelling such as Primeblue and Primegreen to communicate with consumers about the products made with recycled materials. We view Adidas' strategy to launch innovative products (Futurecraft.Loop shoe) to selected groups before releasing to a wider audience as a leading practice. This helps the company analyze consumers' reactions and acceptance of new products, and further adapt to changing tastes globally.

### Adidas has strong control over its supply chain, ensuring fair labor practices, fair wages, and safe working conditions.

The company has long-lasting relationship with the majority of its suppliers. It regularly accesses supplier facilities and introduces measures and trainings in cases of noncompliance, with the issuing of warning letters as a last resort. In our view, Adidas' commitment to see progressive improvement across all fair compensation benchmarks and achieve gender wage parity for all direct suppliers by 2025 is stronger than the targets set by its peers. Within its direct workforce, we see the company as in line with the sector in terms of gender diversity and among top apparel companies on workforce retention.

### Like its peers, Adidas implements a holistic approach to health and safety (H&S) for employees and contractors throughout its supply chain based on ensuring people's physical, social, and mental well-being.

The company ensures its facilities and operations comply with applicable H&S standards and targets implementing H&S management systems at all locations with 50 employees or more by 2025. These practices are common in the sector.

### Adidas commits to engage with communities through the implementation of its vision that "through sport, we have the power to change lives".

We believe this commitment is possible thanks to Adidas' solid global brand reputation. It helps to effectively promote antiracism and antidiscrimination campaigns, powering gender equality and LGBTQ+ inclusion in sports via different programs. This is achieved via annual contributions in community-related projects.

# Governance Profile

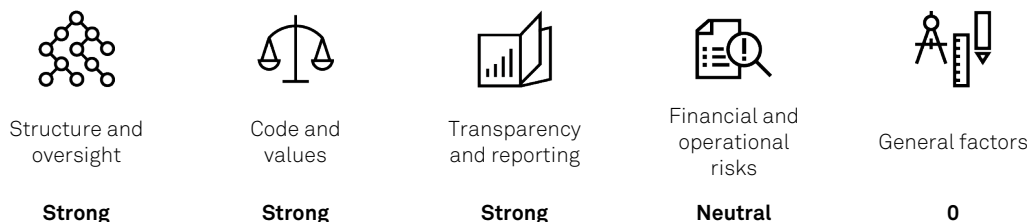
81/100

## Sector/Region Score (29/35)

Adidas is headquartered in Germany, a country with high governance standards. The country exhibits strong institutional effectiveness and rule of law. We also factor in the company's global footprint and increasing exposure to countries such as China, where we see higher exposure to governance risks.

## Entity-Specific Score (52/65)

Note: Figures are subject to rounding.



**Adidas' governance structure follows the German Corporate Governance Code, which we view as broadly aligned with international practices.** The company's supervisory board is composed of 16 members, including eight employee and eight shareholder representatives (referred to as the board thereafter). All shareholder representatives are independent. The board has maintained a diverse background of skills in the sportswear and consumer goods industry, retail, e-commerce, technology, media, and sustainability with the recent addition of a former athlete and a digital specialist. We believe the skillset at the board allows it to respond promptly to any disruptions that Adidas can face and provide necessary advice to the executive board. In addition, employee representatives can provide the board with insights on day-to-day operations. The board's gender diversity is at 38%, in line with global industry peers; and 50% of directors are non-German, matching the company's global footprint including representatives from China and the U.S., its two biggest markets. We view the level of engagement as high, with directors in 2020 attending 97% of board meetings and committees to which they were allocated. The board has strong expertise and a good level of oversight, allowing the company to achieve solid performance across environmental and social factors.

**Adidas's code and values are well integrated throughout the organization and in its incentive structure.** This is further reinforced with the introduction of the 2021 remuneration policy, establishing that 20% of long-term variable incentives is linked to sustainability targets over a five-year period. The company's code of ethics applies across its operations and direct suppliers. Its code of business principles defines its expectations from all employees and suppliers, and provides regular trainings. Other strengths include its comprehensive ethics policies, labor rights charter, and modern slavery policy. The group also has a stand-alone human-rights grievance reporting mechanism covering suppliers, with a separately managed portal.

**Adidas has public commitments to implement sustainability in its operations.** It has a Sustainability Sponsor Board that ensures cross-functional alignment and monitoring of sustainability strategy. The company has a sustainability bond framework and issued a €500 million sustainability bond in 2020 demonstrating implementation of environmental and social values.

**Adidas discloses comprehensive and detailed nonfinancial metrics, which we view as in line with leading industry peers.** The company publishes an annual report that includes sustainability information and is regularly audited. We view as a leading practice Adidas' transparency around its suppliers with a fully disclosed factories list. We view the company's financial reporting as aligned with that of other publicly traded companies.

# Preparedness Opinion

**Strong**  
(+ 6)

## Preparedness

Low

Emerging

Adequate

**Strong**

Best in class

**Adidas is pursuing organic growth and expanding its DTC business model, while keeping sustainability aspects as one of the prominent features of its long-term strategy.** We believe the company is prepared to navigate disruptions and take advantage of opportunities arising beyond the 2021-2025 strategy. In particular, Adidas identified many structural trends shaping its industry in the long-term such as sustainability, premiumization, e-commerce, the increasing role of data, athleisure (that is, athletic clothing that is both comfortable and aesthetically appealing,) and increasing demand from strategic growth markets such as Greater China. Adidas is highly exposed to potential disruption in its value chain. However, we believe the company can manage its upstream risks through its longstanding relationships with suppliers. In addition, we view continuous interaction between the supervisory and executive boards as beneficial for the strategy execution and ensuring it remains relevant. This is underpinned by regular monitoring of strategic key performance indicators, with some of them linked directly to management compensation, which reflects the relatively new performance-driven management culture.

**Adidas' transition to a more consumer focused company will be achieved through increased DTC sales, specifically expanding its e-commerce business.** Through the Own the Game strategy, the company aims to generate €8 billion-€9 billion sales online and 50% of sales in the DTC channel by 2025. This is because online is projected to grow 3x faster than offline in the global sporting goods industry. The company targets to expand its membership base to 500 million users by 2025 (from about 165 million at the end of 2020). We believe this will help it strengthen its competitive advantage over established players and emerging local brands through deeper consumer knowledge and ability to anticipate changing preferences, ultimately supporting a more effective forecasting and inventory management. At the same time, it will allow the company to maintain its competitive edge on sustainable product innovation.

**Adidas' capital allocation is consistent with its strategic objectives.** DTC presents specific supply chain planning challenges as well as cyber risks, so the company plans to increase its digital investment. We expect annual capex will account for 3%-4% of sales over 2021-2025, and 70% of this will be for projects such as e-commerce, automation, and IT planning tools. In our view, Adidas' well established supply chain management will likely result in effective and faster processes from design to manufacturing, logistic, sales, and after-sale services.

**The company's efforts on innovation and collaboration have helped the company maintain its brand identity and support its long-term sustainability focus.** Adidas leverages its established brand image engaging with partners, startups, and competitors to create innovative sustainable solutions. Recent collaborations include the partnership with Allbirds brand to create a running shoe with the company's lowest ever carbon footprint; and the investment in Spinnova, a company that makes textile fiber from wood or agricultural waste. In our view, the wide applications of Adidas' sustainable innovations and technology will help the industry scale up production of sustainable products, which will ultimately reduce average unit costs and sales price to make the products accessible to more consumers. We anticipate near-term costs could be higher but offset by the company's cost reduction initiatives such as usage of alternative materials and diversified channel mix. We acknowledge Adidas' sustainable innovations should continue to meet high standards in the performance and functionality features of its footwear and apparel to remain relevant to its consumer base. In our view, this is a key differentiator compared with other apparel companies or fast-fashion players, which focus on low-price clothing in response to the latest trends.

# Sector And Region Risk

<b>Primary sector(s)</b>	Consumer Goods
<b>Primary operating region(s)</b>	Germany United States Chile China

## Sector Risk Summary

### Environmental exposure

Consumer goods companies are exposed to material environmental risks across their value chain. First, waste associated with the end of life of the product and its packaging is likely to drive new regulation and result in substantial compliance costs. In addition, consumer goods companies are exposed to environmental risks in supply chains. The sector sources its raw materials from the agricultural, mining, forestry, chemicals, and oil and gas supply chains, which have significant land, water, emissions, and pollution impacts. Finally, we believe that consumer goods companies are exposed to environmental risks associated with product manufacturing, distribution, and use. These activities may result in significant water consumption, pollution, and energy use. The nature and scale of the impact largely depends on the nature of the product sold. New regulation may incentivize companies to reduce single-use products, switch to low-carbon freight, and develop energy- and water-efficient products and processes.

### Social exposure

Consumer goods companies are exposed to material social risks across their value chain. First, they are exposed to consumers' fast-changing preferences: innovation and product development are critical to navigating changing consumer preferences, supporting brand value, and maintaining high customer satisfaction and retention. In particular, we expect growing demand for sustainable products, transparent labelling, and responsible advertising to continue, and transition the industry toward purpose-led brands. Second, product safety is a major risk. The manufacturing and use of unsafe products--with harmful components or where a product has malfunctioned--can put the health of employees and users at risk, and result in substantial reputational and financial costs. Finally, they are exposed to risks related to working conditions throughout the supply chain: the manufacturing and distribution of consumer goods, as well as the sourcing of raw materials, rely on a complex and global value chain. This exposes consumer goods companies to human rights breaches and poor working conditions, especially if their suppliers operate in regions with lower labor standards.

## Regional Risk Summary

### Germany

Germany has strong institutional and governance effectiveness, with much transparency and accountability. Rule of law is strong, the judiciary is independent, and corruption is viewed as a minor issue. Germany has a moderate amount of ESG regulation. While Deutsche Börse AG does not require ESG reporting as a listing rule, companies of over 500 employees are implementing the EU Non-Financial Reporting Directive's recommendations, which mandate the disclosure of ESG data like diversity and pay ratios. The German Corporate Governance Code (Kodex) is the reference document for Germany's best practices and works on a comply-or-explain basis. A new version of the Kodex came into effect on Jan. 1, 2020 when the EU Shareholder Rights Directive II was transposed into German law. Notable improvements include recommendations on board independence, as well as board oversight of related party transactions and executive pay. While the recommendations are less specific than most European codes, companies exhibit strong governance practices. Companies are typically governed by a two-tier board system: a management board of executives, which is overseen by a supervisory board comprising non-executives including shareholder and employee or labor union representatives. While not world-leading, there are corporate disclosure requirements for selected ESG aspects and both occupational pension funds and insurers must state whether and how they account for ESG considerations when managing pension fund assets under their control.

### United States

With robust institutions and rule-of-law standards, the U.S. demonstrates many strong characteristics but lags several other countries with respect to ESG regulations and social indicators. Income inequality is higher than in other OECD countries and has been so for over a century. Social services are similarly less generous than in most wealthy countries. Governance is characterized by a very stable political system, strong rule of law, a powerful judiciary, and effective checks and balances. Conditions of doing business are generally high. The U.S. follows a rules-based approach to corporate governance focused on mandatory compliance with requirements from the major exchanges (NYSE and NASDAQ) as well as legislation. State corporate law is also a key source of corporate governance, particularly Delaware where over half over all U.S. listed companies and close to 70% of Fortune 500 companies are incorporated. Exchanges mandate high standards of corporate governance. The NYSE requires companies listing on its exchange to have boards made up of a majority of independent directors and have separate remuneration and nomination committees. However, formal requirements on ESG reporting are not as established as they are in European countries. While a growing number of companies have an independent chair, the combination of CEO and chair roles is still popular. This can undermine management oversight. Remuneration continues to be a contentious point, because U.S. executive pay dwarves global pay levels. The CEO-to-worker pay ratio is ever-increasing, leading to social tensions and shareholder criticism.

### Chile

Chile is one of South America's most stable and prosperous economies with strong political consensus on key economic policies. It enjoys good rule of law and high institutional effectiveness. It is one of only two South American members of the OECD following a two-year compliance period with the organization's mandate. Corporate governance reforms tend to be driven by regulatory initiatives. There is no corporate governance code but various laws and regulations outline governance rules (e.g. The Corporations Act). Chile's Comisión para el Mercado Financiero is the main regulator. In 2015, it instituted the disclosure of information regarding corporate governance standards on a comply-or-explain basis. However, governance requirements still lag behind international markets. Ownership concentration is high and pyramidal ownership structures common. Regulations require local pension funds

(Administradoras de Fondos de Pensiones [AFPs]) to consider governance when making investment decisions and be active owners. Over the years, AFPs have helped improve governance practices. Chile ranks much better than other Latin American countries on corruption at 26 out of 180 on the Transparency International 2019 Corruption Perceptions Index.

## China

Social standards are in line with most other major developing economies. The government recently strengthened legal protection for workers and consumers. Chinese corporate governance standards are also on par with other economies at this stage of development. The central government's recent push to reform state-owned enterprise structures in line with good governance practices is a major development. In 2018, China revised its Code of Corporate Governance for listed companies, accounting for OECD requirements and particularly focusing on ESG disclosure and board diversity. Official corruption has become less of a problem over the past few years due to the central government's anti-corruption drive. This effort has also been extended to government-related companies and financial institutions. Still, corruption among private enterprises remains an issue. Although judicial reforms are ongoing, the private sector has yet to trust that the rule of law is significantly improving.

# Related Research

- “The ESG Risk Atlas: Sector And Regional Rationales And Scores,” published July 22, 2020
- “Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide,” published July 22, 2020
- “Environmental, Social, And Governance Evaluation: Analytical Approach,” published December 15, 2020
- “How We Apply Our ESG Evaluation Analytical Approach: Part 2,” published June 17, 2020

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