ELM SUSTAINABILITY PARTNERS LLC

Analysis: Impacts of Conflict Minerals Ratings on Jewelry Company Sales in 2014

In July 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. Near the end of this 2000+ page legislation, Section 1502 required the US Securities and Exchange Commission (SEC) to establish regulations for companies subject to SEC's jurisdiction to publicly disclose their use of conflict minerals[1] and the countries from which the associated ores came. A basic premise of Section 1502 is corporate reputational risk. The law anticipates conflict-free purchasing standards will develop between supply chain partners in response to public pressure and buying behavior supporting conflict-free products, conversely punishing companies without robust conflict minerals programs.

In December 2010, The Enough! Project[2] published their initial ratings relative to their views on conflict minerals performance of twenty-one major consumer electronics companies[3]. In 2012, THE ELM CONSULTING GROUP INTERNATIONAL LLC conducted an analysis to determine if the ratings had a measurable/material impact on those companies in the intervening year[4]. Our general conclusion from that analysis was no obvious connectivity could be identified between the rankings (used as a proxy for consumer perceptions of conflict minerals) and financially material consumer sales performance; therefore, consumers were not likely to differentially punish or reward companies in response to conflict minerals disclosures or programs[5].

In November 2014, just ahead of the holiday season, Enough issued their next company ratings - this time focusing on major jewelry retailers and gold[6]. In response, ELM SUSTAINABILITY PARTNERS LLC is updating our original analysis as well. As Enough generally followed their original approach, we also followed our original analysis methodology to the extent possible. We sought to answer two questions rooted in the perception and activism on the part of the general public:

Have consumers made buying decisions based on conflict minerals disclosures and programs?

Will consumers punish companies disclosing that material from militia-controlled DRC sources may exist in their supply chain?

We rely on existing but limited information in the public domain and we attempted to assess the data to see what – if any – generalized trends could be distinguished. The intent is not to conduct a definitive academic study, develop new market surveys/data or assess the validity/accuracy of consumer perceptions on the subject.

Assumptions

We use the same assumptions as in our original report, realizing these are optimistic and may be biased toward a particular outcome. However, reasonable, meaningful and comparative results could not be achieved without these in our opinion.

- The Enough ratings are a proxy for consumer purchasing decisions consistent with the sentiment represented by the rankings;
- Negative perception/activism results in sales below the financial performance scale midpoint;
- Positive perception/activism results in sales above the financial performance scale midpoint; and
- Aggregated results of consumer perception/activism are financially material.

Limitations

Like our previous analysis of electronics companies, we encountered certain limitations in the financial data. Of the fourteen retailers rated by Enough, twelve publicly report financial data. Of those, ten incorporate jewelry into broader categories, and two do not identify revenues by categories at all. Only two of the fourteen are jewelry retailers with data specific to this analysis. There is also the timing of the Enough report, published in November 2014. Full-year financials may not be an accurate reflection of impacts of the rankings, but to generate results using consistent data, we used full reporting year results[7].

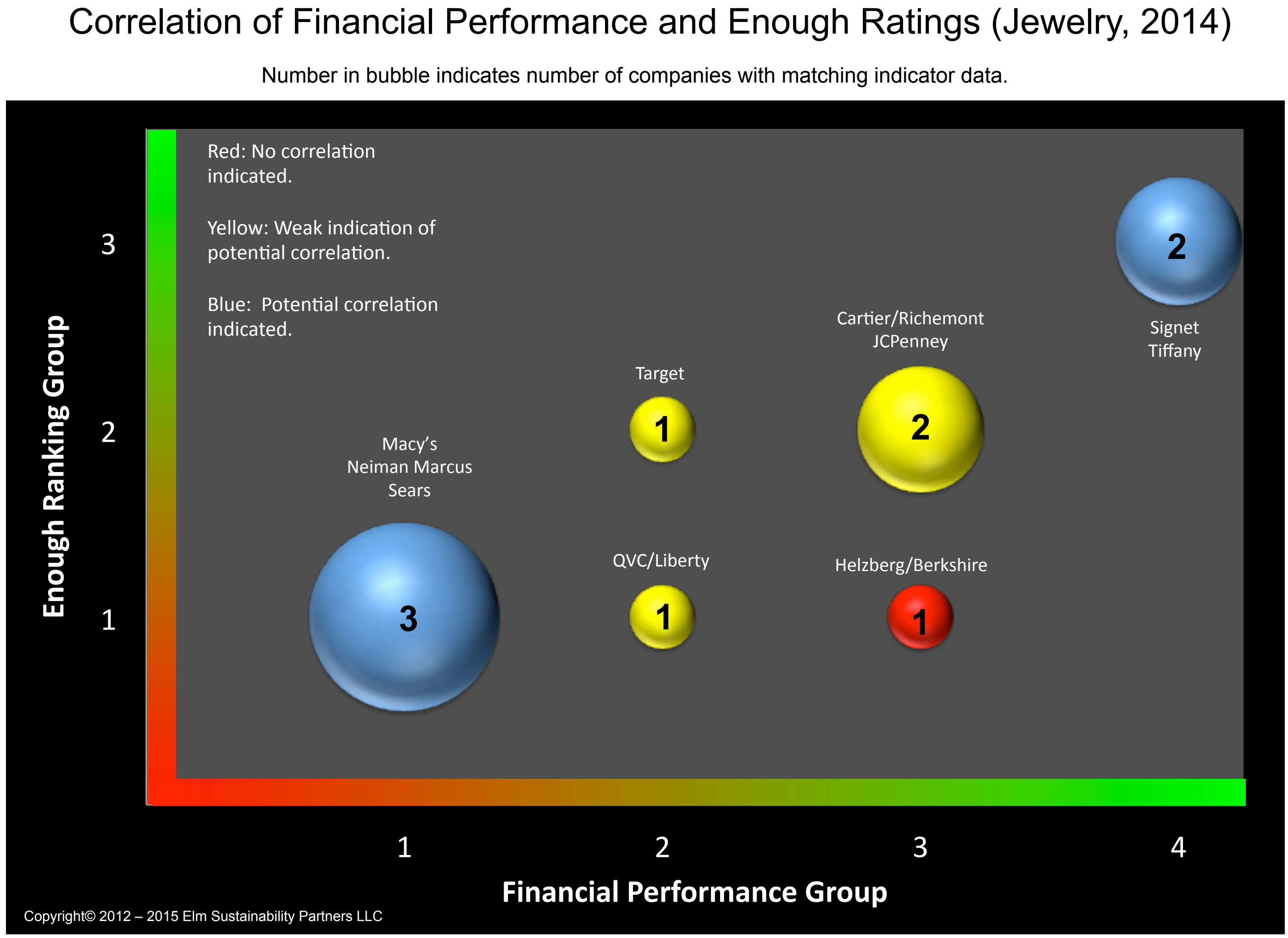
Jewelry-specific data available	Companies reporting jewelry within a broader category	Companies not separately identifying jewelry	Companies that do not publicly report financial data
Signet Jewelers	JCPenney	Wal-Mart Stores	Jewelry Television
Tiffany & Co.	Target Corp.	Costco Wholesale Corp.	Ross-Simons (part of Luxury Brand Holdings)
	Cartier (part of the Richemont Group)		
	QVC (part of Liberty Interactive Corp.)		
	Macy's		
	Helzberg Diamonds (part of BerkshireHathaway)		
	Sears Holdings Limited		

Methodology

Because Enough changed their rating system for 2014, we modified our methodology as well. First, the 2011/2012 Enough ratings used a red/yellow/green indicator that directly corresponded to a scale of 1 – 3 for data plotting. The 2014 ratings are instead percentage scores between 0% and 43.9%. In order to mirror our previous data plotting, we split the scores into thirds to corresponding to a scale of 1 – 3, with 3 being the highest scores, with 3 being the highest and a proxy positive consumer perception/action.

Again, we used the same process for determining financial performance as we did in 2012[8], converting year-over-year financial performance (revenues - 2013 to 2014) to a scale of 1 to 4, four being the best. Revenue gains/losses ranged from -24.1% to 5.7%, but eight of the ten companies reported relevant revenues between 0.6% - 5.7%. Because this spread was narrow and we needed adequate granularity for data plotting purposes, our scale of 1 to 4 is based on the 0.6% - 5.7% range, with the two lowest (negative) performers being assigned a 1.

Analysis



Conclusions

It is interesting to see that the data generally show a correlation between the two factors. But we hesitate to state that there is a direct causal relationship between the Enough ratings and financial performance. We theorize that the relationship is reversed: companies with higher financial performance are likely willing to spend more on conflict minerals programs (and thus achieve higher Enough ratings) than their counterparts facing greater financial pressures[9] who may spend less (resulting in lower Enough ratings). Moreover, where jewelry is part of a larger product category, jewelry sales performance cannot be separately identified, and may be artificially diluted or inflated by the broader category – making the financial indicator essentially meaningless. Finally, full year financial data on which we relied may not be an appropriate measure of any impact the Enough ratings may have had, given that their report was published less than two months before the end of the year.

We also reiterate that, as in our previous analysis of electronics companies, other reasonable conclusions include: the Enough ratings and related public perceptions/activism are not converting to consumer purchasing decisions; the credibility (as viewed by consumers) or public awareness of the Enough Project's rankings is not high; and the financial impact of perception-based purchasing that is occurring is not material. It is also possible that positive consumer perception reduced an otherwise worse financial performance, but that cannot be determined or estimated. The conclusions of this analysis should not be taken out of context of the stated assumptions, limitations and small sample focused in one industry and is not intended to minimize the importance of complying with the final SEC rule or of corporate social responsibility programs.

ELM SUSTAINABILITY PARTNERS LLC is recognized globally as a leader in conflict minerals consulting and auditing. For more information, we invite you to read our blog at http://www.elmsustainability.com, or contact Lawrence Heim, CPEA via email (lheim@elmsustainability.com) or phone at 678-200-5220.

Endnotes:

[1] Conflict minerals are defined as tin, tantalum, tungsten and gold, also known as “3TG”. There are technical complexities concerning the definition that are not relevant for this analysis and are therefore not discussed herein. The intent of Section 1502 is to eliminate the potential funding of armed groups in the Democratic Republic of Congo (DRC) and the nine adjoining countries, known as “Covered Countries”. These armed groups are known to systematically commit human rights abuses and sexual violence as a weapon of their war. It is believed these groups obtain much of their funding through the control, sale and illegal taxation of 3TG from Covered Countries.

[2] The Enough! Project is a non-governmental organization (NGO) whose stated mission is “to end genocide and crimes against humanity, focused on areas where some of the world’s worst atrocities occur.” http://www.enoughproject.org. Reference to and inclusion of Enough in this analysis is not an endorsement of the Enough Project or the rankings, nor do we imply the rankings are valid, credible or accurate. Use of the rankings herein only reflects (a) the limitation that no other specifically-targeted indicators or rankings currently exist and (b) that they are intended for the general public/consumers. ELM is not responsible for information from those sources on which we relied.

[3] http://www.enoughproject.org/publications/getting-conflict-free. The original ratings were updated in August 2012 at http://www.enoughproject.org/publications/taking-conflict-out-consumer-gadgets-company-rankings-conflict-minerals-2012

[4] At the time of that analysis, ELM SUSTAINABILITY PARTNERS LLC had not been formed. Today, ELM SUSTAINABILITY PARTNERS LLC is a wholly-owned subsidiary of THE ELM GROUP. Our original study is at http://elmsustainability.com/wp-content/uploads/2014/07/Elm-Analysis-CM-Financial-Risk.pdf

[5] Other assumptions and reasonable corollary conclusions were brought forth as well, which are the same as in this report.

[6] http://www.enoughproject.org/reports/going-gold-engaging-jewelry-industry-responsible-gold-sourcing-africa’s-great

[7] Some companies published holiday season sales figures, which would probably be a better indicator. But since these figures were not available for all the companies, we could not use those figures alone.

[8] Annual financial reports for the companies were reviewed to obtain 2013 and 2014 sales for jewelry or the related segments, and the percent year-over-year change was calculated. Quartiles were then established as the financial indicator scale, with Grouping 1 as the lowest performers and Grouping 4 as the highest.

[9] It has been widely publicized that JCPenney, Sears and Target faced broad-based downward financial performance in recent years. In addition, of the ten companies reporting financial data used herein, eight reported higher revenue growth in the previous period (2012 – 2013) than they experienced for the period reviewed in this analysis. The two with better performance this period are JCPenney and Target.