

## Case Study: H&M & Sustainability

### Background

Hennes & Mauritz AB (H&M) is an international clothing retailer from Sweden. Founded in 1947, it has grown to one of the biggest brands in the fashion industry and has more than 5000 stores worldwide. H&M's success can be largely attributed to its fast-fashion business model, which relies on a large and continuous flow of new clothes from the designer table to the stores. The revenue comes from a high merchandise turnover and through the constant resupplying with the latest trends. This model requires a great marketing team that can predict the next trends for target demographics. H&M has a wide customer base and makes men's, women's, teenagers', and children's clothing, but focuses mostly on a younger and fashion-conscious urban consumer. Although it started as purely brick and mortar, H&M has increased its digital investments and does online sales as well. In 2021 the company announced that they would be permanently closing 350 stores after concluding that more and more customers are shopping online. However, the company believes in a mixture of physical stores and online shopping and aims to integrate the two channels. The fast-fashion strategy is not limited to H&M, but the company has a distinct business model that relies on over 900 external suppliers that are overseen by 30 strategically situated offices around the world (Tun, 2021). Although H&M outsource the production of its clothes, the company still employed over 110,000 people in 2020 (Statista Research Department, 2021a).

In 2019, H&M was considered the fourth most valuable apparel brand in the world, after Nike, Zara, and Adidas. That year 3.5 billion U.S. dollars were generated in Germany, which is H&M's biggest market. In 2020, the H&M group had a global operating profit of approximately 334 million U.S. dollars, a significant drop from the previous year. H&M's operating profit has dropped significantly in the last decade falling to 334 million from over 3.5 billion dollars in 2010. (Statista Research Department, 2021b). The H&M stock is listed on the Stockholm Stock Exchange (Nasdaq Stockholm) and was as of November 11<sup>th</sup>, 2021, priced at 171 SEK (approximately 20 U.S. dollars). The H&M stock recovered from the 2020 stock market crash but has been trending downward since March 2021. Since 2000 the stock price peaked at just over 360 SEK in early 2015 and has steadily trended downward (H&M Group, 2021c).

Over the years, H&M has been part of various controversies. For example, in 2018 H&M faced backlash after an advertisement containing a black boy modeling a hoodie with the slogan "Coolest Monkey in the Jungle." This led the company to issue a statement saying: "We have got this wrong and we agree that, even if unintentional, passive or casual racism needs to be eradicated wherever it exists." This event led H&M to appoint its first global leader for diversity and inclusiveness (Blanchard, 2019). More recently, in 2021, H&M faced boycotts in China after having expressed concerns surrounding the alleged use of Uighur forced labor in cotton production. This statement resulted in many people in China calling for boycotts as well as celebrities cutting ties and e-commerce platforms dropping H&M (Brant, 2021).

### Definition of Sustainability

H&M has recognized the need for new sustainable fashion industry. Therefore, the company started transforming its business to address the global challenges, which are becoming increasingly apparent in the business landscape. The company

has started its transition and has the vision of leading the change toward circular and climate-positive fashion while being a fair and equal company. For H&M, sustainability involves three components: Leading the Change, Circular & Climate Positive, and Fair & Equal; thus, its definition includes both environmental and non-environmental factors (H&M Group, 2021b).

Leading the Change refers to H&M's determination to become a role model for its industry by improving sustainability performance in its value chain. H&M aims to demonstrate the resilience of sustainable businesses and the company wants to amplify its positive impact by partnering with others. This component to H&M's definition of sustainability acts as the mindset that influences the company's whole operation and contributes to it achieving its ambition to become fully circular and climate positive while being a fair and equal company. This mindset focuses on two key areas that could maximize the company's impact: innovation and transparency. Innovation stimulates the transformation toward the company goals (Circular & Climate Positive and Fair & Equal) through identifying, testing, and scaling new solutions and business models. Transparency refers to sharing clear, accurate, and relevant information in a truthful and accountable manner. By openly sharing company progress and challenges, H&M can create accountability and encourage other companies to do the same. Also, through collecting and disclosing sustainability information from the company's supply chain, products and, business practices, H&M can increase its visibility and facilitate informed decisions. An important part of its approach is to publicly engage on policy issues with decision-makers. These policy issues include wage-setting mechanisms, labor laws, climate change, due diligence, circular economy, and biodiversity. Via the sharing of knowledge and expertise H&M aims to add value to legislation and promote progress beyond its industry. The company thinks that ambitious and well-defined legislation is key in making industries and governments take on shared responsibility in creating change (H&M Group, 2021b).

Circular & Climate Positive refers to the environmental aspect of H&M's sustainability definition. The company recognizes that two of the currently biggest challenges facing the planet are climate change and the depletion of resources. These challenges have a negative impact on biodiversity and worsen existing human rights issues. H&M realizes that as a large fashion retailer it has a substantial impact on the health of the planet. Thus, to confront these issues H&M aims to become a climate positive and fully circular business with a net positive impact on biodiversity by 2040. Becoming circular means transitioning away from a linear business model to one where the value of products and resources are maximized. This is done by reusing the resources as much as possible before finally recycling them at the end of the product lifecycle. To become circular H&M must create circular products that are made to last and are produced from safe, recycled, and sustainably sourced materials that can recirculate multiple times. Circularity also involves a circular supply chain, which means that both all upstream and downstream processes become sustainable through circular production processes, circular material flows, and recirculation of products. The last component to circularity, circular customer journeys, involves H&M providing accessible methods for customers to experience and engage in sustainable fashion where products are used more, repaired, reused, and recycled. As the climate crisis is one of the most serious challenges to the business world, H&M aspires to be part of the solution by becoming climate positive by 2040. According to H&M, climate positive means that the company removes more

emissions than it emits. This work focuses on four priority areas: energy efficiency, renewable energy, circularity, and nature-based solutions (H&M Group, 2021b).

Lastly, Fair & Equal makes up social and governmental issues in H&M's definition of sustainability. The Fair & Equal component refers to the fundamental human rights of all people across the company's value chain, supply chains, and in the communities where it operates. H&M wants all people to be treated equally with respect, dignity, and the empowerment to be who they want to be. The focus areas of the Fair & Equal component include human rights, which concentrates on different issues that have negative impacts on people. Another focus area is "fair jobs for all," which involves encouraging pleasant and meaningful jobs with fair compensation and benefits throughout H&M's operations and value chain. These jobs should also be in safe and secure workplaces that are free from discrimination and where everyone has the right to freedom of association. The last focus area, inclusion & diversity, refers to the enabling of inclusive and diverse workplaces that endorse equity for all. H&M aims to foster diversity and equality through its products and communication, and forward inclusion in its communities and society at large (H&M Group, 2021b).

H&M's definition of sustainability includes many different environmental, social, and governance (ESG) issues and contains all the standard components, such as renewable energy use, emission standards, water usage, waste management, biodiversity, etc. However, it also covers many unusual elements, such as toxics, resource risks, equity, worker safety, employee well-being, etc. Sustainability is addressed internally through the management, which also considers how the company can impact its value chain and surrounding communities. H&M's sustainability efforts extend to all its brands, but each brand is allowed to maintain its unique identity and develop a customized approach to achieve the overall goals. All sustainability initiatives are connected to the Change-Making Programme. The program includes goals, roadmaps, standards, and methods that help the company to work towards its vision by promoting change and to ensure that sustainability is integrated into all its actions. Through training programs, H&M has involved its employees in sustainability issues, especially human rights, local safety and health, and inclusion and diversity (H&M Group, 2021b).

H&M's approach to its supply chain management involves partnering with associates that share the company's vision of a sustainable fashion industry. Thus, it chooses to work with suppliers that are open to challenging themselves and H&M, so they together can cause positive change. The Sustainability Commitment outlines H&M's expectations for suppliers and business associates. This commitment includes compliance with minimum requirements and international standards, as well as going beyond compliance to create lasting impacts. All suppliers and business partners are required to sign and follow the Sustainability Commitment and H&M's Code of Ethics. The company monitors compliance using a system of risk-based audits and its Sustainable Impact Partnership Programme. The program gives H&M more accurate performance assessment than audits alone, which generates a positive feedback loop that encourages continuous progress. H&M has been using the Sustainable Impact Partnership Programme since 2016 and has constantly increased coverage to incorporate more components of its supply chain. The Sustainable Impact Partnership Programme involves several components (H&M Group, 2021b).

H&M acknowledges Sustainable Development Goals and has signed the UN Global Compact. The company also informs customers and stakeholders about its sustainability efforts through transparent reporting that is in accordance with the GRI Standards. The reporting includes a Sustainability Performance Report, reporting

indexes, a Statutory Sustainability Report in the Annual Report, and supporting web content, which is all accessible to the public. H&M was ranked as the number one in Fashion Revolution's 2020 Fashion Transparency Index. The company plans to encourage more informed choices amongst its customers by providing more information about the impacts and journey of its products and encouraging sustainable consumption behavior by enabling, inspiring, and rewarding sustainable actions. H&M is piloting different initiatives that return different manufactured goods for reuse. One effort is, for example, the launching of the Conscious Exclusive collection that uses Circulose, which is a man-made cellulosic fiber derived from recycled cotton waste (H&M Group, 2021b).

## **Leadership**

The current CEO, Helena Helmersson, was appointed by the board of directors on January 30<sup>th</sup>, 2020. Helena joined the company's buying department in 1997 and has worked in various roles. For example, Helena was the head of sustainability as well as the head of the production for five years. She also worked as COO for approximately a year before becoming the CEO. Helena's experience as the head of sustainability makes her well versed in ESG issues; thus, she recognizes the importance of sustainable development and emphasizes how it needs to be integrated into all aspects of the business (annual report). The CEO has taken an active role in addressing sustainability through different internal and external outlets. She has previously said in an interview regarding sustainability that "the problem is that the system behind it needs to be changed." She thinks that fast doesn't necessarily have to be unsustainable. However, she recognizes that change is required, and the biggest need lies in finding better methods of scaling up recycling (Chan, 2020). Thus, with the need for transitioning away from the linear business model toward a circular model, the leadership has integrated sustainability into the culture, goals, and values of the company (H&M Group, 2021a).

January 1<sup>st</sup>, 2021, Leyla Ertur took over the position as Head of Sustainability from Anna Gedda, who will now take on a new role as Head of Steering and Strategic Planning at H&M Group. Since joining the company in 2000, Leyla has worked in multiple continents and led different teams in various areas including HR, Production, and Global Supply Chain Management. She worked extensively in production countries where the company operates. Most recently she held a dual position as Regional Country Manager Production in Europe and as Head of Global Quality Strategy and Compliance (H&M Group, 2020a). As the Head of Sustainability, Leyla is responsible for the implementation and performance of the company's sustainability vision and strategy. She works together with the executive management team and reports directly to the CEO. The Head of Sustainability reports the performance of key sustainability indicators to the board of directors twice a year. H&M's global sustainability department includes approximately 40 experts that are in charge of establishing the company's sustainability strategies, goals, policies, and follow-up procedures. They are also responsible for incorporating relevant strategic metrics into the business, in close collaboration with both internal and external stakeholders. The sustainability department strategy team reports progress on the sustainability key performance indicators, key challenges, learnings, and activities every quarter. The head of sustainability reviews these reports with the CEO and CFO. Every brand, retail market, production market, and H&M group function has a sustainability manager whose role is to drive performance toward the company's

sustainability strategy. Over 230 employees are involved in sustainability efforts (H&M Group, 2021b).

Sustainability leaders and functions are of great importance to H&M, which hires internally experienced and respected people for those roles. The organizational structure, level of authority amongst sustainability leaders, and big internal programs devoted to sustainability efforts demonstrate how highly sustainability is regarded within the company. This is something that other companies across all industries can take inspiration from and apply to their businesses. H&M's leadership is a great example of how sustainability can be successfully integrated into a company structure, and it demonstrates sincerity toward ESG issues.

### **Strategy & Metrics**

H&M has several key performance indicators and goals for its sustainability effort, all of which are established by its global sustainability department. Most of these goals and indicators work toward its overarching ambition to become a fully circular business that is climate-positive and has a net positive impact on biodiversity by 2040. Several subgoals have been established for both environmental, social, and governance issues. One specific environmental goal is to reduce absolute scope 1 and 2 greenhouse gas (GHG) emissions by 40 percent by 2030, with 2017 as the baseline year. Related is the goal to reduce absolute scope 3 GHG emissions with 59 percent per product (or 20 percent in absolute terms) by 2030, which also has 2017 as the baseline year. Another effort is to increase the annual sourcing of renewable electricity to 100 percent by 2030. H&M also wants to decrease electricity intensity during the opening hour by 25 percent by 2025 compared to 2016. H&M has set targets for water consumption, greenhouse gas emissions, renewable energy use, and internal operations to reduce waste, chemical use, and reduce the use of packaging (H&M Group, 2021b).

H&M provides different kinds of training related to social and governance issues. One such training is internal inclusion and diversity training. However, the company also offers, and sometimes requires, human rights, anti-corruption, and DEI training. During the pandemic, H&M additionally provided personal protective equipment, health and safety videos, sanitation protocols, and training to employees who could not work from home (H&M Group, 2021a). The H&M Foundation also donated 500,000 USD to the COVID-19 Solidarity Response Fund, to help the World Health Organization's efforts in combating the pandemic. The foundation collaborates and innovates to co-create, fund, and share solutions for urgent global challenges. One collaboration is the six-year-old partnership with WaterAid where H&M helped fund the SusWASH program, which aims to strengthen inclusive water, sanitation, and hygiene systems. Also, within the framework of the International Labour Organization Call to Action, H&M is partnering with various stakeholders to secure funding to support suppliers and their employees. The goal of this work is to secure social protection for workers within eight priority countries: Bangladesh, Cambodia, Ethiopia, Haiti, India, Indonesia, Myanmar, and Pakistan. Other efforts include the H&M Group's donation of 500,000 USD to organizations, such as the National Association for the Advancement of Colored People Legal Defense Fund (NAACP), American Civil Liberties Union (ACLU), and National Action Network (NAN) (H&M Group, 2021b).

ESG issues are taken seriously and are important to the overall organizational strategy. The board sees sustainability as one of the company's long-term interests as it might impact the supply chain, price of raw materials, and consumer

preferences. Thus, H&M surveys key stakeholders every year on its ESG performance. Respondents gave, for example, ratings on company transparency, circularity, and inclusion, and diversity. The company had improved in all these areas and 92 percent of the respondents said that the H&M Group is good or very good at paying attention to and incorporating stakeholder feedback in its sustainability work (H&M Group, 2021b).

Senior executives are occasionally entitled to variable compensations that depend on their fulfillment of targets, which include the overarching financial targets involving pre-set goals for profits and sales, sustainability, and individual goals within their specific area of responsibility. Fulfillments of targets are measured over one year and the purpose of these targets is to promote the company's short and long-term development (H&M Group, 2020b). Thus far, H&M has managed to reach 100 percent sustainably sourced cotton, which means that the cotton is either certified organic, recycled, or sourced through the Better Cotton initiative. H&M has 12 key performance indicators relating to the Circular & Climate Positive component. All targets are measured with data and statistics and have specific timelines that adhere to the ultimate goal of H&M being climate positive by 2040 (H&M Group, 2021b).

H&M's strategy and metrics for sustainability efforts can be implemented by many other companies across industries. The company's global sustainability department has influenced all operations through the targets and measurements it has established. These quantitative goals facilitate company awareness and define success within sustainability issues. Over the years H&M has improved these measurable goals by introducing new targets and specifying existing objectives. Managing these metrics has become a routine procedure at the company and they are now central for company strategy and performance assessments (H&M Group, 2021b).

### **Relationship with Suppliers and Partners**

The H&M group partners with about 700 commercial product suppliers in a total of approximately 1,900 manufacturing factories and final product processing units for apparel, footwear, accessories, home interior, furniture, and beauty products. The company has 19 production offices located in 17 different markets. The supply chain is complex and suppliers are divided into various levels or 'tiers', where the two most important ones are tier 1 and tier 2 suppliers. Tier 1 suppliers are manufacturing suppliers and subcontracted factories that manufacture the products by cutting, sewing, and processing. Tier 2 suppliers are suppliers that deliver the fabrics and yarns for the products, including spinning, tanning, and fabric dyeing and printing facilities. H&M desires to operate alongside suppliers that share its vision for a more sustainable fashion industry. Therefore, it is required for all its suppliers and business partners to sign the group's Sustainability Commitment and Code of Ethics. These mandatory guidelines outline the group's expectations for all its partners and, as previously mentioned, require compliance with minimum requirements and aspirations to exceed the minimum requirements for long-term impacts. In the Code of Ethics, there is a zero-tolerance policy on corruption that also mandates business partners and employees to abide by local legislation as well as the H&M's own business principles. Adherence to the requirements is supervised using a system of risk-based audits. The Sustainable Impact Partnership Programme also provides more insight into performance, which creates positive reinforcement to encourage constant improvement and development capacity. The program is constantly expanding its coverage to include all tier 1 supplier units and an increasing proportion

of tier 2 suppliers. Supplier factories are also being evaluated using tools created by the Sustainable Apparel Coalition and its partners (H&M Group, 2021a).

### **The Future of Sustainability at H&M**

H&M has done a lot of good work in ESG issues; thus, it was recognized, in 2020, by Dow Jones Sustainability Index, which sets benchmarks for investors that considers companies' sustainability practices when investing (S&P Global, 2021). The index gave H&M the maximum score for human rights, environmental reporting, social reporting, and materiality. H&M also got the highest score in its industry for supply chain management and strategy for emerging markets. H&M also received the highest score on its 2020 climate CDP report, which recognizes companies in front of environmental transparency and performance. Lastly, as previously mentioned, H&M Group ranked first in Fashion Revolution's 2020 Fashion Transparency Index (H&M Group, 2021b).

Despite the recognition for all H&M's efforts in reporting, transparency, and sustainability, the company still has a long way to become sustainable according to its definition. For example, the company's gross global Scope 1 emissions were approximately 12,000 metric tons CO<sub>2</sub>e and its gross global Scope 2 emissions were just under 565,000 metric tons CO<sub>2</sub>e between December 1<sup>st</sup>, 2019 to November 30<sup>th</sup>, 2020. Also, for H&M's 2021 CDP report, the company received a B-score, which is a significantly worse score than the year before (CDP, 2021). Further, in some of the KPIs for Circular & Climate Positive H&M was not able to reach its 2020 ambitions. For example, the company wanted to have all supplier factories compliant with the Zero Discharge of Hazardous Chemicals (ZDHC) Manufacturing Restricted Substances List, which was not achieved. H&M was neither able to have all of its operational facilities using water-efficient equipment. The company blamed some of these shortcomings on the pandemic, which created physical barriers as well as shifted short-term priorities (H&M Group, 2021b).

H&M has a lot of ahead to become sustainable and reach company goals. Thus far, it has not had a low-carbon transition plan as a scheduled resolution item at Annual General Meetings, but the company intends to start implementing that into the meetings within the next two years. Also, the company is not tracking data such as its revenue from low carbon products during the reporting year, which should be included in the CDP report (CDP, 2021). H&M must scale up programs that offer customers an organized and accessible range of reuse, resell, and recycle options. The company also needs to minimize waste and maximize resource efficiency, while also eliminating the use of toxic chemicals. Further, the company should increase the use of renewable and recycled materials in its products, while also designing out unnecessary waste via new optimization technologies. H&M is recognizing these issues and plans to work on them moving forward. However, it has not established timelines for all these efforts (H&M Group, 2021b). H&M has demonstrated its ability to transform its operations and integrate sustainability into its business strategy. Sustainability functions have become increasingly important to the company, and this is a trend that is likely to continue as societal pressure is beginning to change company culture and the business landscape.

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