



# **CORPORATE SOCIAL RESPONSIBILITY REPORT 2005**

**H&M**

Stockholm 2 April 2006

Dear Reader,

We appreciate the positive response to our previous reports, and I would like to thank all of you who have provided us with valuable feedback. Many suggestions made by our stakeholders on last year's report have been incorporated in this report and we hope you will find the reading even more interesting and relevant this time.

The main focus in this report is a thorough description of our first trials using our new FAP (Full Audit Programme) methods and tools. Responding to the demands for audit results we are also reporting on the results from those few first FAP audits, having spent considerable time to manually collect the statistics. Our ambition next year, given that our new reporting tool is up and running by then, is to report all FAP results from 2006. We are very satisfied with the early results from using our FAP methodology. We strongly feel that we are on the right path towards sustainable improvements albeit it will in some cases be a slow process.

There seems to be a consensus that multi-stakeholder initiatives are the flavour of the year. We describe in this report some of the various initiatives H&M are participating in, such as Better Factories Cambodia, MFA Forum Bangladesh and H&M's decision to participate in the FLA. We already see several benefits from these joint initiatives and believe that cooperation is the right way forward.

Viewing the introduction of FAP and participation in joint initiatives as some of the success stories this year, we can note that we have not met the mark when it comes to reduction of carbon dioxide emissions. However, we have set a five year target, and changes are taking place that we believe will have an effect already next year

on reducing energy consumption. Thanks to setting a target, we now have this issue in focus. In the next couple of years we will work on ways to reduce the emissions from transport, in particular air and sea-air transport. We can also note that a substantial part of the increase comes from improved data collection and inclusion of several points of departure that were not previously included.



As anticipated, the ending of the Multi-Fibre Agreement did not have a major impact on H&M's sourcing patterns. Bangladesh, one of the countries many feared would be losing business has instead been a growth market for H&M during 2005. We have also had a strong CSR focus in Bangladesh and we report on various promising initiatives taken there.

Environmental impacts of cotton farming are in focus as we are moving into 2006. We had set a target of using at least 20 tonnes of organic cotton in 2005; the actual consumption was more than 40 tonnes. We have not set a fixed target for 2006 but we are looking at various strategies to gradually increase our yearly consumption of organic cotton. We are also participating in the recently started Better Cotton Initiative, briefly introduced in the report.

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Ingrid Schullström  
CSR manager

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### OUR SOCIAL RESPONSIBILITY

In this section, we describe this year's social performance and activities, including results from FAP audits. We also explain the challenges that we face in various countries of production, as well as our working methods. There is also information about remediation projects, our quality work and community involvement.

It is essential for us to understand what our stakeholders expect from us. This section includes feedback on our CSR reporting from representatives of four significant stakeholder groups.

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## **H&M** **OUR BUSINESS**

This section covers basic facts about corporate social responsibility (CSR) and H&M. We describe our CSR vision and strategy, as well as the main aspects of our responsibility. We also provide information about our company, products and employees.

## CSR IN 2005: HIGHLIGHTS

- We began auditing our suppliers' and their subcontractors' factories in accordance with the Full Audit Programme (FAP), our new method for factory monitoring. Read more about FAP on page 24.
- H&M was accepted as a participating company of the Fair Labor Association (FLA). The FLA will conduct independent external monitoring visits at some of our suppliers' factories in China. Read more about the FLA on page 40.
- H&M joined several multi-stakeholder initiatives during the year: Better Factories Cambodia, MFA Forum Bangladesh, and the Better Cotton initiative. Read more on page 41 and 69.
- We asked representatives of four significant stakeholder groups to provide feedback on our CSR reporting. Their statements can be found on page 43.
- Our chemical restrictions were updated for the sixth time since 1995. More information about our quality work is available on page 53.
- We increased our use of organic cotton from five tonnes in 2004 to more than 40 tonnes in 2005. Read more about our environmental work on page 63.



## STATEMENT FROM OUR MANAGING DIRECTOR

CSR at H&M is a process that never ends. We are continuously reviewing our work and we discuss, both internally and with our stakeholders, how we can improve further. However, the most important thing is that we do not stop at talking; action is what it takes to reach results. This report demonstrates how H&M takes its commitment to CSR seriously, not just in words but in actions and that we do achieve results.

During 2005, I met with our Code of Conduct auditing team in Bangladesh, and I was impressed by their commitment and their enthusiasm. They come from varying backgrounds and they all bring their special knowledge to their team. Far away from the fashion world and the H&M stores they, as well as their colleagues around the world, make a very important contribution to H&M's success.

Looking back at the events of 2005, it is easy to remember the remarkable fashion show in Central Park, the opening of our first store in San Francisco, or the success of our collection by Stella McCartney. But there is another memory that stands out as a very proud moment; my visit to H&M's training centre in Dhaka. Understanding the difference that the education provided by H&M makes in the lives of our trainees and their family was, to say the least, moving.

H&M is a company with values rooted in a tradition of dialogue and respect for other perspectives than our own. This has become an asset in

our contacts with trade unions, NGOs, investors and other organisations with opinions about how well H&M is performing in the field of CSR. Some of their voices are heard in this report. However, exchange of opinions is not enough. We have learned through our own experience that we can reach better results in cooperation with others. Our decision to join the Fair Labor Association from 2006 was based on that insight.

Finally, and on a personal note, I would like to make a few reflections on the environment. I have grand children, and their future health and quality of life depend on our decisions today. It may sound as a bit of a cliché, but never the less it is true that each and every one of us has a responsibility towards future generations. This responsibility we have to incorporate in our daily decisions at home as well as at the workplace. I would like to end this letter with my message to every H&M employee and to all of H&M's suppliers. Together we can reduce H&M's negative impact on the environment, and we have a responsibility to the coming generations to do so. Therefore we are committed to our environmental policy and to the targets we have set to reduce H&M's impact on the environment.



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Rolf Eriksen

## CSR VISION AND STRATEGY

### CSR vision

H&M's corporate social responsibility (CSR) vision is to uphold human rights, contribute to sustainable development, and thereby earn trust from our stakeholders.

### CSR strategy

H&M's business strategy is to continue to grow whilst maintaining good profitability. H&M believes that long-term profitability and good relations with the world around depend on us taking responsibility for how people and the environment are affected by our activities.

Our environmental policy sums up H&M's general strategy on corporate social responsibility:

“Continuous improvements are significant for all H&M activities. This includes our environmental and social efforts, which are conducted within the framework of our business operations. H&M's business concept is to give our customers unsurpassed value by offering fashion and quality at the best price. Our quality concept is based on ensuring that our customers are satisfied with our products and H&M as a company. To this end, we are committed to acting responsibly in our community. We will also cooperate with our suppliers to improve the social and environmental standards in the factories that manufacture H&M clothing, thereby contributing to sustainable development in these areas.” ■

### CORPORATE SOCIAL RESPONSIBILITY

H&M defines CSR as “a concept whereby companies integrate social and environmental concern in their business operations and in their interaction with their stakeholders on a voluntary basis in order to meet or exceed the ethical, legal, commercial, and public expectations that society has of business”.

## MAIN RESPONSIBILITY ASPECTS

H&M has identified a number of responsibility aspects that we consider the most pressing within our industry, especially with regard to our supply chain.

### Social aspects

H&M does not own or operate any factories. We work together with approximately 700 suppliers<sup>1</sup>, who in turn use subcontractors<sup>2</sup>. In all, about 2,000 production units<sup>3</sup> and more than 700,000 people around the world are involved in the production of our goods. More than half of these production units are located in countries where human rights violations exist, and where labour standards are not fully observed.

Our risk assessments as well as several years of experience in monitoring garment factories has shown that the main aspects are violations of laws concerning working hours and wages. Other pressing issues, although less common, are compulsory overtime, restrictions on the right to organise, physical and verbal abuse, and sexual harassment. Unclear employment conditions, exploitation of migrant workers and use of child labour are other examples of violations that occasionally occur.

In our Code of Conduct, we make it clear that we do not accept any of these violations, and since we began monitoring factories, the conditions have improved substantially. However, many challenges still lie ahead, and we believe that it is important that we as a buyer work together with our suppliers in order to achieve progress.

<sup>1</sup> In this report, the term 'supplier' denotes a prime contractor which supplies products to H&M, and which consequently has a direct business relationship with H&M. Our suppliers may have factories of their own, or subcontract all or parts of their production.

<sup>2</sup> A company hired by a prime contractor (supplier) to perform a specific task as part of the overall project. Thus, a subcontractor does not have a direct business relationship with H&M.

<sup>3</sup> In this report, the term 'production unit' refers to factories that produce garments for H&M, both suppliers' and subcontractors' factories.

### Environmental aspects

Conventional cultivation of cotton as well as dyeing and processing of fabrics have substantial environmental effects. Examples of issues arising in garment production are energy consumption, water pollution and chemical handling. H&M's Code of Conduct includes environmental requirements, and in recent years we have taken steps to address issues further down the supply chain. Read more about the cleaner production programme on page 66, and about organic cotton on page 68.

Transportation of H&M goods accounts for about 50 per cent of total carbon dioxide emissions caused by H&M operations. It is therefore vital for H&M, in cooperation with our transport service providers, to aim for more environmentally adapted transport.

At the end of 2005, H&M operated 1,193 stores and 14 distribution centres. H&M uses considerable amounts of materials and other resources when building and re-building stores. We aim to limit the environmental effects by establishing requirements for our property owners and contractors. Furthermore, the operation of our stores results in waste from packaging, hangers, decorative materials, disposable materials etc. We strive to reduce waste and re-use and recycle waste material whenever possible.

### Health and safety aspects

All our suppliers have signed an agreement to abide by H&M's chemical restrictions. In this way, we contribute to the reduction of environmental harm during the manufacture of our goods as well as during the disposal of worn out clothing. Due to continuously increased awareness about the effects of various substances, our chemical restrictions are regularly updated. Our restrictions concern chemicals used in the production of H&M clothing and cosmetics. ■



## OUR BUSINESS CONCEPT

H&M offers fashion and quality at the best price through a wide and varied range of fashion, divided into different concepts. The range covers everything from updated classics and basics to clothes that reflect the latest international trends. It also includes underwear, sportswear, accessories and cosmetics. The largest department is women's wear, followed by children's wear, teenage fashion and men's wear. The majority of our stores are full-range stores, but H&M also has concept stores offering garments for women, men, teenagers or children only, and stores that sell only cosmetics, lingerie and accessories.

H&M has been selling cosmetics since 1975. Today, the range consists of make-up, body care and hair care products as well as accessories for women, men and teenagers.

Since 1980, H&M has offered its customers an alternative and convenient way to shop by mail order through H&M Rowells.

In 1998, it became possible to shop at H&M on the Internet. Online shopping is available to customers in Sweden, Denmark, Finland and Norway. A considerable expansion of online and catalogue sales is being prepared to complement the stores in the existing markets. The Netherlands will be the first country outside the Nordic region to start online sales in autumn 2006.

### H&M IN BRIEF

- H&M was established in Sweden in 1947.
- The business concept is "Fashion and quality at the best price".
- Today H&M sells clothes and cosmetics in approximately 1,200 stores in 22 countries. H&M's growth target is to increase the number of stores by 10–15 per cent per year but also to increase sales at existing stores.
- In Scandinavia H&M Rowells sells fashion by mail order.
- In Sweden, Denmark, Norway and Finland H&M sells fashion via the Internet.
- H&M does not own or operate any factories, but instead works with around 700 suppliers. About 60 per cent of the production takes place in Asia, and the rest mainly in Europe.
- H&M has 22 production offices: nine in Europe, eleven in Asia and one each in Central America and Africa. The group has more than 50,000 employees.
- The turnover in 2005 was MSEK 71,885.8 including VAT.

### NET TURNOVER BY COUNTRY

	2004/05	2003/04
Sweden	4,961	4,717
Norway	3,717	3,326
Denmark	2,405	2,183
UK	5,365	4,909
Switzerland	3,599	3,387
Germany	16,881	15,258
Netherlands	3,652	3,310
Belgium	2,084	1,819
Austria	3,578	3,485
Luxembourg	270	254
Finland	1,472	1,270
France	4,371	3,709
USA	3,819	3,231
Spain	2,494	1,685
Poland	654	384
Czech Republic	305	164
Portugal	256	189
Italy	498	197
Canada	542	168
Slovenia	217	50
Ireland	114	–
Hungary	8	–
<b>Total</b>	<b>61,262</b>	<b>53,695</b>

## OUR PURCHASING PROCESS

### Buying office

The design and buying department in Stockholm is where H&M's collections are created. Its task is to find a good balance between the three components that make up H&M's business concept; fashion, quality and the best price. Over 500 people work together to create H&M's collections for women, men, teenagers and children.

### Production offices

In order to be able to follow up production, H&M has 22 production offices: eleven in Asia (e.g. China, Bangladesh), nine in Europe (e.g. Italy, Turkey) and one each in Central America and Africa. The production offices employ approximately 750 people. The role of the production offices is to serve as links between the buying office in Stockholm and the suppliers. Our production office staff place orders, oversee production, and follow up on H&M's requirements including Code of Conduct compliance, quality and product safety.

### Suppliers

We work with around 700 suppliers. Approximately 60 per cent of the production takes place in Asia, and the rest mainly in Europe. We make an effort to cooperate only with suppliers who meet a number of requirements relating for instance to capacity, quality, lead times, and compliance with our Code of Conduct. H&M endeavours to bring about long-term relationships with suppliers. Continuous cooperation facilitates observance of our requirements.

### Distribution

Every stage in the transport chain, starting with the forwarder, is controlled by H&M, which acts as importer and retailer. Once the garments are ready for shipment, they are distributed to H&M's stores via distribution centres. Most sales countries have a distribution centre where the garments are checked and sent on to the stores. Having few links and as few stops as possible in the distribution chain makes the supply of goods efficient. ■



The design and buying department is where H&M's collections are created.

## OUR EMPLOYEES

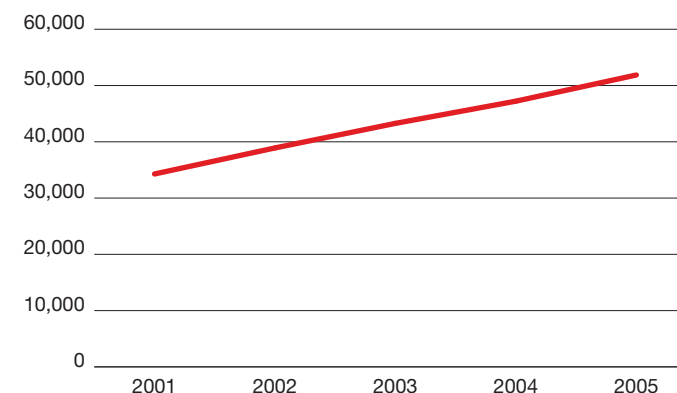
At the end of 2005, H&M employed more than 50,000 people. This represents a net increase of 9.8 per cent (4,650 employees). The average number of employees was 34,614 (converted into full-time positions). 80 per cent of our employees were women, and 20 per cent were male.

Of the management positions (including group management, buying office division managers and production and sales country managers), 44 per cent were held by women, and 56 per cent by men.

H&M Group	Total	Female %	Male %
Sweden	3,872	81	19
Norway	1,523	91	9
Denmark	1,066	95	5
UK	3,408	77	23
Switzerland	1,317	89	11
Germany	8,778	81	19
Netherlands	1,840	82	18
Belgium	1,260	86	14
Austria	1,681	88	12
Luxembourg	125	88	12
Finland	657	89	11
France	2,467	73	27
USA	2,406	68	32
Spain	1,721	77	23
Poland	601	75	25
Czech Republic	209	91	9
Portugal	181	71	29
Italy	383	76	24
Canada	294	76	24
Slovenia	70	76	24
Ireland	77	82	18
Hungary	8	87	13
Other countries	670	62	38
<b>Group total</b>	<b>34,614</b>	<b>80</b>	<b>20</b>

H&M Management positions	Total	Female %	Male %
Group management	11	27	73
Buying office division managers	7	71	29
Production office managers	13	46	54
Sales country managers	14	29	71
<b>Total</b>	<b>48</b>	<b>44</b>	<b>56</b>

### NUMBER OF EMPLOYEES 2001–2005



In the past five years, the number of H&M employees has increased from approximately 34,000 to more than 50,000.



### The spirit of H&M creates commitment

H&M's strong corporate culture – the spirit of H&M – has existed ever since the days of H&M's founder, Erling Persson. This strong culture is of great value and is a contributory factor to H&M's success over the years.

The spirit of H&M is based on a number of values that describe in simple terms how we want to work. These are in turn based on our business concept – fashion and quality at the best price. The fundamental values behind the spirit of H&M include common sense and own initiative.

Within H&M, we provide room for people to make their own decisions and take responsibility, and employees get regular feedback on their performance. It is an important part of H&M's culture that responsibility is delegated to the stores. Great commitment is essential and employees are expected to take their own initiative within certain given confines.

Our employees' commitment makes a major contribution to H&M's success. We believe in individuals' abilities and encourage our employees to develop further. Respect for the individual is a fundamental value at H&M. This applies to everything from fair pay, reasonable working hours, and freedom of association to the opportunity to grow and develop with the company. To make our corporate policy on freedom of association and the right to collective bargaining clear, H&M has an agreement with the international trade union network **UNI**<sup>1</sup>. This agreement declares that both UNI and H&M regard the **ILO**<sup>2</sup> **Declaration on Fundamental Principles and Rights at Work** to be the cornerstone for their cooperation.

In June 2005, H&M signed an agreement that lays out the terms for a three-year contract between the trade union **UNITE-HERE**<sup>3</sup> and H&M warehouse employees in New Jersey and Connecticut. H&M and UNITE-HERE worked diligently to agree on terms that were fair and in the best interests of the warehouse employees. ■

<sup>1</sup> Union Network International

<sup>2</sup> International Labour Organization

<sup>3</sup> Union of Needletraders, Textiles and Industrial Employees and Restaurant Employees International Union

## SAFETY AT H&M

Our security policy guides our safety work. Attention is centred on:

- Fire prevention and evacuation
- Loss prevention
- Crime prevention

### Security organisation

Generally, the manager for each H&M unit is responsible for security issues. The managers are supported by a corporate organisation which facilitates and governs the security work in the group. The head of security reports to the managing director. The corporate organisation also has security managers for information and information technology, as well as internal audit.

In addition, the following H&M units have security managers:

- Buying department and production offices
- Sales offices and stores
- IT department
- H&M Rowells

Every store manager must, in collaboration with the country's security manager, analyse the risks of crime against the store and train the staff accordingly.

### FOCUS AREAS IN 2005

- Shrinkage reduction programme: We have initiated a project with the aim to further reduce and prevent shrinkage in all H&M stores. Each store's development is monitored every month, and staff from our sales and security departments conduct follow-up visits on a regular basis.
- Incident handling system: During the year, we improved our incident handling by implementing a web-based system for reporting all types of incidents with regard to loss of property, personal injury, and the H&M Code of Ethics.
- Crisis management: Our sales countries worked on developing contingency plans for their organisations.

### SECURITY POLICY

H&M must be a place where both staff and customers can feel safe. Every employee of the company must, in their daily work and personal behaviour, strive to create a working climate that avoids the risk of fire, criminal behaviour and damage to both customers and staff – without in any way limiting space for spontaneity and creativity in daily activities together or hindering sales in the company's stores.

A properly functioning security system, where everything is ordered and well organised, creates a safer place in which to work; it reduces the company's costs for damage and loss and contributes to increased profitability and comfort.

The person responsible for security is always the manager for each respective H&M unit. It is possible to delegate part of this responsibility, but the ultimate responsibility always lies with the manager. It is the business of every employee to take part in security work and to contribute to safety at H&M.

### **Combating corruption**

We dissociate ourselves from corruption in any form whether direct or indirect. Our Code of Ethics is based on a commitment to honesty, integrity and fair play, and defines what we consider corrupt behaviour.

H&M's Code of Ethics was updated in December 2005. To emphasise our corporate culture and its incompatibility with any form of corruption to our staff, there is a separate employee version of the Code. We inform all potential production office employees of H&M's standpoint towards corrupt behaviour during the recruitment process, and they sign our Code of Ethics when they are hired. It is the responsibility of our production office managers to regularly go over the contents and significance of the Code of Ethics with staff. Usually, this is done in connection with workshops about once a year, or whenever it is found to be necessary.

In addition, our suppliers sign the H&M Code of Ethics to confirm that they have fully understood it and that they undertake to comply with it. Our suppliers are also required to inform all their subcontractors about the content of the Code of Ethics, and to make certain the subcontractors comply accordingly. Finally, our suppliers are requested to inform the production office manager immediately if an H&M employee should offer or solicit any improper benefits.

We conduct internal reviews of the Code of Ethics procedure to make sure that it has been implemented properly. If an employee is found offering, giving or accepting improper advantages in any form, the matter will be reported to the police for investigation. If a supplier does not comply with our policy on this matter, we will be forced to discontinue all business connections with this supplier.

During 2005, we have had a few breaches of our Code of Ethics, within both the sales and production organisations. As a consequence, several employees were dismissed and we permanently terminated all business connections with some suppliers. Reports of these incidents were made to the police.

### **Information and IT security**

Our Information Security Policy and Guidelines guide all security work on information and IT. These instructions cover:

- Organisation and responsibility
- Asset classification and control
- Document and information management
- Physical security
- Communication and operations management
- Access control
- Systems development and maintenance
- Routines for incident management
- Business continuity planning

The intention is for H&M's security work to be harmonised with the SS-ISO/IEC-17799 standard for information security management. All our work must at least meet legal requirements.

**INTERNET POLICY**

Rapid access to correct information is important if we are all to do our jobs in the best way possible. The Internet is a source of information that can be used to supplement and rationalise this knowledge gathering. The Internet is intended for the gathering of information and knowledge for business purposes. Employees must be aware that it is an external medium in which – as in all other external situations – he or she is representing the company. Employees who wish to have access to information on the Internet from their PC in order to carry out their work undertake to abide by the following Internet policy.

- Websites that supply pornographic, racist, or other unethical or unlawful information must not be visited from H&M's computers. Storage of such information on H&M's computers is absolutely prohibited and may result in dismissal.
- The user shall always be responsible for observing the necessary security measures, copyright rules and licensing procedures for software, sound and images when downloading via the Internet.
- The employee does not object to the company checking the Internet addresses to which he/she has been connected.

**Policy on information and IT security**

The levels of the security procedures depend on the possible damage that could be inflicted on H&M's businesses.

**Responsibility and support**

Security is a line responsibility that extends from the operation manager all the way down to the co-worker. The information security manager coordinates and monitors the security work and revises the security level – he/she is the business support within the information security area.

**Risk analysis**

Damage prevention and damage-limiting measures are to be preceded by a risk analysis and the cost must be in proportion to the identified risks.

**Consequences of disregarding laws, regulations and internal rules**

Employees who do not follow laws and regulations may be dismissed. Employees who do not follow the internal rules may be given a warning and in serious cases may be dismissed. We report all types of crime to the police.

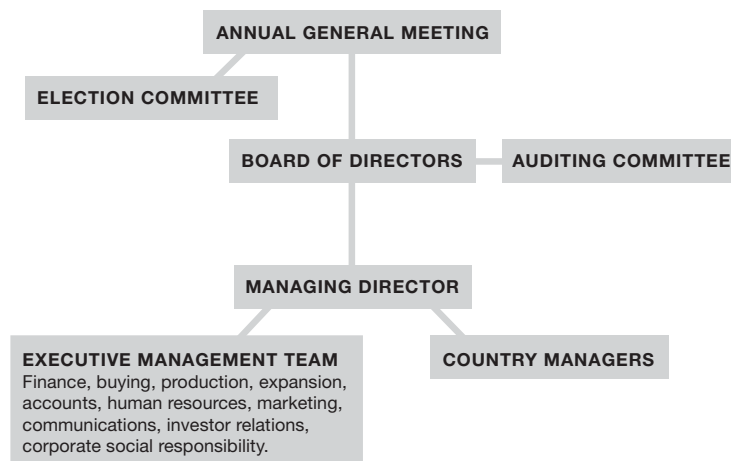
**Privacy policy**

We have a **privacy policy** on our website at hm.com. Our privacy policy is based on PUL, which is a Swedish law that regulates personal data handling. PUL is based on the EU Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data. The provision concerning cookies is based on the law on electronic communication. ■

## GOVERNANCE STRUCTURE

This section comprises information on the governance structure of H&M, including the board of directors, the auditing and election committees and company management. We also report on board fees, remuneration to the managing director and other members of the company management, as well as the terms of employment of the managing director. Finally, there is information on a bonus system for the managing director and other senior executives, as well as related party transactions. More information is available in the **Annual Report** and **Corporate Governance Report**.

### Corporate governance structure



### Auditing committee

H&M's auditing committee is appointed annually by the board of directors. The auditing committee held two meetings during the year at which minutes were kept. The majority of the members of the auditing committee are independent. The committee addressed issues concerning the company's financial reporting and the scope and focus of auditing assignments, and also updated the established guidelines for services other than audits that the company may purchase from the accounting firm. Authorised public accountants Åsa Lundvall and Erik Åström attended both of the auditing committee's meetings and reported to the committee on their auditing work.



### **Election committee**

As per a resolution at the annual general meeting (AGM) on 26 April 2005, an election committee (previously nomination committee) has been formed. In accordance with the resolution, the process was as follows: The primary shareholder and the five largest shareholders thereafter at the end of August 2005 appointed the members of the election committee. The election committee consists of Stefan Persson and family (representative: Stefan Persson), Lottie Tham (representative: Lottie Tham), Robur Fonder (representative: Mats Lagerqvist), Alecta (representative: Tomas Nicolin), AMF Pensionförsäkrings AB (representative: Magnus Wärn) and Nordeas fonder (representative: Peter Rudman).

This election committee will remain in place until the end of August 2006. If the 2006 AGM adopts the current directive, the next election committee will consist of the principal owner and the five largest shareholders at the end of August 2006. The election committee has appointed Stefan Persson as its chairman. This is deemed a natural choice taking into consideration H&M's ownership structure. No special fees were paid to the election committee's chairman, nor to any other member of the committee.

### **Board of directors**

The board of directors consists of nine members and four deputy members. Five of the members are female and eight male. Five of the thirteen are employed by the company, and four are independent. H&M's definition of "independence" corresponds to that found in the **Swedish Code of Corporate Governance**.

### **Company management**

H&M's managing director is responsible for the day-to-day operations. The managing director has appointed a team of senior executives with ongoing responsibility for the various parts of the business.

This team consists of the managing director himself and ten other individuals, three of whom are women. The executive management team is responsible for the following areas: finance, buying, production, expansion, accounts, human resources, marketing, communications, investor relations and corporate social responsibility.

### **Board fees**

Board fees for the year as approved by the AGM amounted to MSEK 3.9 (3.9), of which MSEK 2.4 m (2.7) was paid to the chairman of the board. No board fees were paid to board members who are also employees of the company.

### **Managing director's terms of employment**

Remuneration to the managing director in the form of salary and benefits amounted to MSEK 10.7 including a bonus of MSEK 1.5 (previous year, MSEK 8.4 including a bonus of MSEK 1.5). The pension expenses for the managing director during the year were MSEK 6.5 (previous year MSEK 6.3), of which MSEK 3.9 comprises pension commitments entered as liabilities. The total pension commitments entered as liabilities amount to MSEK 33.1. The managing director may retire at the age of 65 (previously 62) and receive pension of 65 per cent of regular salary for three years and thereafter a lifetime pension equivalent to 50 per cent of the same salary. The managing director is entitled to 12 months' notice. In the event the company cancels his employment contract, the managing director will receive severance pay of an extra year's salary in addition to the 12 months' notice. The managing director's terms of employment are determined by the board of directors.

### **Terms of employment for other group senior executives**

Remuneration to other members of group management in the form of salary and benefits amounted to MSEK 26.1 (23.8), which

included bonuses of MSEK 2.5 (2.0). Pension expenses for other members of group management (see “Company management” above) during the year were MSEK 9.1 (previous year MSEK 4.7). There are rules in place for these senior executives in respect of supplements to retirement pension beyond the ITP plan. The retirement age varies between 60 and 62 years. The cost of this commitment is covered by separate insurance policies. In addition, a bonus amounting to MSEK 5.7 (6.1) was paid out to 13 country managers. No severance pay agreements exist within the group other than for the managing director as described above. The terms of employment for other members of group management are determined by the managing director and the chairman of the board.

#### **Bonus system**

The managing director, country managers and certain senior executives are included in a bonus system. The size of the bonus per person is based on 0.133 per cent of the increase in the regular dividend established by the AGM and the fulfilment of targets in their respective areas of responsibility. The maximum bonus per person and year is MSEK 0.5. In the case of the managing director, the bonus is 0.40 per cent of the regular dividend increase with a maximum of MSEK 1.5. The bonus paid after tax must be invested entirely in shares in the company, which must be held for at least five years.

#### **Related party transaction disclosures**

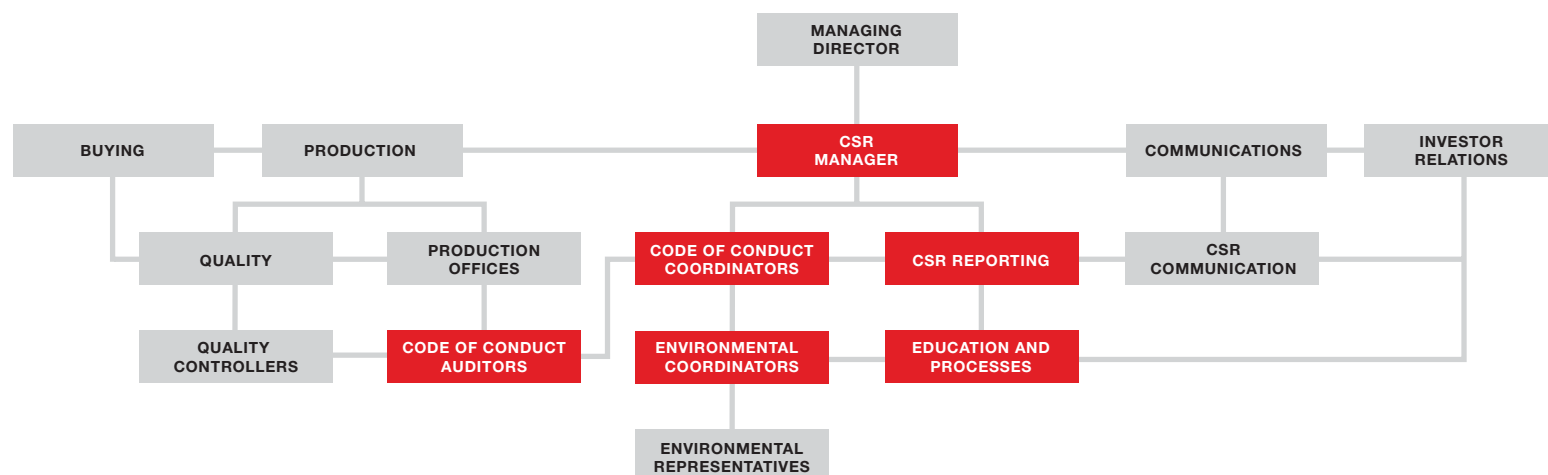
The H&M group leases the following store premises in properties directly or indirectly owned by Stefan Persson and family: Drottninggatan 50–52 in Stockholm, Drottninggatan 56 in Stockholm, Sergelgatan 11 in Stockholm, Kungsgatan 55 in Gothenburg, Stadt Hamburgsgatan 9 in Malmö and Amagertorv 23 in Copenhagen. Rent is paid at market rates and amounted to a total of MSEK 44.3 for the financial year (previous year MSEK 46.7). An agreement has been entered into with chairman Stefan Persson’s company, Ramsbury AB, regarding leasing the premises at Beridarebanan 13, Stockholm, for occupancy at the end of 2007/beginning of 2008. The rent has been reviewed by two independent evaluators and is at the market rate. ■

## CSR ORGANISATION

H&M's global CSR team comprises about 50 people. There are more than 40 Code of Conduct auditors. The auditors work at H&M's production offices, where we also have about 140 quality controllers who report any infringements of the Code of Conduct that they observe. The auditors report to the local H&M office as well as to the CSR department in Stockholm. The CSR department, which consists of seven people including the CSR manager, is a corporate level department. Its functions are shown in red in the chart below. The CSR manager reports directly to the company's managing director.

The following corporate functions have environmental representatives: advertising, building, IT, logistics, travel and H&M Rowells. The representatives' prime function is to be the communicative link with the CSR department. All major production offices and sales offices also have environmental representatives.

Please note that this is not a complete organisational chart; it serves to illustrate how H&M's CSR department is linked to the company's corporate level functions, and other relevant parts of the organisation. ■



## CORPORATE MEMBERSHIPS

### CSR initiatives

- Since 2001, H&M has participated in the **United Nations Global Compact** and undertakes to respect its ten principles for human rights, labour standards, environment and anti-corruption.
- H&M supports **OECD's Guidelines for Multinational Enterprises**. Our support for the Guidelines was publicly endorsed in connection with the publication of the Annual Report for the year of 2001.
- H&M supports the **Swedish Partnership for Global Responsibility**.
- H&M is a member of **Business for Social Responsibility**.
- H&M is a participating company of the **Fair Labor Association**.
- H&M contributes to **Better Factories Cambodia**.
- H&M actively participates in **MFA Forum Bangladesh**.
- H&M is a member of **Amnesty Business Group's Business Forum** in Sweden.
- H&M participates in the Better Cotton Initiative.
- H&M is a member of the **Organic Exchange**.

### Principal memberships

- **European Retail Round Table**
- **Nordic Council of Shopping Centers**
- **Confederation of Swedish Enterprise**
- **Textile Importers' Association in Sweden**
- **Swedish Federation of Trade**
- **Swedish Association of Environmental Managers**
- **The Network for Transport and Environment**
- **Näringslivsgruppen Miljöpack**
- **Swedish Public Relations Association**
- **The Swedish Marketing Federation**

## SUSTAINABILITY RATINGS

H&M is a constituent of several sustainability indices, among them DJSI World, FTSE4Good and the Ethibel Sustainability Index.

### Dow Jones Sustainability World Index



**Dow Jones Sustainability World Index (DJSI World)** comprises more than 300 companies that represent the top ten per cent of the leading sustainability companies out of the biggest 2,500 companies in the Dow Jones World Index. The assessment of companies' performance is done by SAM Research, a research firm based in Switzerland.

### Ethibel Sustainability Index



H&M has been selected for inclusion in the **Ethibel Pioneer Investment Register**. The Ethibel Investment Register is used as the basis for SRI products (the Ethibel Label and the Ethibel Sustainability Indices) for a growing number of European banks, fund managers and institutional investors. The characteristics of Ethibel's methodology originate from the integration of sustainable development and stakeholder involvement.

### FTSE4Good



H&M is a constituent of the FTSE4Good Europe and FTSE4Good World indices. The purpose of the **FTSE4Good Index Series** is to measure the performance of companies that meet globally recognised corporate responsibility standards, and to facilitate investment in those companies.

### H&M rated best-in-class by Storebrand



H&M has earned "best-in-class" status for leading environmental and social performance in **Storebrand's** textiles and apparel industry report, and thus qualifies for investment in Storebrand's SRI mandates. The Storebrand Group is a leading Norwegian asset management, life insurance and banking institution.

### H&M one of the 100 most sustainable companies



H&M was included in the **Global 100 Most Sustainable Corporations in the World** listing. The list was presented at the World Economic Forum in Davos, by Corporate Knights. It lists companies that demonstrate the strongest sustainability performance relative to their industry peers.



## **H&M**

# **OUR SOCIAL RESPONSIBILITY**

In this section, we describe this year's social performance and activities, including results from FAP audits. We also explain the challenges that we face in various countries of production, as well as our working methods. There is also information about remediation projects, our quality work and community involvement.

It is essential for us to understand what our stakeholders expect from us. This section includes feedback on our CSR reporting from representatives of four significant stakeholder groups.

## ADDRESSING SUPPLY CHAIN WORKING CONDITIONS

### Responsibilities and opportunities

H&M sources from about 700 suppliers who in turn use sub-contractors. In all, around 2,000 production units and more than 700,000 people are involved in the manufacture of our products. Over the last few years, we have experienced a steady increase in the proportion of production that takes place in Asia.

Our choice of countries of manufacture places particularly high demands on us. We are aware of the risk of human rights violations and non-compliance with local labour law and internationally agreed labour standards. At the same time, we have an opportunity to contribute to better working conditions for all the hundreds of thousands of people who make our products. We are committed to conducting our business in a responsible manner. The following chapter explains how we do it.

### H&M's Code of Conduct

Our **Code of Conduct**, which is based on the **Convention on the Rights of the Child** and the **ILO's Declaration on Fundamental Principles and Rights at Work**, sets out our requirements of our suppliers. The Code was published in 1997. In 1998, we began conducting factory audits.

#### H&M'S CODE OF CONDUCT<sup>1</sup>

H&M's Code of Conduct comprises the following sections:

- Legal requirements
- Child labour
- Safety (Building and fire safety, first aid)
- Workers' rights (Freedom of association, no forced labour, non-discrimination, wages and working hours)
- Factory conditions
- Housing conditions
- Environment
- Inspections and compliance

The H&M Code of Conduct is available in its entirety on [www.hm.com/csr](http://www.hm.com/csr).

All our efforts aim at contributing to and ultimately reaching the Code of Conduct objectives that we have set up. When setting our yearly targets, we make certain that they lead towards these long-term objectives.

#### OUR CODE OF CONDUCT OBJECTIVES

- Full Code of Conduct compliance by all suppliers and their subcontractors.
- Code of Conduct completely integrated with our business operations. The importance of Code of Conduct issues should be reflected in everyday decisions as well as in strategic decisions.
- Factory workers empowered to claim their rights. Factory workers should be informed about labour laws and human rights according to national and international legislation. Their efforts in improving their working conditions should be supported.
- Code of Conduct compliance maintained through effective management systems. Tools and procedures should be developed in cooperation with the supplier.
- Knowledge among our stakeholders about our corporate social responsibility efforts. The information or education given should be adapted to the various stakeholder groups.

<sup>1</sup> In Sweden and Norway, H&M sells brands of cosmetics and hygiene articles other than H&M's own. After years of negotiation with our external cosmetic suppliers, a few still will not sign H&M's Code of Conduct commitment.

The suppliers/brands that have not signed and are not willing to continue discussions are Procter & Gamble and the Gillette Company. Suppliers willing to discuss but who, because of their parent company's policies or for other reasons, still have not signed H&M's Code of Conduct are Lever Fabergé, Beiersdorf, Henkel Norden and Colgate-Palmolive. SCA Mölnlycke in Norway has signed our code; however, the Swedish branch has not. Many international brands are sold through national agents in Sweden and Norway. In those cases, the local agent may be willing to sign but is not allowed to do so by the brands it sells. This is most common with Procter & Gamble's brands and such agents are Marwel Hauge in Norway and Scandinavian Cosmetics in Sweden.

H&M has no reason to believe that the above companies are not complying with our Code of Conduct, but we do not have permission to verify this through audits. Customers who have questions regarding products made by the above companies are asked to contact these companies directly.

### MONITORING OUR SUPPLY CHAIN

During 2005, our global CSR team has focused on implementing our new monitoring method, the Full Audit Programme (FAP). This section explains the purpose of FAP, describes its features and methods, and provides data on both traditional inspections and FAP audits carried out during the past year. There is also a report from auditors in three of our countries of manufacture.

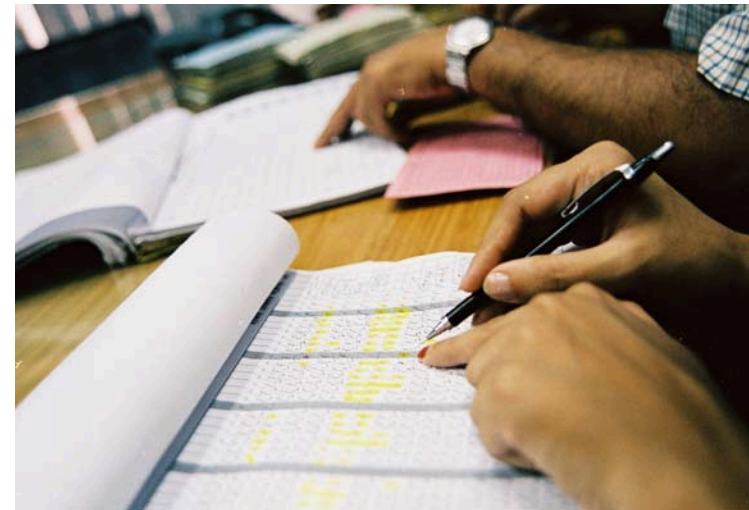
#### Introducing the Full Audit Programme

By 2004, we had conducted more than 12,000 factory inspections, and the conditions in our suppliers' and their subcontractors' factories had improved substantially, especially with regard to the standard of fire safety and overall working environment. However, in order to be able to move to the next level and begin to address the more complex issues and – equally important – to ensure that the improvements are sustained, a new approach was needed. By digging deeper to find the causes of the various issues, we will come one step closer to finding possible long-term solutions. We hope that the Full Audit Programme will help us move in this direction.

Although what we do, i.e. the actual components of an audit – visual inspection of factory premises, document review, and management and worker interviews – remain the same, the difference between our traditional monitoring method and FAP lies in how we do it. At the outset of a supplier relationship, we conduct a FAP audit and take the time to cover all areas at the same time. The range of issues that are examined has increased and each issue is investigated more thoroughly. The FAP audit form now contains more than 300 items and a FAP audit takes between two and seven working days to complete, depending on the country of production, number of employees, and the commercial significance of a supplier to H&M. Information about how we prioritise our work is available on page 26. The findings from the FAP audit serve as

the point of departure for our improvement efforts. The suppliers work on improving the issues identified during the FAP audits and our auditors check progress in connection with follow-up audits. Depending on the situation, it can be up to two years before it is time to conduct a new FAP audit and thus begin the improvement cycle anew. Read more about the remediation process on page 38.

**“The FAP audit form now contains more than 300 items and a FAP audit takes between two and seven working days to complete.”**





We believe that working according to FAP benefits both us and our suppliers. By conducting a FAP audit early on in the course of a supplier relationship, both parties will know from the start what issues require attention, and the work can be focused accordingly. In addition, by sticking to one action plan rather than finding new violations in connection with each factory visit, the audit and improvement processes become more predictable and it will be easier for our suppliers to understand our requirements. Many of our suppliers have expressed concerns that the audits they are required to undergo take up too much of their time and effort. Conducting fewer, but more comprehensive and focused audits should give our suppliers time to concentrate on improvements.

#### FAP IN BRIEF

- Searching to find the causes rather than just the violations.
- From a policing approach to improvements sustained by effective factory management systems.
- Fewer but more comprehensive audits.
- Extended audit form containing more than 300 items.
- Worker interviews are an integrated part of each FAP audit.
- A FAP audit takes two to seven working days to complete.
- Issues that depend on poor routines are included in management action plans (MAP).
- Continuous follow-up of suppliers' action plans.

#### Our audit team

At present, H&M's CSR organisation consists of about 50 employees, of which 40 are full-time auditors. Approximately 70 per cent of our auditors work in Asia, and the rest in Europe. There are three regional coordinators, one is based in New Delhi, one in Shanghai and one in Hong Kong.

Our auditors come from different backgrounds; many of them have worked as auditors for other companies in the apparel and footwear industry, external audit firms or governmental bodies. Several H&M auditors have worked with human resources at garment factories, some have an NGO<sup>1</sup> background, and some have come to work for H&M directly after graduating from university.

Our ability to identify and subsequently to address compliance issues in the supply chain largely depends on the skills of our auditors. Thus the expectations on the performance of our auditors are high, and we do our best to create the conditions for every auditor to meet these expectations. H&M gives newly employed auditors a thorough introduction to both H&M and the auditor's role. We also seek to continuously educate and challenge our auditors.

H&M's introduction plan for auditors covers topics that are communicated in writing, orally, or through practical training. Some examples are:

- H&M's company values
- The role of the auditor
- The ILO Core Conventions
- Relevant labour law
- H&M's Code of Conduct
- FAP tools
- H&M's CSR report

The introduction is carried out by a senior auditor or by the Stockholm-based Code of Conduct coordinators.

In the past year, we have directed our efforts towards training our auditors in conducting audits in accordance with the Full Audit Programme working methods. Initial FAP workshops were held in China, Bangladesh, Turkey and Bulgaria, and were attended

<sup>1</sup> Non-governmental organisation

by auditors from several H&M production offices. They received training in conducting audits using the various FAP tools, the new extended audit form being the main one. Test audits were also conducted at our suppliers' premises. Later in the year, management system tools were introduced to all our auditors. Finally, several follow-up and evaluation workshops were arranged. Apart from our auditors, staff from the CSR department in Stockholm, production office managers and product managers have participated in the process of introducing FAP.

**Prioritising our work**

FAP aims to detect all compliance issues as early as possible in order to rationalise and manage our monitoring and remediation efforts. If we are able to identify the issues that require attention at the outset of a supplier relationship, we can then focus on guiding our suppliers towards sustainable improvements. We direct our monitoring efforts by considering the following factors:

- Country of production: The countries in which our suppliers' factories are located have been divided into risk categories, based on their human rights track records. Factories in high risk countries are subject to more comprehensive audits. The risk categories are outlined in the table below. The risk assessment is based on "**Business & Human Rights: A Geography of Corporate Risk**" published by **International Business Leaders Forum (IBLF)** and **Amnesty International (AI)**, as well as on our own experience.
- Number of factory employees: Larger production units mean that more people are affected if conditions are poor. In addition, more time is required to gain a reliable picture of the conditions at larger units.

- Commercial significance of supplier to H&M: Our requirements are the same for all suppliers. We do however invest more time and effort in suppliers that we, based on factors such as price, lead time, quality and Code of Conduct compliance, assess to be significant. Also, if we are a major buyer, we are able to have a greater influence with a particular supplier. The assessments are carried out in connection with H&M's regular supplier performance evaluation process each season.

**“If we are able to identify the issues that require attention at the outset of a supplier relationship, we can then focus on guiding our suppliers towards sustainable improvements.”**

High risk markets	Medium risk markets	Low risk markets
Bangladesh	Brazil	European Union
Cambodia	Bulgaria	
China	Mauritius	
India	Mexico	
Indonesia	Romania	
Pakistan	Tunisia	
Sri Lanka	Turkey	
Thailand	South Korea	
Vietnam	Ukraine	

▲ The risk classification displayed in the table is based on IBLF's and AI's assessments.

### **Audit procedures**

An audit typically comprises the following steps:

- **Basic data collection:** We gather information regarding for instance the supplier's ownership structure, production capacity and types of production stages.
- **Factory inspection:** The factory is inspected to evaluate working environment, fire safety and environmental aspects (e.g. waste-water treatment where applicable).
- **Document review:** Various types of documents are reviewed and compared against each other to cover most issues in the audit form, e.g. employment contracts, age of factory employees, status of any migrant workers, grievance and dialogue systems, working hours, remuneration, and sick leave and other kinds of compensation. We also look for indications of discrimination based on e.g. gender or ethnicity. Cross-checking documents such as attendance records, production records, broken needle records and pay slips also makes it easier to determine whether the documents might be falsified.
- **Worker interviews:** Most items in the audit form are also verified through individual conversations with factory employees. Worker interviews are conducted as part of each FAP audit. Workers are selected from the documentation to cover different departments and different positions, and also randomly in connection with the visual inspection of the factory premises. We choose employees who stand out for different reasons, e.g. if they look young or if they are at a work station that seems temporary. All interviews are conducted individually; nobody other than the factory employee and H&M staff may be present during the conversation. All workers that we talk to receive contact information in order to be able to get in touch with H&M after the audit.
- **Management interviews:** Factory managers are questioned concerning issues such as policies and routines.
- **Inspection of dormitories:** If there are residential facilities at the suppliers' premises, we inspect them as well. Dormitories are mainly checked for safety and cleanliness according to our audit form.
- **After the audit:** The audit results and possible measures are discussed with the supplier in connection with a closing meeting. Subsequently, we compile a final report of the audit findings, and send it to the supplier by letter. The supplier is asked to establish a corrective action plan that specifies how the identified non-compliance issues will be addressed, who is responsible for the remediation process, and by when the improvements will be implemented. We recommend that our suppliers seek assistance from external partners such as NGOs or consultants, especially to handle serious violations such as abuse or sexual harassment. Our auditors monitor the process and its results by conducting follow-up audits.

Systematic non-compliance issues, i.e. non-compliance that largely depends on poor routines and management systems, can be selected for a management action plan (MAP). This process is described in greater detail on page 38.



Interview with a factory employee in Bangladesh.

### **New supplier evaluation**

All new production units must be approved by the CSR department. All new suppliers sign our Code of Conduct, and the general rule is that no production unit may start manufacturing for H&M before it has been approved by our audit team. Suppliers that have been graded 'Temporary' or better may produce for H&M. The 'Temporary' grade gives the supplier six months to make necessary improvements and thus move to the next grade. The same procedure applies when an existing supplier wishes to use a new factory or subcontractor for H&M production.

### **Our grading system**

Our grading system helps us to identify an entry level where we can start working with new suppliers. The grading scale consists of five levels:

**Rejected:** A supplier or production unit is graded 'Rejected' if workers are denied any of their basic rights, if factory premises are unsafe, if the supplier has not signed our Code of Conduct, if H&M is denied access to the factory premises, or if management refuses to cooperate in other ways. A production unit that has been graded 'Rejected' is suspended, but can do business with H&M if it makes major improvements in accordance with our Code of Conduct.

**Temporary:** A production unit graded 'Temporary' meets our requirements regarding worker's basic rights, minimum wages, basic safety and basic housing conditions. A production unit that has been graded 'Temporary' has six months to make the improvements necessary to earn an 'Insufficient' grade.

**Insufficient:** A production unit graded 'Insufficient' fulfils all 'Temporary' requirements. Our requirements concerning additional safety, and housing and factory conditions are also met. Overtime work is voluntary, and compensation is paid. Workers receive the sick leave to which they are entitled.

**Satisfactory:** A production unit graded 'Satisfactory' fulfils all Code of Conduct requirements.

**Permanently rejected:** Repeated employment of child labour, repeated use of faked documents and repeated use of undeclared units are severe violations that cause H&M to permanently terminate business with a supplier.

If a supplier's production unit is graded rejected or permanently rejected, our purchase order system prevents our buyers from placing an order with that particular supplier.

As we had anticipated, we managed to uncover more complicated and sometimes serious non-compliance issues using the new and more effective FAP tools. In most cases, we have chosen not to downgrade our existing suppliers immediately, but rather given them some time to remedy the problem. This is a temporary effect of the implementation of a new monitoring system. When all suppliers have been audited according to the Full Audit Programme, we will fully revert to using our regular grading scale for all suppliers.

#### SUPPLY CHAIN CLOSE-UP

In **last year's report**, we described some of the scenarios that our auditors face when monitoring factories. This time, we take a closer look at three of the countries in which our products are manufactured. To get a varied view, we asked our auditors in Romania, India and China to describe both their recent achievements and some of the challenges that they face. We hope that their reports will give the reader a feeling for the different conditions that our auditors encounter.

#### Romania

##### Did you know that ...

- ... apparel and footwear products make up about 25 per cent of all Romania's exports?
- ... Romania's 7,200 garment factories employ about 450,000 people representing nearly 20 per cent of the industry labour force?
- ... being the world's fourth largest supplier of textiles and apparel to the EU, Romania is known as the tailor of Europe?
- ... every tenth Romanian garment worker produces H&M products?
- ... our auditors conducted 150 audits of Romanian factories in 2005?

As a result of the FAP audits, we have detected and begun to address violations that we were not able to verify using our traditional inspection methods. Below, we discuss some of these issues.

Romania has ratified the **Right to Organise and Collective Bargaining Convention**, and all employees in all sectors enjoy the right to bargain collectively under Romanian law. Collective agreements must be negotiated in workplaces with a minimum of 21 employees, and the initiative rests with the employer. The negotiation process should at least cover the issues of wages, working hours and working conditions.

However, implementation as well as follow-up conducted by Labour Chamber is still weak. The challenge is thus to ensure that factory workers enjoy the rights that they are entitled to by law. In nearly all factories that we audited this year, workers had a collective contract. At the same time, this does not guarantee that the collective bargaining process actually took place, that the negotiations were held with the workers' representatives and that all required points were covered.

Taking a closer look at various kinds of documentation, and questioning factory managers and employees revealed interesting information. We found workplaces where collective contracts had been issued by the management with no prior negotiation with workers' representatives, or that contracts had been negotiated with representatives appointed by the management, or that management somehow interfered in the process so that the negotiation was compromised. There were also cases where the representatives elected by the workers did not engage in a bargaining process, and just signed the agreement presented by the management. Finally, in some instances, the agreements were not on a par with Romania's labour code.

Why is it that thorough and fair processes do not take place? The lack of information from the Labour Chamber and other sources, and consequently the low awareness level among workers are part of the explanation. The conversations that we have had with factory employees show that they know nothing or very little

about the right to bargain collectively, or its benefits. On the other side are the employers who do not have any interest in initiating negotiations with their employees. Meanwhile the state labour inspectors are satisfied that collective agreements are in force and do not question the process behind them. In some cases even the Labour Chamber can be regarded as a part of the problem, as it asks employers to establish collective contracts without guidance or any additional explanation.

Another issue that came into focus with the FAP audits was the falsification of documents. As we now check a greater variety of documentation, it has become easier to verify any suspicion that documents are falsified. Obviously, worker interviews are essential as well. We noticed an increase in faked documents after the state inspectors moved their attention to this area and began to penalise non-compliance. From our perspective, the first priority is to make certain that all overtime hours are recorded and compensated properly. As production is not on a constant level throughout the year, it is very difficult to always keep the legal limit of 32 overtime hours per worker and month. Even though we prefer our suppliers to be honest about the actual conditions, they can feel compelled to falsify documents for fear of not getting orders. Most often, the only way of getting the suppliers to show us the actual documentation is confronting them with indisputable evidence that the records are false.

Worker interviews provide valuable information that is difficult to obtain in other ways. The integration of worker interviews into each FAP audit is undoubtedly a step forward. As many buyers have moved in the same direction, workers have become familiar with the interviews and understand their purpose. In many cases however, the possible connection between audit results and order placement has been pointed out to the workers, and they fear that poor audit results could affect their income or even their jobs.

Consequently, one of our challenges is to deal with workers being coached, or even threatened by their managers before audits.

**“Worker interviews provide valuable information that is difficult to obtain in other ways.”**

2005 has not been a great year in terms of progress towards Code compliance among our suppliers in Romania. The fact that one third of our audits resulted in a rejection is a clear indication that things did not go in the right direction. One possible explanation of this regressing trend could be the economic context in Romania. The beginning of this year brought a sudden drop of the euro against the lei by nearly 20 per cent, followed later in the year by a raise in the minimum salary and multiple increases in the costs of utilities. These changes were fatal to many Romanian garment factories, while in many of the surviving ones, workers had to bear a heavy burden.

What we consider progress in 2005 is our new approach to monitoring the suppliers. The use of the Full Audit Programme is definitely a step forward, as it helps us get a more realistic picture of the factories, allowing both us and the suppliers to identify the root causes of the violations. We hope that our new way of working will eventually lead to increased ownership of labour and environmental issues by our suppliers. Once suppliers become truly committed to operating their business in a socially responsible way, once they start complying because they see the benefits and not because we ask them to, we will finally be able to signal a real move forward.

## India

### Did you know that ...

- ... India has the largest area under cotton cultivation in the world?
- ... the textile industry provides direct employment to more than 35 million people?
- ... the textile industry is India's largest foreign exchange earner?
- ... nearly 40 per cent of India's garment exports are shipped to Europe?
- ... H&M has two offices in India, one in New Delhi, and one in Bangalore?

India has a very diverse economy, encompassing modern industries such as IT, automobiles and aviation on the one hand, and labour intensive branches like agriculture and garment manufacturing on the other. Although the Indian IT sector has received a great deal of attention in recent years, the textile sector is still the country's largest foreign exchange earner.

H&M purchases everything from basic underwear and t-shirts from large factories employing 1,000 or more people, to handmade fashion items from medium-sized or small family businesses. These different product suppliers are located around five main cities. H&M currently has four full-time auditors that regularly visit 200 production sites to ensure that these units adhere to H&M's Code of Conduct.

Generally, the problems that we face in India are similar to those encountered in several other countries; falsified documentation of working hours and payments, excessive overtime working hours and use of undeclared production units. The issues do however differ slightly depending on the type of production unit. Although there are numerous exceptions, the general pattern is that larger production units are more well-organised in terms of health and safety, and calculation and payment of wages and overtime compensation.

An issue that we have observed in the majority of all Indian factories that we purchase from is that they do not have proper communication channels and that worker-management dialogue does not function well. The textile sector is rather conservative and the need to interact with employees is not recognised among all managers. As a consequence of this, employees cannot raise issues further up in their organisations, regardless of whether they are relatively petty issues like poor ventilation, or severe problems such as abuse. This in turn means that problems cannot be sorted out in a constructive way. As one can imagine, this can cause frustration among workers and minor issues can easily turn into big problems and result in absenteeism, wildcat strikes, or high employee turnover. In addition, the suppliers do not make the most of their employees' knowledge to improve both working conditions and production-related issues.

The obvious challenge is to increase factory employees' awareness of their rights and enable them to address any problems that they might have themselves. This involves promoting worker-management dialogue, and the prerequisite is of course to try to influence the attitudes among management, which might require investing in employing qualified middle-managers, or at least training those currently employed.

During the year, the CSR team in India has begun to work according to the Full Audit Programme. With the help of the new methods, we are able to work with our suppliers on the issues discussed above in a more constructive manner. There have been many discussions between H&M and our suppliers, but it is much too early to say that we have been successful in what we are trying to accomplish. Nevertheless, we have begun to place the questions of communication channels and grievance systems on the agenda, and we hope that eventually, employees and their managers will be able to work together to create a better working environment.

## China

### Did you know that ...

- ... about one in every five garments in the world has been produced in China?
- ... H&M's first ever production office was established in Hong Kong nearly 30 years ago?
- ... at present, China is H&M's most important sourcing market?
- ... ten full-time auditors monitor our supplier's factories?
- ... six of our suppliers' fabric suppliers participate in H&M's cleaner production programme with the aim of reducing the environmental impact of their manufacturing processes?

One of the major challenges in China is to get the rapid economic development and increased sourcing from China to work hand-in-hand with improved working conditions in the factories. Short-term economic gains are sometimes overshadowing genuine understanding and willingness to make sustainable improvements. Hard-driven production is resulting in maximum use of the factories' resources. Workers are facing long working hours, sometimes with no or little overtime payment, which in turn leads to increased migration of workers between different factories. In South China, the shortage of factory workers has contributed to a continuation of excessive working hours. Many factories are however now taking action to improve production efficiency by trying to reduce staff turnover with improved employment and living conditions for their workers.

Another apparent challenge in China is the issue of freedom of association. Under Chinese law, the **All China Federation of Trade Unions (ACFTU)** is the only recognised trade organisation. This means that Chinese workers have no possibility of establishing and joining organisations of their own choosing. Obviously, the



Garment manufacture in China.

Chinese system strictly limits the scope of action. At present, we try to promote the benefits of worker-management communication to our suppliers, especially as many companies experience high employee turnover.

Double record-keeping with the main purpose of hiding excessive working hours is still a problem but we believe that improved audit methods together with a cooperative approach to solving the problems together with the suppliers is beginning to have positive effects.

In the past year, we have seen cases where factory managers have taken action and solved major safety problems caused by poorly managed material and workflow in their workshops. These actions confirm that safety is not being compromised, regardless of how busy they are.



### FACTORY MONITORING IN 2005

In the past year, the vast majority of audits were conducted according to our traditional monitoring method. The figures presented below refer both to these audits and to FAP audits. The FAP audits that we have conducted during the year are presented in detail in the next section. We expect that by March 2006, every audit will be conducted in accordance with the Full Audit Programme.

#### Our supply base

In 2005, about 700 suppliers and 2,000 production units were registered in our supplier database. Based on purchase value, 60 per cent of the suppliers that we cooperate with are located in Asia and the rest mainly in Europe. Together, these production units had a workforce of over 700,000 people.

**Suppliers** have direct business relationships with H&M. Our suppliers may have factories of their own, or subcontract parts or all of their production.

**Subcontractors** are companies hired by suppliers to perform a specific task. Subcontractors thus do not have direct business relationships with H&M.

**Production units** are factories that produce garments for H&M, and include both suppliers' and subcontractors' factories.

#### Monitoring data

##### Total number of audits

	2005	2004	2003
Number of audits, existing units	1,997	2,120	1,909
Number of audits, potential new units	673	595	669
<b>Total</b>	<b>2,670</b>	<b>2,715</b>	<b>2,578</b>

In 2005, we conducted a total of 2,670 audits. 673 of these were audits at potential new production units and 1,997 were conducted at existing factories. Our Asian suppliers' and their subcontractors' operations were reviewed 1,387 times, and in Europe, the corresponding figure was 610. As expected, the total number of audits has gone down even though our monitoring team has grown. This development is mainly due to the introduction of the Full Audit Programme; we now conduct fewer, but more comprehensive audits. Our auditors conducted 81 FAP audits in Asia and 89 in Europe and other markets.

33 per cent of all audits at existing production units in Asia and 41 per cent in Europe were unannounced. In 2005, we interviewed factory employees in 200 factories, which can be compared to 143 factories in 2004, and 43 factories in 2003.

Apart from the audits captured in the statistics above, our auditors also conduct other types of targeted factory visits. For instance, they may go to factories at night and during weekends or holidays to see if production is running. The purpose is to compare with time records to detect any unreported overtime. Another example is visits to factories on the day wages are paid, in order to check whether the wages register corresponds with the amounts that the workers have been paid. If any employee training, evacuation drills, or other activities aimed at improving safety and/or workers' awareness are scheduled, we may visit the factory to observe.

**Audits at potential new production units**

Region	2005		2004		2003	
	Number of new factories evaluated	Accepted for H&M production	Number of new factories evaluated	Accepted for H&M production	Number of new factories evaluated	Accepted for H&M production
Asia	400	342	338	327	365	Not available
Europe, other markets	273	252	257	198	304	Not available
<b>Total</b>	<b>673</b>	<b>594</b>	<b>595</b>	<b>525</b>	<b>669</b>	<b>-</b>

The above table reflects the number of potential new production units that were approved for H&M production, i.e. graded 'Temporary' or better. Some factories are considered to have potential for improvement, and they are therefore given a second chance in connection with a re-audit. The above figures refer to factories that have been approved for H&M production either after an initial audit or after a re-audit.

Supply base turnover or growth may be because H&M wishes to cooperate with new suppliers, or because our existing suppliers employ new or additional factories to manufacture H&M products. In order to be able to continue to expand, the present trend is that we favour larger manufacturers over smaller units.

**Rejected production units**

	2005	2004	2003
Number of rejected production units	184	143	164

At the end of 2005, 184 production units remained rejected from H&M production due to Code of Conduct violations. If these production units improve, we will be able to place orders with them. At the end of 2004 and 2003, the corresponding figure was 143 and 164 respectively.

During the year, we permanently ceased placing orders with one supplier due to Code of Conduct violations. We had reached the decision to do so in early 2004, but we had cooperated with this particular supplier for a long time and H&M was the major buyer. In order to give the supplier time to find other buyers and consequently to avoid dismissals, we decided to phase out business with this particular supplier over a period of a year and a half.

**FAP audits in 2005**

As stated in our 2004 CSR Report, we will not be able to provide aggregated audit statistics until 2007 at the earliest. The reasons for this are twofold; firstly, a new IT support system is still under development, and will be introduced during 2006, and secondly, due to our new monitoring method a fair comparison between 2004 and 2005 is not possible. As an interim step, we would like to give our stakeholders a picture of what the FAP audits have shown up to now.

In 2005, we conducted FAP audits at 170 facilities; 81 in Asia and 89 in Europe. The total number of audits during the year was 2,670, which means that six per cent of all 2,670 audits were FAP audits. The statistics below include findings from several audits that were conducted in connection with FAP training and test audits, so the results are not necessarily in line with what we can expect to see in future.

Country/Asia	No of audits	Country/Europe	No of audits
Bangladesh	42	Bulgaria	15
Cambodia	2	Italy	7
China	13	Lithuania	6
India	22	Romania	13
Indonesia	2	Morocco	4
		Turkey	44
<b>Total</b>	<b>81</b>	<b>Total</b>	<b>89</b>

Please note that the FAP statistics presented in the following section are not representative of all production units where H&M places orders, or all audits conducted during 2005. Furthermore, the number of audits conducted in different countries does not necessarily correspond to the number of factories contracted by H&M in those markets.

The tables show detected Code of Conduct violations, i.e. the number of audits where we have verified violations is shown in relation to the total number of audited factories in Asia and in Europe. Our audits also cover areas that indicate either risk prevention or risk exposure. For instance, well-functioning grievance systems are not required by law or according to our Code of Conduct, but they make it possible for factory employees to claim their rights without the involvement of their direct superior. This indicates a lower risk of undetected violations.

<sup>1</sup> Generally speaking, the legal minimum working age should not be less than 15 years (ILO convention 138, article 2, point 3, and our Code of Conduct). Bangladesh's regulations deviate from this general rule; the legal working age in Bangladesh has been set to 14 years in accordance with ILO's Minimum Age Convention (138), article 2, point 4 which permits the minimum age to be lowered in certain circumstances.

	Asia	Europe, other markets
<b>Child labour and young workers</b>	<b>81 audits</b>	<b>89 audits</b>
Use of child labour	1 (1%)	0 (0%)
Working conditions of young workers	12 (15%)	42 (47%)
<b>Total</b>	<b>13 (8%)</b>	<b>42 (24%)</b>

### Child labour

Reference: **H&M Code of Conduct**, section 2.

We found one factory employee in Bangladesh who had not yet reached the legal working age of 14<sup>1</sup>. The girl, aged 13, worked at one of our supplier's subcontractor's facilities. Our auditors met with the girl and her parents to discuss different options, and agreed that going back to school would be the best solution for her. H&M made a financial arrangement with the girl's former employer, which involved the subcontractor in question depositing a sum of money that H&M will pay to the girl's family on a monthly basis during her period of schooling.

As the table shows, it is fairly common that suppliers do not take special measures to protect juvenile workers. Instead, young employees work under the same conditions as all other factory employees, e.g. with regard to working hours. With the introduction of FAP, we have focused more on the working conditions of juvenile workers.

<b>Workers' rights</b>	<b>Asia 81 audits</b>	<b>Europe, other markets 89 audits</b>
Employment contract	44 (56%)	33 (37%)
Foreign and/or migrant workers	1 (1%)	0 (0%)
Freedom of association and collective bargaining	5 (6%)	1 (1%)
Worker-management communication system	62 (77%)	63 (71%)
Grievance system	62 (77%)	63 (71%)
Discrimination	0 (0%)	0 (0%)
Verbal abuse	13 (16%)	4 (5%)
Physical abuse and/or sexual harassment	6 (7%)	0 (0%)
Forced/compulsory labour	21 (26%)	4 (4%)
Hours of work, regular	5 (6%)	22 (25%)
Hours of work, overtime	52 (64%)	48 (54%)
Minimum wage	5 (6%)	14 (16%)
Payment of wages (correct regular, on time)	29 (36%)	23 (26%)
Overtime compensation	13 (16%)	27 (30%)
Social security	3 (4%)	21 (24%)
Sick leave	13 (16%)	13 (15%)
Annual leave	20 (25%)	14 (16%)
Leave of absence/miscellaneous	11 (14%)	12 (13%)
Maternity leave (as per law)	2 (2%)	2 (2%)
Day-care centre (if required by law)	24 (30%)	2 (2%)
<b>Total</b>	<b>391 (24%)</b>	<b>366 (21%)</b>

### Workers' rights

Reference: **H&M Code of Conduct**, section 4.

Suppliers need to fulfil several conditions in order to comply with the employment contract requirement. Each worker should have a contract issued by the employer, which specifies the employee's name, terms of employment, job title, hours of work, salary, overtime compensation, right to sick leave, annual leave and maternity leave (if applicable), and the conditions for termination of employment. The employment contract may contain additional terms. The most common violation is that employees do not receive a copy of their employment contract in the local language.

There are a number of areas which we believe are underreported, for instance discrimination and freedom of association.

Thus far, factory monitoring has not been sufficiently effective in verifying whether workers at factories supplying H&M enjoy the right to organise freely. Instead, we are occasionally contacted by local unions when our suppliers do not respect their employees' right to organise. Freedom of association is also a particularly difficult issue in China, given the current Chinese legislation. According to Chinese law, workers may organise only under the government-supported **All-China Federation of Trade Unions (ACFTU)**. The Full Audit Programme provides the tools necessary to begin to examine some of these issues more closely. We also hope to address the issue of freedom of association in a constructive manner in collaboration with the **Fair Labor Association**.

All verified cases of forced or compulsory labour were instances where the factory employees were not able to decline overtime work.

	<b>Asia</b>	<b>Europe, other markets</b>
<b>Health and safety</b>	<b>81 audits</b>	<b>89 audits</b>
Safety requirements	14 (17%)	41 (46%)
First aid (equipment, training)	16 (20%)	64 (72%)
Fire fighting training	7 (9%)	45 (51%)
Availability of medical care	12 (15%)	14 (16%)
Protective equipment	17 (21%)	37 (42%)
Drinking water	3 (4%)	16 (18%)
Canteen/dining area (if required by law)	13 (16%)	5 (6%)
Building safety	0 (0%)	1 (1%)
<b>Total</b>	<b>82 (13%)</b>	<b>223 (31%)</b>

### Health and safety

Reference: **H&M Code of Conduct**, section 3.

We are quite surprised to see the high number of violations of the first aid equipment and training requirements in Europe, and will investigate the conditions behind these figures. Again, we wish to point out that these figures are not representative of our entire supply base.

We have begun to examine the matter of building safety through discussions with external parties. Building safety is included in our Code of Conduct, and the matter is examined during audits. However, when our Code was established in 1997, building safety was mainly considered as a way of determining whether the design of a production unit enabled or hindered the fulfilment of our fire safety and safety requirements. The recent building collapses in Bangladesh have brought about renewed discussions regarding structural building safety.

	<b>Asia</b>	<b>Europe, other markets</b>
<b>Factory conditions</b>	<b>81 audits</b>	<b>89 audits</b>
Cleanliness	10 (12%)	9 (10%)
Air/ventilation	12 (15%)	20 (22%)
Temperature	5 (6%)	15 (17%)
Light	3 (4%)	3 (3%)
Toilets (number, cleanliness, access)	24 (30%)	14 (16%)
<b>Total</b>	<b>54 (13%)</b>	<b>61 (14%)</b>

### Factory conditions

Reference: **H&M Code of Conduct**, section 5.

	<b>Asia</b>	<b>Europe, other markets</b>
<b>Environment</b>	<b>81 audits</b>	<b>89 audits</b>
Environmental law	6 (7%)	3 (3%)
Permits and licences	6 (7%)	7 (8%)
Labelling of chemical containers	21 (26%)	26 (29%)
Material safety data sheets	38 (47%)	49 (55%)
Chemical handling training	32 (40%)	42 (47%)
Wastewater treatment and sludge (where applicable)	19 (23%)	2 (2%)
Hazardous waste (where applicable)	20 (25%)	39 (44%)
<b>Total (average) prevalence</b>	<b>142 (25%)</b>	<b>168 (27%)</b>

### Environment

Reference: **H&M Code of Conduct**, section 7.

About half of our suppliers do not comply with our requirements regarding material safety data sheets (MSDS) for chemicals. One of the reasons for this is that quite often our suppliers are not able to obtain proper information from their suppliers of chemicals. The chemical containers are not properly labelled, and MSDSs are not made available. In some countries, it can be difficult to find suppliers that are able to provide correct information in the local language.

## **TOWARDS SUSTAINABLE IMPROVEMENTS**

H&M implements a variety of measures to contribute to the improvement of working conditions in the supply chain. Monitoring is still the major component of our efforts as it makes it possible to identify and follow up issues, and helps us to direct our work. In this section we explain the remediation process that follows audits, and give an account of the projects aimed at factory managers and their employees. Two of these projects are explained in more detail.

### **Post-audit process**

As explained above, audit findings and possible measures are discussed with the supplier after an audit has been conducted. Next, we compile a final report of the findings, and send it to the supplier. The supplier establishes a corrective action plan that specifies how the identified non-compliance issues will be addressed, who is responsible for the remediation process, and by when the improvements will be implemented. Our auditors monitor the process and its results by conducting follow-up audits.

Issues where non-compliance mainly is a result of poor routines and management practices are included in a so-called management action plan (MAP). MAP was introduced in the autumn of 2005 as a part of the Full Audit Programme. The MAP process begins with a management interview, where we identify and assess the relevant policies, how they have been communicated and implemented and what control and feedback routines are in place. Once we and the factory management have agreed on what the deficiencies are, management is asked to develop a long-term action plan, usually with several intermediate goals. We track the suppliers' progress as part of our follow-up audits, and a new overall assessment is finally conducted in connection with the next FAP audit.

The underlying idea is that our suppliers need to assume ownership of and consequently responsibility for improving their own organisations. As a buyer, we can help our suppliers identify the root causes of the violations, but the necessary management changes within the organisations have to be addressed by the suppliers themselves.

**“The underlying idea is that our suppliers need to assume ownership of and consequently responsibility for improving their own organisations.”**

### **Examining our own practices**

We are sensitive to the fact that H&M's purchasing practices may negatively affect our suppliers' ability to comply with our requirements. For instance, late changes in the styles of the garments can make it difficult for some suppliers to meet the shipping date, which may result in excessive overtime.

One of our long-term objectives is complete integration of the Code of Conduct with our business operations. We are undertaking a number of initiatives to analyse and improve H&M's own practices as part of finding the causes of, remedying and preventing labour standards violations at our suppliers' facilities.

### **Raising awareness in the supply chain**

Poor conditions in garment factories are often a result of insufficient knowledge among factory management at all levels. Awareness raising is thus crucial to improve the situation. To this end, H&M organises workshops on topics such as labour and human rights, local legislation and safety. The target groups are managers of our suppliers and their subcontractors.

During 2005, 21 workshops were organised to educate our suppliers and their subcontractors on how to comply with international labour standards and H&M's Code of Conduct. The majority of all workshops were organised by H&M, but we also invited our suppliers and their subcontractors to workshops organised by organisations such as BSR. A total of 664 factory managers and middle managers attended.

#### **Special focus on maternity leave in Bangladesh**

During the year, H&M held a workshop on maternity leave for managers of factories with low maternity leave rates. The workshop took place in Dhaka, Bangladesh and was carried out in cooperation with **Phulki**, a local NGO. 42 managers from 22 supplier companies attended.

The majority of the garment workers in Bangladesh are women of childbearing age. However, many of them do not utilise the maternity benefits to which they are legally entitled. The results from our regular factory monitoring led us to research the matter further. We found great differences between different factories. As few as 0.1 per cent and up to 8.4 per cent of the female factory employees were utilising their right to maternity leave. According to various NGOs, a realistic maternity leave rate is around 8–10 per cent. The main reason for the at times far too low maternity leave rates appears to be low awareness about maternal rights among both workers and management.

The purpose of the workshop was to discuss maternal rights in general and measures aimed at increasing awareness of the issue among workers and middle managers in particular. Two suppliers with good maternity leave routines and high scores in our survey presented the actions that they had taken in order to improve their practices. The participants received guidance and advice on what action they could take within their own organisations. Among the

suggested measures were training programmes for both workers and middle management, a simplified leave application procedure, systematic medical check-ups, as well as additional information via notice boards, handbooks and employment contracts. H&M will closely monitor the actions taken by the participants after the workshop. The Full Audit Programme will help us measure any progress made by the suppliers.

#### **Education of garment workers in Bangladesh**

Our audits have shown that generally, awareness about workers' rights among both workers and middle managers at H&M's Bangladeshi suppliers is low, and that communication between management and workers does not function well. As described in last year's CSR report, H&M has initiated a project with a local women's rights NGO, **Karmojibi Nari (KN)**, in order to address these issues.

During 2005, KN held educational seminars on workers' legal rights (e.g. wages, working hours and maternity leave). The participants were provided with leaflets to be used to educate co-workers, thereby spreading the knowledge to their peers. The target for 2005 was to reach about 400 workers directly and 2,000 indirectly. Due to various obstacles such as peak production season and limited staff resources at KN, this goal was not met; we managed to reach 238 workers directly and around 1,360 indirectly.

After having evaluated both the methods and the outcomes of this year's activities, KN and H&M chose to alter the training procedures somewhat for 2006. The first step is to provide the factories selected for the project with their own trainers. Welfare and/or human resources officers from each factory will attend three-day courses for trainers at KN. In this way, they will be able to hold awareness classes for workers and for middle managers in their respective workplaces. Orientation programmes for new

employees will also be held. As a second step, the factory workers will watch an inspirational play performed by KN's director Rokeya Ratifique Baby, who is also a well-known actress. The play will focus on the importance of workers' rights and worker-management dialogue. Furthermore, H&M will produce posters with summarised information about national labour law in Bangla, which will be posted in the factories. Finally, the factory managers will be responsible for implementing grievance systems in their factories.

The goal is that by the end of 2006, all middle managers and workers in the four participating factories will have been trained, and that all four factories have well-functioning grievance systems.

#### **H&M participates in the Fair Labor Association**

In 2005, H&M was accepted as a participating company in the Fair Labor Association (FLA), effective 1 January 2006. The FLA is a multi-stakeholder coalition of companies, universities and NGOs dedicated to protecting workers' rights and improving working conditions.

Being a participating company of the FLA involves committing to a rigorous programme of implementing FLA's Workplace Code of Conduct, monitoring and remediation. More precisely, it means that the FLA will conduct unannounced independent external monitoring visits at some of H&M's suppliers' factories in China. The independent monitoring conducted by FLA will however not substitute our own audit programme – it will supplement it. At the end of 2006, FLA will publicly report the results of the independent audits it has performed. The report will be available on **FLA's website**.



Our participation in the FLA is a way of demonstrating to our stakeholders how we strive towards full compliance with our Code of Conduct. It will enable us to cooperate with other brands and FLA partner organisations to improve labour standards in our supply chain. We will also use the results from FLA's audits as a benchmark in order to ensure the quality of our internal monitoring programme. ■



## STAKEHOLDER ENGAGEMENT

With the introduction of the Full Audit Programme, we are beginning to address some of the more complex issues in the supply chain. However, as the problems and the causes that lie behind them are found on many different levels, there are limits to what any single actor can manage. Below, we give an account of the multi-stakeholder initiatives in which we participate. We also present the feedback on our CSR reporting that we have received from representatives of four important stakeholder groups.

### COOPERATION FOR CHANGE

#### Improving working conditions in Cambodia

H&M supports Better Factories Cambodia (BFC), an **International Labour Organization** (ILO) programme that seeks to improve working conditions in Cambodia's export garment factories. This is done by monitoring garment factories according to national and international standards. Summary reports of audit findings are published on the **Better Factories Cambodia website**. Remediation efforts also include helping factories to improve working conditions and productivity as well as collaborating with the government and international buyers to bring about lasting improvements.

Better Factories Cambodia is managed by the ILO and supported by the Royal Government of Cambodia, the **Garment Manufacturers' Association in Cambodia** (GMAC) and unions. BFC works closely with other stakeholders including international buyers. All of H&M's suppliers in Cambodia participate in this programme, which serves as a complement to H&M's own audits. In addition, the information collected by Better Factories Cambodia can give us guidance when we are looking for new factories to collaborate with in Cambodia. Participation in BFC's remediation and training programmes also provides valuable opportunities for

H&M's suppliers to improve their practices and bring them into line with the internationally agreed labour standards.

#### MFA Forum Bangladesh

H&M participates in the MFA Forum Bangladesh. We believe that Bangladesh's garment industry faces several issues that need to be addressed on a country and industry level, rather than on a company level only. Such issues include excessive working hours, poor safety, low minimum wages and low productivity.

The MFA Forum brings together a number of international and local stakeholders, including buyers, the **World Bank**, **Oxfam International**, **ITGLWF**<sup>1</sup>, **ETI**<sup>2</sup>, **SAI**<sup>3</sup>, **FLA**<sup>4</sup>, representatives of the Bangladeshi government, **BGMEA**<sup>5</sup> and **BKMEA**<sup>6</sup>. All stakeholder groups contribute in different ways, and the task of the buyers group is to agree on common approaches to compliance, both in terms of adopting a joint code of conduct as well as harmonising the implementation of this code.

More information about the MFA Forum Bangladesh is available at [www.mfa-forum.net](http://www.mfa-forum.net).

#### H&M participates in GRI's Sector Supplement Working Group

H&M participates in the Global Reporting Initiative's (GRI) working group whose task is to develop an Apparel and Footwear Sector Supplement.

The Global Reporting Initiative is a widely recognised sustainability reporting framework with the 2002 Sustainability Reporting Guidelines (the Guidelines) as the core of its reporting structure. As the Guidelines are generic, they are supported by sector supplements that cover aspects that are not directly addressed in the Guidelines.

<sup>1</sup> International Textile, Garment and Leather Workers' Federation

<sup>2</sup> Ethical Trading Initiative

<sup>3</sup> Social Accountability International

<sup>4</sup> Fair Labor Association

<sup>5</sup> Bangladesh Garment Manufacturers & Exporters Association

<sup>6</sup> Bangladesh Knitwear Manufacturers & Exporters Association

The aim of the current project is to enable companies in the apparel and footwear industry to improve their sustainability reporting by creating a draft version of the GRI Apparel and Footwear Sector Supplement. The supplement is prepared by a multi-stakeholder group working together with the GRI. The working group consists of about 20 individuals from different geographic regions representing buyers, manufacturers, NGOs, trade unions, investors and other groups.

An obvious characteristic of companies in the apparel and footwear sector is that they rely heavily on supply chains. H&M's stakeholders demand information on our supply chain work, but also on our suppliers' performance. Reporting on the actual conditions or performance of entities over which we have no direct control, i.e. the independent suppliers that we source from, presents a significant challenge. A standardised reporting framework that enables us to report on sustainability issues in our supply chain in a way that makes comparisons within the industry possible is, however, a welcome development. We therefore appreciate being given the opportunity to become a member of the sector supplement working group, and consider this work to be an important step towards a more consistent reporting framework for our industry.

By the end of 2005, the working group had held two out of four meetings. The work will proceed in 2006, and a draft version of the Apparel and Footwear Sector Supplement will be published on **GRI's website** for public comment in the spring of 2006.

## LISTENING TO OUR STAKEHOLDERS

### Our stakeholders' opinions on the 2004 CSR Report

Once again, we asked representatives of four significant stakeholder groups to provide structured feedback on our CSR reporting. Last year's comments from **Industrifacket** (Industrial Workers' Union), **Fair Trade Center**, **Banco** and **Globalt Ansvar** (Swedish Partnership for Global Responsibility) were highly appreciated and we have tried to meet the requirements that they put forth, especially concerning audit results.

This year, we asked the following individuals and organisations to provide feedback on our CSR reporting:

- Joel Lindfors, coordinator at the Swedish branch of the **Clean Clothes Campaign (Rena Kläder)**
- Neil Kearney, general secretary of **ITGLWF**
- Anna Nilsson, head of SRI<sup>1</sup> analysis at Swedish mutual fund manager **Robur**
- Lena Tham, manager corporate partnerships at **WWF Sweden**

Our questions and the answers that we received are presented here.

### How important are sustainability/CSR reports to you in your work?

Joel Lindfors, Rena Kläder	As the quality of CSR reports improves, they become an important tool in the ongoing dialogue between stakeholders. Rena Kläder uses CSR reports to estimate how seriously a company takes its CSR work. The level of transparency and self-reflection gives us an idea of whether they are heading in the right direction.
Neil Kearney, ITGLWF	–
Anna Nilsson, Robur	CSR reports are one of the main tools in my work, which involves conducting sustainability analysis of companies. The results are used both to decide what companies to invest in for the sustainability funds, and also to identify critical issues for companies in Robur's traditional portfolios.
Lena Tham, WWF	WWF regards CSR reports as important tools to measure, evaluate and compare companies' environmental and social performance.

<sup>1</sup> Socially responsible investment

**What are the three key aspects that you look for in a retail company's CSR report?**

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Joel Lindfors, Rena Kläder	The biggest value of a CSR report lies in showing which problems exist in the supply chain, how the company has contributed to these problems and how they have dealt with these problems. A CSR report should also contain an analysis which includes criticism and recommendations from other stakeholders.
Neil Kearney, ITGLWF	Workers everywhere complain that inadequate wages make excessive overtime working the only way to come near to earning a living wage. But real improvements in wages and working hours only happen through collective bargaining, which is near impossible in the absence of trade unions in the workplace. Mature systems of industrial relations and proper management systems are also the best ways of dealing with day-to-day workplace issues. However, all these are dependent on workers not being prevented from exercising their right to organise. This empowerment of workers needs to be at the heart of H&M's CSR agenda. Equally, H&M's purchasing practices need to be documented in a way that enables objective assessment of their impact on workers in the supply chain.

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Anna Nilsson, Robur	<p>1. A basic aspect we look for is information on the supplier network (e.g. geographical distribution) and purchasing processes (e.g. indirect/direct purchase, length of contracts) to determine the sustainability risk.</p> <p>2. The most important issue for retailers is the quality of the supplier evaluation process, as the supplier network is largely concentrated in countries where there is a risk of poor labour conditions and low environmental standards. We look for codes of conduct, clear descriptions of the inspection process (e.g. brief reviews or thorough audits, review intervals, levels in the supply chain that are audited), training of inspectors and collaboration with suppliers to raise awareness. Is the focus on improvements in the supply chain and is there a reporting system to show the development?</p> <p>3. The company's position on labour rights for its own staff including the right to form free trade unions is also an important factor for retailers.</p>
Lena Tham, WWF	Generally, we would seek to evaluate the context and commitment to sustainable development, management processes and policies, performance measurement, external verification and reporting.

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**To what extent are these aspects addressed in H&M's 2004 CSR report?**

Joel Lindfors, Rena Kläder	H&M's CSR Report 2004 does all this to some extent. What it fails to do though, is to reflect sufficiently on its own role.
Neil Kearney, ITGLWF	<p>The report outlined H&amp;M's corporate values, its aspirations for workplace conditions and its proposed CSR approach but failed to provide evidence of progress on the ground. It claimed a change of approach from policing to remediation, from determining what is wrong to why it is wrong. But is anything wrong?</p> <p>Linking buying practices to the application of CSR and developing long-term contracts is essential, said the report. It didn't say whether this is already happening. It also said worker interviews are key to establishing whether there is compliance with local labour laws and the H&amp;M Code of Conduct. Yet only 143 such interviews were conducted in 2,000 production units employing some 600,000 workers. And no information was given on where such interviews were conducted.</p>
Anna Nilsson, Robur	The most important sustainability aspects are extensively covered in the report. However, we lack information on the status of the environmental and labour rights aspects within the supplier network and the results of H&M's supplier evaluation. What is the gap between the Code of Conduct and the reality?
Lena Tham, WWF	H&M's CSR report for 2004 demonstrates a commendable openness and willingness to discuss difficult issues in public with its stakeholders. The report follows the GRI guidelines to a large extent which makes it reasonably comprehensive, easy to follow and should facilitate year on year comparisons.

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**Which are the major strengths of H&M's 2004 CSR report?**

Joel Lindfors, Rena Kläder	The main strength of H&M's report is that it genuinely discusses the function of the company's monitoring work, and how it contributes to preventing violations. It quite clearly states that H&M, as other stakeholders, has realised that audits alone will not solve all problems.
Neil Kearney, ITGLWF	H&M's Corporate Responsibility Report 2004 was a bit like a good appetizer, whetting the appetite for the meal to follow. Unfortunately, the next servings were a disappointment – a passable starter but no main course!
Anna Nilsson, Robur	A strength of the report is that H&M shows a clear commitment towards sustainability issues and gives a description of the responsibility aspects of the company. It also reports the specific goals with the results (albeit qualitative, not quantitative). Another strength is the in-depth description of the supplier evaluation system and the challenges of the Code of Conduct inspections. We also appreciate the broad range of sustainability issues covered in the report and the fact that H&M let stakeholders express their views.
Lena Tham, WWF	The social and ethical parts of the report are the strongest where it is evident that H&M has made considerable effort in recent years. To be commended for example is H&M's move to longer term relationships with suppliers.

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### How can H&M's CSR reporting be improved?

Joel Lindfors, Rena Kläder H&M avoids any serious discussion of its own role when it comes to wages, purchasing practices, transparency and a proactive, structural approach.

H&M states that “due to rigorous checking of documents such as salary records, time cards and payslips we can be quite sure that all workers receive at least the legal minimum wage”. This would be fantastic, if only we could be sure it is true. H&M has over 700 suppliers, and it is quite impossible to audit all these in a year. Secondly, from checking documents it is rather hard to make sure that the workers themselves have actually received the wages they are entitled to. And above all this, we know that a minimum wage is rarely a salary that workers can make a living off.

This clearly relates to H&M's purchasing practices. Unfortunately, the report doesn't say anything about this. It remains unclear whether and to what extent the demands H&M places on its suppliers in terms of speed, delivery time and cost-effectiveness influence their suppliers' ability actually to adhere to the company's code of conduct.

H&M is ambitious when it comes to CSR. Rena Kläder applauds that. Nevertheless, during 2005 Nike, Puma and Levi's disclosed their list of suppliers, in what seems to become a trend. H&M could have set this trend, and should certainly follow it.

Overall, H&M responds properly to cases of violations, including breaches of the right to freedom of association, the most crucial workers' prerogative. What would make H&M's ambitions really hold true would be if they could go beyond this, and make sure that violations don't happen in the first place.

A proactive, structural approach, starting from the workers' perspective, is what can make H&M stand out.

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Neil Kearney, ITGLWF H&M's commitment to 'continuous improvement' could not be verified from the report, nor was it possible to determine whether most suppliers were in compliance even with local labour legislation. Reference was made to 'country risk categories' but no further information was forthcoming, the absence of which made it impossible to establish whether H&M consider Chile a greater risk than China or vice-versa. All in all, a disappointing meal! Fortunately improvements were promised.

H&M's Code of Conduct seems to be based very much on the application of minimum local legal requirements. This cannot, on its own, deliver a living wage for a standard working week. The Code needs rewriting to align it with accepted good practice.

H&M must be more transparent and disclose full details of the company's supply chain as part of their CSR reporting. This would open the whole CSR process to greater scrutiny requiring more meaningful future reports based on action undertaken and demonstrating whether a process of continuous improvement is actually in hand.

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Anna Nilsson, Robur The most important improvements to the report would be to give a better description of the status of the environmental and labour rights aspects within the supplier network and the results of H&M's supplier evaluation work, preferably presented in quantified data. We also want a description of the environmental aspects throughout the whole supply chain. Would H&M consider publishing a gap analysis produced by an external party of its sustainability work in relation to the commitments of the company?

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Continued ►

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### How can H&M's CSR reporting be improved? – continued

Lena Tham, WWF	<p>By its own admission, H&amp;M has not given enough attention to environmental issues. Consequently there are areas where WWF would like to see improvements. These include:</p> <ul style="list-style-type: none"> <li>■ A clear understanding of the life cycle impacts of its products which would help shape the environmental strategy as well as set meaningful and measurable targets. More attention should also be given to the environment management system. Life cycle analysis could identify new issues where efforts are more cost effective than in current areas of work; i.e. the most significant environmental effects are likely to be related to cotton growing and production of synthetic fibres. H&amp;M should consider undertaking research to generate such information to confirm or improve its current strategy.</li> <li>■ Data on raw material quantities and sources is inadequate; a 5–10 year target for organic cotton use (and other forms of less impacting cotton) should be considered.</li> <li>■ Even if H&amp;M feels that it is not ready for a third-party audited CSR report, it would probably help its management to commission external experts to assist in the process of priority setting and maximising benefits from investments being made. Benchmarking with other companies in the industry would also help to set up more ambitious and measurable targets.</li> <li>■ H&amp;M has identified CO<sub>2</sub> emissions as one of its key challenges. However the present target is not ambitious enough as it will not reduce the climate change impact of H&amp;M absolutely but only slow its increase down. WWF would like to see H&amp;M set an absolute target for reduction of CO<sub>2</sub> emissions, independent of volume growth.</li> </ul> <p>H&amp;M's public support for the health and environmental objectives of REACH is to be commended. In order to be more transparent H&amp;M could highlight its advocacy activities on this issue too. More clarity is needed on its chemicals listings.</p>
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### Meeting with our stakeholders

During 2005, H&M participated in a number of meetings, conferences and projects where we had a fruitful dialogue with various stakeholders. Examples of such meetings and events are:

- **MFA Forum Bangladesh** in London, Dhaka and Washington D.C. (read more on page 41)
- **The Clean Clothes Campaign's** conference on freedom of association in Frankfurt
- **ETI's** biennial conference in London
- **BSR's** annual conference in Washington D.C.
- The Responsible Competitiveness conference, arranged by the **Directorate-General for Employment, Social Affairs and Equal Opportunities** and **AccountAbility** in Brussels
- **The Global Compact's summit in Shanghai**
- **Amnesty International's** China expert meeting in Amsterdam
- **Amnesty Business Forum** in Stockholm
- **Better Factories Cambodia** in Phnom Penh (read more on page 41)
- **CSR Asia's** conference "The supply chain talks back" in Shekou
- **Better Cotton Initiative** in Washington D.C. (read more on page 41)
- **Organic Exchange conference in Izmir**
- **GRI** apparel and footwear sector supplement working group meetings in Amsterdam and Colombo (read more on page 41).

At these and other events, among others we met with representatives of:

- International and local trade unions
- International and local social and environmental NGOs
- Swedish and foreign governments
- The European Parliament and the European Commission
- Financial institutions ■



## COMMUNITY INVOLVEMENT AND CHARITY



### Global cooperation with UNICEF

In 2004, H&M entered into a three-year cooperation agreement with **UNICEF**, the United Nations Children's Fund. H&M contributes to UNICEF's HIV/AIDS Awareness and Prevention Programme in Cambodia and its **Global Girls' Education Programme**.

#### *HIV/AIDS Awareness and Prevention Programme in Cambodia*

Cambodia is one of the countries where H&M's products are manufactured. We wish to contribute to the development of the country by helping to address one of the country's major problems; the spread of HIV/AIDS.

After decades of genocide, war and famine, Cambodia remains one of the poorest countries in Asia. Roughly one third of the population lives in extreme poverty, the country has a weak health infrastructure and the HIV/AIDS prevalence rates is among the highest in South-East Asia. The majority of new infections are among the young. However, young people also offer the greatest opportunity

to defeat HIV/AIDS. It is crucial to educate them about HIV/AIDS and teach them skills that translate knowledge into practice: negotiation, conflict resolution, critical thinking, decision-making and communication.

Young women are a major risk group that UNICEF wishes to reach. Cambodia's around 200 garment factories employ about 290,000 people, of which the vast majority are young women. The programme supported by H&M specifically addresses several garment factories that we source from. The aim of the programme is to increase female factory workers' knowledge about HIV/AIDS and reproductive health, to help them gain better access to health services, and teach them life-skills to improve their self-confidence and help them make informed choices.

Several activities will be carried out. For instance, 300 workers will be trained as peer educators. They will in turn educate their fellow workers using a "talk to ten" approach, which means that a minimum of 3,000 factory employees will be reached by UNICEF's educational efforts. The peer trainers also receive questions either directly or through suggestion boxes. The answers are recorded and played through amplifiers during lunch breaks. Lunch breaks are also used to hold health promotion sessions. There is also a toll-free HIV/AIDS counselling hotline running for nine hours a day, six days a week.

#### *Global Girls' Education Programme*

Over 115 million children around the world have no opportunity to go to school. The majority of these are girls. This violates the UN Convention on the Rights of the Child, which states that all children have the same rights, including the right to basic education.

The international campaign "**25 by 2005**", which H&M supports, aims to accelerate the development of girls' education.

There are many reasons why girls do not have access to the

same educational opportunities as boys. Cultural values, long geographical distances and shortages of teachers all play a part. Among other things, UNICEF's work encourages discussion and opinion-forming among authorities and parents by presenting the benefits of letting girls go to school. It is also geared towards making education more available in practice. One of UNICEF's initiatives is mobile schools, a programme that brings the teaching to areas that are otherwise out of reach. UNICEF also trains female teachers and supports special grants for girls.

In addition to these projects, H&M and UNICEF cooperate locally in countries where H&M operates. A few examples are mentioned below.

Read more at [www.hm.com/csr](http://www.hm.com/csr) and [www.unicef.org](http://www.unicef.org).

#### **H&M contributes to WaterAid**

For the past four years, H&M has supported the work of the British charity organisation **WaterAid** on improving access to and quality of water for people living in Asia and Africa. For over one billion people, obtaining water is a daily struggle. Many women and children in developing countries spend hours every day walking miles to fetch water. WaterAid focuses on using practical solutions to provide safe water, effective sanitation and hygiene education to the world's poorest people. They also seek to influence policy at national and international levels.

H&M supports WaterAid's work by donating ten per cent of the proceeds of selected swimwear. In 2005, H&M contributed GBP 40,000 to WaterAid's projects, enough to provide nearly 3,000 people with a lasting supply of clean water and sanitation. H&M's donation goes to Bangladesh, a country where some of the garments that we sell are manufactured.

<sup>1</sup> Flora and Fauna International

<sup>2</sup> The Humane Society of the United States

<sup>3</sup> People for the Ethical Treatment of Animals



#### **Stella McCartney for H&M t-shirt**

One of the t-shirts in our Stella McCartney for H&M collection was made of 100 per cent organically grown cotton. H&M and Stella McCartney decided that 25 per cent of the proceeds from this t-shirt would be shared by four organisations. **FFI's**<sup>1</sup> International Gorilla Conservation Programme, **Animal Aid**, **HSUS's**<sup>2</sup> Protect Seals Campaign and **PETA's**<sup>3</sup> Animal Emergency Fund received SEK 125,000 each.

Read more about organic cotton on page 68.

#### **Solange friendship bracelet**

One of the products in the Solange for H&M jewellery collection was a so-called friendship bracelet. 25 per cent of the sales revenue (SEK 125,000) from this bracelet went to UNICEF's international campaign "25 by 2005", which aims at accelerating the development of girls' education.

#### **Teaching sewing skills in Bangladesh**

H&M runs a programme for young people in Dhaka, Bangladesh who train to become sewing machine operators. The programme was initiated in 1999, and was initially intended to run for two years but after the positive response from the students and their families we decided to keep it. Today there are two training centres at which around 100 young people a year receive training in sewing after completing their basic education.

After four months of initial training at one of H&M's training centres, the students become trainees at selected H&M suppliers. All trainees receive continuous support from H&M's instructors, and the students' skills and development are observed in cooperation with the factory management. H&M pays the students a wage during the training period and once they have finished their training they are guaranteed work as sewing machinists at one of H&M's suppliers.

In the autumn of 2005, the training centre in Dhaka initiated a project for heavy knit operators, in order to encourage more boys to join the training programme.

#### Charity initiatives

Apart from our global cooperation agreements, our sales organisations engage in local charity projects. Here are a few examples from 2005.

- H&M Sweden supports **Mentor Sverige**, the Swedish chapter of the **Mentor Foundation**, an organisation focusing on the prevention of drug misuse and the promotion of health and well-being of young people. In 2005, H&M Sweden contributed MSEK 1.5.

H&M Sweden also supported UNICEF's Evening of Comedy, which was broadcast on Swedish national television. The aim of the show was to engage new monthly donors through UNICEF's programme Global Parent. H&M promoted the event through a competition, H&M Club send-outs, window-displays as well as a number of other activities, primarily in the major stores in Sweden.



- H&M Switzerland also helped to promote UNICEF's Global Parent programme via its stores and a children's wear catalogue.
- H&M USA donated USD 40,000 in 2005 to **Childhood USA**, the US-based affiliation of **World Childhood Foundation**. H&M expanded its support through Childhood to the Legal Services for Children, a children's legal aid society located in San Francisco, dedicated to help children at risk with legal and social services.  
H&M USA also continues to support **Inwood House** Teen Choice programme in New York, a school-based effort helping adolescents make responsible choices about reproductive health, drugs, and family and partner relationships.
- Pink bracelets were sold in H&M's Danish stores. The bracelets sold out and H&M Denmark was able to forward DKK 200,000 to **Kræftens Bekæmpelse** (the Danish Cancer Society).
- H&M Norway donated NOK 275,000 to **Den Norske Kreftforening** (the Norwegian Cancer Society).
- H&M Austria collected EUR 9,000 towards UNICEF's Girls Education Programme.

### **Disaster relief in 2005**

This year, H&M felt that it was important to provide support to areas affected by natural disasters. Apart from clothing, we donated EUR 150,000 to support those affected by the tsunami in Asia, SEK 500,000 to help earthquake victims in Pakistan and USD 20,000 in connection with Hurricane Katrina in the USA. We also had collection boxes in our stores and were able to forward EUR 275,000 towards UNICEF's tsunami relief efforts.

### **H&M donates clothes**

H&M continues to donate clothes to victims of war and natural catastrophes and other people in need. H&M's efforts at improving quality have resulted in a number of orders being held back from sale in recent years. Clothes that do not meet H&M's quality standards are not passed on to the stores. Instead, we have signed agreements with reputable aid organisations in our sales countries and large quantities of new clothes have been sent to those in need through these organisations. Some of the organisations that we work with are **UNHCR**<sup>1</sup>, **Oxfam**, **Caritas**, **Red Cross** and **Terre des homes**. Naturally, we never give away clothes that do not pass our safety or chemical requirements. Such garments are destroyed. ■

<sup>1</sup> United Nations High Commissioner for Refugees

## PRODUCT RESPONSIBILITY

Quality is an integral part of H&M's business concept. Our ambition is to make sure that all customers are always both safe and satisfied regarding the quality of all our goods. Our customers' expectations lead our work.

### Ensuring quality in production

Our quality work is managed through our production offices. The quality department at the Stockholm buying office supports the production offices in quality-related issues. Our GPQ<sup>1</sup> staff, our technicians and our quality controllers all contribute to providing correct information and support to help our suppliers to manufacture and deliver goods that live up to H&M customers' expectations.

#### QUALITY DEPARTMENT: ORGANISATION

##### QUALITY STANDARDS AND TESTING

This section focuses on implementing requirements for our physical and chemical tests in accordance with the safety requirements of the sales country with the strictest regulations.

##### TECHNICAL

This section centres its attention on issues related to fit, sizes and technical making of garments.

##### PRODUCT CONTROL

This section is concerned with issues such as consumer product safety and children's safety. Much attention is also centred on the implementation of our Guidelines for Production and Quality Control (GPQ) at our suppliers' factories.

In order to foresee or detect and correct any quality problems as early as possible, and thus ensure the quality of all products, H&M requires each factory to monitor quality systematically. H&M's Guidelines for Production and Quality Control (GPQ) are part of the order contract between H&M and the supplier as they set out the minimum quality control necessary to manufacture goods in accordance with our requirements. The GPQ covers all stages from the sample procedure to packing and final inspection.

Our production office technicians serve as the link between pattern makers at the buying office in Sweden and our suppliers. They work together with the suppliers' sample technicians to solve technical and safety issues during the sample stage, i.e. before production starts.

Our around 140 quality controllers regularly visit factories in order to inspect and correct any quality problems in the course of production. When necessary, they also carry out final inspections before the goods are shipped. H&M uses the AQL 2.5<sup>2</sup> system to determine whether the products are acceptable for shipment.

**“Our around 140 quality controllers regularly visit factories in order to inspect and correct any quality problems in the course of production.”**

<sup>1</sup> Guidelines for Production and Quality

<sup>2</sup> Acceptable quality level refers to the maximum percentage of defectives (in this case 2.5 per cent) that, for the purpose of sampling inspection, can be considered satisfactory as a process average.

### HOW GARMENTS ARE QUALITY CONTROLLED

#### PRE-PRODUCTION MEETING

When possible, our quality inspectors meet with the supplier prior to production in order to identify and solve any technical difficulties that might occur in the course of production.

#### INITIAL AND INLINE INSPECTIONS

Initial inspections are performed after a few hundred pieces have been manufactured, whereas inline inspections can be carried out anytime during the production process. The purpose of the initial inspection is to make certain that the product that H&M has ordered is suitable for mass-production. Both types of inspections aim at detecting quality difficulties as early on as possible.

#### FINAL INSPECTION

During the final inspection, the quality controllers check to see if the garments are produced according to the approved sample and other requirements. They also check price tags, labels and sizes.

Samples of every product in H&M's collections undergo a number of quality and safety tests. Each year, hundreds of thousands of tests are carried out, mainly at our production office and sales country laboratories, but also at external laboratories. Garments are washed and measured to check that they do not shrink or twist, and to check their colourfastness and dry rubbing. In addition, we test salt and chlorine bleaching, pilling and seam strength. Durability tests are carried out on details such as zippers and press-buttons. Flammability tests are performed to check that the garment is not flammable. Random quality control also takes place at our distribution centres before the garments are distributed to the stores.

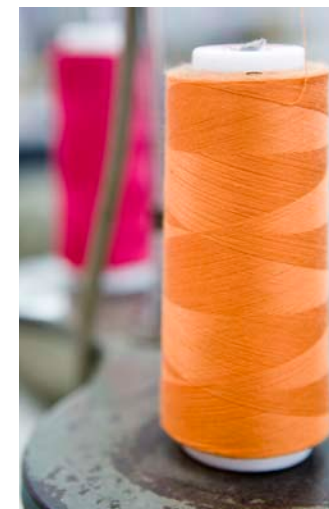
#### Children's safety

Children's clothes must meet particularly high safety requirements; H&M therefore designs baby and children's wear with safety in mind.

Our designers, buyers and production office staff receive continuous training on children's safety. New employees are trained as well. When designing children's clothes, we try to avoid adding too many details and decorations to prevent the garments from being a safety risk. We also pay attention to hoods and drawstrings in order to avoid situations where the construction of the garment increases the risk of entrapment or suffocation. H&M always follows the safety requirements of the sales country with the strictest regulations.

All baby and children's wear suppliers are required to sign H&M's Safety Requirements for Baby and Children's Wear. In so doing, they undertake to follow our policies on e.g. button and accessory testing, broken needles and needle detection machines. Each supplier must also appoint at least one person who is trained and updated on children's safety by H&M staff. H&M reserves the right to cancel an order or, if it has already been delivered, return the goods if any of the conditions in H&M's Safety Requirements for Children's and Baby Wear are not met.

H&M's involvement in children's safety issues goes well beyond the various safety measures during the design and manufacturing phases. At the request of **SIS** (Swedish Standards Institute), H&M participates in a working group with the purpose of establishing safety standards for baby and children's garments. The work is organised by **CEN** (The European Committee for Standardization), and in January 2005, it resulted in a new standard (EN 14682:2005) that specifies requirements for cords and drawstrings for children's clothing.



### Restricting the use of chemicals

Out of concern for the health of our customers and employees, the factory employees who make our products, as well as for the environment, H&M has established chemical restrictions for textile, leather, plastic and metal products. These are chemicals that are, or could potentially be, harmful for health and environment. Particular consideration is given to substances that could cause skin irritation or allergies or that may be carcinogenic. There are also restrictions for cosmetic and hygiene products (see page 56).

The precautionary principle guides our work with chemical restrictions. Thus, the restrictions include both chemicals restricted by law and chemicals that we have chosen to add to the list for precautionary reasons. As an important part of H&M's long-term work against allergies, we participate in a project organised by CEN that aims to develop standardised methods for analysis of allergens in materials and products.

We require that all our suppliers comply with our chemicals restrictions. To this end, all suppliers must sign the Chemical Restrictions compliance commitment. Cosmetics suppliers also sign the Restrictions for Cosmetic and Hygiene Products compliance commitment (see page 56). We support our suppliers with information on how to implement and comply with our chemical restrictions. Our suppliers also receive information on how to locate and resolve problems if they infringe our restrictions. In this way we contribute to reducing the environmental impact in the production process, as well as in the incineration and in recycling of worn-out clothing.

We perform tests in order to check that banned chemicals are not present in the products. AZO dyes, disperse dyes, formaldehyde and phthalates are examples of substances we routinely test for. About 21,000 chemical-related tests were performed during 2005. In addition, jewellery and metal details are tested for nickel release.

In order to stay ahead, close cooperation and dialogue with relevant authorities is also crucial. Our cooperation and sharing of information with the US Consumer Product Safety Commission (CPSC), the National Chemicals Inspectorate in Sweden, the Swedish Consumer Agency and other similar organisations have helped us become a leader in the field.

**“About 21,000 chemical-related tests were performed during 2005.”**

### Chemicals restrictions update

Our chemical restrictions are continuously updated, most recently during 2005. Among other things, the limit for APEOs (alkylphenolethoxylates) was decreased. Our aim is to phase out APEOs entirely from the production of H&M products. Also, the fluorinated compound PFOA (perfluorooctanoic acid) was added to our restrictions list during the year. PFOA and PFOS (perfluorooctane sulphonate) form the group PFAS (perfluorinated alkylated substances). The updated chemical restrictions list can be found under a drop-down menu at [www.hm.com/csr](http://www.hm.com/csr).

### Following legislation through Eco-track

Our concerns about the impact of certain substances on the environment and on human health require us to keep abreast of the stringent legislation that exists in many of our sales countries. **Eco-track** provides valuable and up-to-date information on relevant legislation – existing and forthcoming – that may affect our products.

**REACH – Proposal for new chemicals legislation within the EU**

Chemicals are used in the manufacturing processes for almost every product, and as ingredients in the products themselves. However, the information on what harm these chemicals do to our health and to the environment is insufficient. Companies that are dependent on chemicals for their products are presently unable to obtain the information they need. Still, they cannot afford not to have such information. To tackle this deficiency, a new set of EU legislation is taking shape. The existing patchwork of different chemicals laws will be replaced by one single piece of legislation for the registration, evaluation and authorisation of chemicals (REACH).

H&M's ambition is to make certain that all our customers always are both safe and satisfied regarding the quality of our products. To this end, we avoid using hazardous substances. We have already phased out brominated flame-retardants, PVC, as well as certain organotin compounds and phthalates from our clothing lines in favour of substitutes.

REACH will lead to internationally harmonised and authorised criteria for substances of very high concern. This will obviously assist H&M in selecting substances for substitution, in very much the same way as our chemical restriction list process. We have adopted the precautionary principle, and that means we have to be proactive and solve the problems upstream. The most cost-effective and the only adequate control measure should be substitution – not to continue to use hazardous chemicals. A strong REACH would benefit H&M's business by minimising our business risks and by reducing our costs in ensuring that all products we offer our customers are free from substances that are, or could potentially be, harmful to health and environment.

The Council of Ministers reached an agreement on REACH in December 2005. Rather than supporting the principle of substitution, the Council claimed that evidence of "adequate control" is sufficient ground for granting authorisation for e.g. carcinogenic substances. This means that some chemicals could stay on the market, even if safer alternatives are available, which is not what H&M had hoped for. REACH is still to be formally adopted and approved, and could subsequently come into force at the end of 2006.

**Limiting the use of chemicals in cosmetic products**

Since 1997, H&M has had a list of restrictions of the chemical content of cosmetic and hygiene products. All suppliers of cosmetic and hygiene products undertake to abide by H&M's restrictions. These include detailed requirements of the content, chemicals, packaging and labelling of the products. H&M's restrictions and requirements are continually updated and are adapted to the sales country which has the most stringent legislation. In addition to H&M's own requirements and restrictions on the use of chemicals, the supplier must also undertake to observe the **EU directive on chemicals in cosmetic and hygiene products (76/768/EEC)**. The supplier has a duty to provide information and to ensure that subcontractors also abide by H&M's restrictions. If it emerges during H&M's quality controls that the supplier is not abiding by the agreement, H&M has the right to terminate the cooperation.

**H&M does not allow animal testing**

H&M does not allow animal testing for cosmetic and hygiene products, either during production or for the finished products. All the ingredients used in H&M's products are approved in accordance with the high requirements set by the authorities and H&M. Products are always assessed for their safety and quality. H&M has had a policy on animal testing since the mid-1990s. This policy forms part of the above mentioned restrictions for cosmetic and hygiene products. Read more in our fact sheet on animal rights issues, which can be downloaded from [www.hm.com/csr](http://www.hm.com/csr).



### Product and labelling policies

- H&M does not sell real fur.
- H&M only sells leather from cow, buffalo, sheep, goat or pig that has been bred for meat production, not just for the sake of the skin.
- H&M does not purchase leather products from Indian suppliers due to the grim conditions in which the animals are transported.
- Due to the poor working conditions in the Indian silk industry, H&M does not buy silk from India.
- Down and feathers should only be picked from slaughtered birds that have been bred for meat production. H&M requires a certificate that shows that the down and feathers have been properly washed and steamed (120–130 degrees Celsius for 30 minutes).
- H&M's suppliers must guarantee that material used for H&M's products does not contain endangered species in any form.
- For products made of wood originating from countries with tropical rain forest (Bolivia, Brazil, Central African Republic, Cameroon, Colombia, Congo, Congo-Kinshasa, Ecuador, Equatorial Guinea, Gabon, Guyana, Indonesia, French Guiana, Malaysia, Papua New Guinea, Peru, Surinam and Venezuela), H&M requires a certificate from FSC (Forest Stewardship Council).
- H&M's children's clothing must be comfortable and practical. We aim not to sell children's clothes that may be perceived as provocative.
- H&M does not use camouflage patterns on garments.
- Prints on tops and other garments must not be offensive, racist, sexist, political or religious.
- Since autumn 2002, in accordance with American legislation, all garments are labelled with country of origin information.

### Recall management

In spite of well-organised quality work, garments that do not live up to our standards do on rare occasions reach our stores. In such cases, our recall management system ensures fast and professional recall of a particular item. In 2005, one item was recalled. For information on recalled items, please visit [www.hm.com/quality](http://www.hm.com/quality). ■

## COMMUNICATIONS AND MARKETING

All H&M's communication aims at building the H&M brand in the long term. The way in which we communicate with the world around us influences our credibility. Both internal and external communication must therefore be characterised by an open attitude with clear messages, accessibility and awareness.

H&M conveys the brand via a number of different channels, the main channel being our stores. Our methods of communicating include advertising in magazines, on television, billboards and the Internet. Our advertisements are largely identical in all our markets, but the media mix is adapted to local needs and conditions. Commercial images are a matter of taste, and it is very difficult to satisfy all preferences. Through customer surveys in all our markets, we however know that the vast majority of our customers appreciate our marketing and that it creates positive brand values.

### **Our fashion models**

Fashion changes continuously and our campaigns strive to follow the different trends. This means that different campaigns benefit from the use of different fashion models. However, when trends move towards unhealthiness, we should not follow them in our communication.

Our models are chosen in cooperation with internationally recognised modelling agencies. Representatives from H&M are always present at commercial photo shoots to ensure that our demands are met.



### **H&M'S ADVERTISING POLICY**

H&M communicates its business concept – fashion and quality at the best price – through various advertising campaigns each year throughout Europe and North America. The campaigns are designed to be clear and simple and aim to inform our customers of what is new at H&M and to show who we are and what we stand for. We show the latest fashion and the price of the goods.

Advertising is produced centrally in Sweden by H&M's marketing department in cooperation with various creative professionals. The advertisements are largely identical in all H&M's markets, but the media mix is adapted to local requirements and conditions.

Our marketing has a major impact. It is therefore essential for us to convey a positive and healthy image. H&M's advertising images do not aim to communicate a specific ideal. We use different characters and a mix of different looks and styles to advertise our various concepts for women, men, teenagers and children.

The people we show in our advertising must be healthy and wholesome. H&M deliberately distances itself from drug and alcohol abuse. The models are chosen in cooperation between internationally recognised agencies and our own representatives. The reason why we use professional models is that they are used to being in front of the camera and can give a true impression of our clothes. By working with professional models, photographers and stylists, we can communicate our fashion and quality in a clear and inspirational way.

We have special guidelines for the advertising of our children's concepts. Our target group is parents, not children. This means that we place advertisements in media that is not aimed directly at children. Whenever children are involved in a photo shoot there is always a representative of H&M present to ensure professionalism and the safety of the children. We market clothes for both boys and girls of different ages. By using children from different cultures, we highlight the diversity of society.

If a situation that is incompatible with our position should arise, we will take action. During the autumn of 2005, we chose to alter a campaign and hire a different fashion model as it had come to our attention that the model that we had chosen initially had used narcotics during the period of our cooperation. As a consequence of this incident, we have begun to review our advertising policy and practices. We have also initiated dialogue with relevant external parties in order to gain a better understanding of this particular problem area. ■

## SOCIAL TARGETS 2005: FULFILMENT

These are the targets that the CSR department had set for 2005. The table shows our progress against these targets.

OBJECTIVE	TARGETS AND ACTIVITIES	TIMEFRAME	RESPONSIBLE	COMMENT/SCOPE	FULFILMENT
Code of Conduct compliance maintained through effective management systems	Full Audit Programme (FAP): Our target is to introduce a new method of performing more thorough audits at production units.	Spring 2005	Tobias Fischer, Ingrid Schullström.	Read more about FAP on page 25 in our 2004 CSR report.	Done within time frame.
	FAP: Introduce a new audit form to be used when inspecting production units. All auditors will receive training, and the form will be put into use during 2005.	Spring 2005	Lars-Åke Bergqvist, Maritha Lorentzon, Ingrid Schullström.	Read more about FAP on page 25 in our 2004 CSR report.	Done within time frame.
	FAP: Finalise and test the new IT system.	2005	Tobias Fischer, Ann-Charlotte Dahl.	Read more about FAP on page 25 in our 2004 CSR report.	In progress.
Full Code of Conduct compliance by all suppliers and their subcontractors	FAP: Integrate worker interviews in all audit and verification procedures.	Spring 2005	Tobias Fischer	Worker interviews are to be an integrated part of FAP.	Done within time frame.
	Reduce overtime: Collect information on best practice regarding overtime reduction, and investigate how much overtime production units in each market have. This data will form the basis of future efforts to reduce overtime.	2005	Lars-Åke Bergqvist, Maritha Lorentzon.	–	In progress.
	Education of suppliers: Examine the need for education in each market, and locate potential partners, i.e. NGOs, public authorities etc.	2005	Tobias Fischer, Magnus Mattsson.	–	Results from FAP audits will serve as a starting point. Project continued.

## SOCIAL TARGETS 2006

The targets described here are the ones that are specific to the CSR department at a corporate level. Each production office has targets and activities relevant to their own market.

OBJECTIVE	TARGETS AND ACTIVITIES	TIMEFRAME	RESPONSIBLE	COMMENT/SCOPE
Full Code of Conduct compliance by all suppliers and their subcontractors.	Full Audit Programme (FAP): Evaluate and, if necessary, modify the follow-up audit and management action plan (MAP) tools.	2006	Ingrid Schullström, Lars-Åke Bergqvist, Maritha Lorentzon, Ann-Charlotte Dahl.	–
	Test and guarantee the quality of FAP and its tools.	2006	Lars-Åke Bergqvist, Maritha Lorentzon.	The exact method of assessment is yet to be decided.
	Capacity building: Locate potential local partners, i.e. NGOs and consultancies that will be able to assist our suppliers in connection with remediation processes, especially with regard to various complex and/or sensitive issues.	2006	Lars-Åke Bergqvist, Maritha Lorentzon.	–
	Reduce overtime: Collect information on best practice regarding overtime reduction, and investigate how much overtime production units in each market have. This data will form the basis of future efforts to reduce overtime.	2006 and on.	Lars-Åke Bergqvist, Maritha Lorentzon.	–
	Home work: Revise and further develop H&M's guidelines regarding home work.	2006	Maritha Lorentzon, Ingrid Schullström.	The amended guidelines will form the basis for evaluation of working conditions of home workers.
Code of Conduct completely integrated with our business operations.	Criteria for supplier performance evaluation: revise and improve the Code of Conduct ranking factor, which is part of H&M's overall supplier evaluation.	2006	Ingrid Schullström, Maritha Lorentzon, Lars-Åke Bergqvist, Per Vestervall, Karl-Gunnar Fagerlin.	The aim is to make our method of grading suppliers on Code of Conduct performance more effective and functional.



# **H&M**

## **OUR ENVIRONMENTAL RESPONSIBILITY**

This section is divided into two main parts. The first part describes our policies and organisation. The second part gives an account of projects in the environmental area and environmental performance.

## ENVIRONMENTAL MANAGEMENT

In this section, we present our environmental objectives and policy and describe our requirements of transport service providers and other business partners.

### Main aspects

H&M centres its environmental work on two main areas. The first is the various environmental aspects associated with the production of our goods, especially those related to dyeing and processing of fibres and textiles. The other area of focus is energy use, with particular attention on carbon dioxide emissions which are associated with climate change. Transport of H&M goods accounts for about half of total carbon dioxide emissions caused by H&M operations. The second largest contributor to carbon dioxide emissions is electricity use, mainly in our around 1,200 stores.

#### ENVIRONMENTAL OBJECTIVES

**Environmental awareness:** Promotion of environmental awareness among our employees and suppliers.

**Respect for nature:** Caution in decision-making out of respect for nature.

**Sustainable use of resources:** Resource conservation, recycling and reduction of waste.

**Healthy products:** Products that are safe to use and harmless to the environment.

**Clean production chain:** Sustainable production and production methods throughout the supply chain.

**Green transport:** Clean and efficient transport with limited influence on the climate.

#### OUR ENVIRONMENTAL POLICY

Continuous improvement is characteristic of all H&M activities. This includes our environmental effort, which is conducted within the framework of our business operations. H&M's business concept is to give our customers unsurpassed value by offering fashion and quality at the best price. Our quality concept is based on ensuring that our customers are satisfied with our products and with H&M as a company.

To this end, we are committed to acting responsibly in our community. We also aim to cooperate with our suppliers on improving the social and environmental standards in the factories that manufacture H&M clothing, thereby contributing to sustainable development in these areas. To achieve this goal, H&M has adopted the following principles.

#### We shall:

... always consider the health and safety of our employees. By adopting the precautionary principle, we will continuously update our restrictions against the use of environmentally and health hazardous chemicals in the production of our garments and other products.

... continuously update ourselves on environmental news and legislation. We will not be content to follow existing environmental legislation, but will in certain areas do more than the law requires.

... conduct our business in a manner that utilises natural resources as efficiently as possible.

... develop new and continuously improve existing environmental requirements concerning the purchase of products and services.

... train, inform and motivate our employees to participate and take responsibility, thereby making environmental work an integral part of H&M's daily routines.

... specify to our suppliers our position regarding behaviour towards the environment and human rights and follow up to ensure that our suppliers improve their operations in line with these requirements.

### Environmental requirements for transport service providers

Generally, H&M cooperates with one transport service provider per country of production and means of transport. Since 2001, we evaluate our transport service providers on a variety of environmental factors in order to improve their environmental performance.

Our requirements are gradually becoming stricter. From 1 January 2005, the following minimum requirements apply to road transport service providers.

- Road transport for H&M must be carried out with vehicles which meet the requirements of Euro 1 or US 91.
- All vehicles purchased must meet the requirements of Euro 3 or US 98.
- Diesel with maximum sulphur content of 500 ppm (0.050%) for USA and Canada and 350 ppm (0.035%) for other countries.
- Instructions to drivers on what fuel quality to use.
- At least 50 per cent of all drivers must have received theoretical and practical training on fuel-efficient driving, i.e. eco-driving.
- Company policy banning idling in excess of one minute.

As of 1 January 2006, road transport for H&M must be carried out using vehicles which meet the requirements of Euro 2 or US 94.

During 2005, we carried out several checks of engine type and vehicle age at our distribution centres in ten of our sales countries. We found one deviation from the Euro 1/US 91 requirements.

### Environmental requirements for store equipment suppliers

H&M sets minimum environmental standards when purchasing store equipment. Apart from legal requirements, we also apply a number of H&M specific environmental requirements.

The following materials, metals, and chemicals should be avoided in the manufacturing of store equipment or in the finished products:

- Materials: Polyvinyl chloride (PVC), halogen-based plastic materials, paper-based materials processed with chlorine or chlorine derivatives and wood from tropical rainforest (unless FSC labelled).
- Metals: Lead, chrome (especially Cr6+), cadmium, mercury.
- Chemicals: Bisphenol A, brominated or chlorinated flame-retardants, e.g. polybrominated biphenyls (PBB), polybrominated diphenyl ether (PBDE), octabromodiphenyl (octaBDE), tetraethylene pentamine (TEPA), tris(2-carboxyethyl) phosphine hydrochloride (TCEP), bis(2,3dibromopropyl) phosphate, chloroparaffins, chlorinated or aromatic organic solvents, ozone depleting compounds, nonylphenoethoxylates (NPE) and formaldehyde.

In addition to this general position, there are some fields of application where we have banned the use of the above-mentioned materials, metals and chemicals. There is a guideline on first choice materials, metals and chemicals that should be used instead in order to obtain more environmentally adapted products.

### Environmental requirements for IT product suppliers

In order to be able to make environmentally sound choices when purchasing IT products, H&M requires that all products offered to us are accompanied by an **IT Eco Declaration**. The IT Eco Declaration is a system for declaration of environmental aspects of IT and telecom products, developed by the Nordic IT organisations, IT-Företagen in Sweden, ITB in Denmark, IKT-Norge in Norway and TTK ry in Finland. The IT Eco Declaration includes information on the environmental practices of the manufacturer as well as environ-



mental features of their products. Nemko Group, a Norwegian firm that offers testing, inspection and certification services, randomly selects and examines 25 per cent of all companies that submit IT Eco declarations to verify that the information is accurate.

H&M has developed an evaluation model to assess the information in the declarations. Our evaluation model takes into account legal standards as well as additional H&M requirements.

#### **Environmental information to employees**

Our environmental information is communicated through a number of channels. Employees who make decisions with potentially greater impact on the environment receive more in-depth education. For other employees we mainly focus on awareness raising. Communication channels include:

- Key group education: During 2005, our graphic designers and plastic bags buyer received education about the **EU directive (94/62/EC)** on packaging and packaging waste.
- Training at the buying office: This training takes place approximately twice a year.
- H&M Wallpaper is our news billboard. It is found on walls near lunchrooms and other social areas in the entire company.
- H&M's intranet site: All H&M offices have access to the intranet.
- H&M's Internet site.

#### **ISO-certification**

H&M's environmental management system is not ISO-certified. Although we consider it important to have a systematic approach, our focus is to reduce our environmental impact by keeping to simple and viable methods. ■

## ENVIRONMENTAL ACTIVITIES AND PERFORMANCE

This section describes our environmental activities and performance in terms of projects and tangible results. We describe five projects, and report on carbon dioxide emissions, and recycled cardboard and hangers. Finally, we explain the reasons for omitting other environmental aspects.

### Our Code of Conduct sets environmental requirements

H&M's Code of Conduct includes environmental requirements. When we audit facilities to verify compliance with local environmental law and our Code of Conduct, we focus on four main areas: environmental law and permits, chemicals, wastewater treatment and waste management.

We begin by reviewing factories' permits. We also examine how chemicals are handled. The focus is on workers' safety and on chemical emissions to water and into the ground. To evaluate this, we check whether and how chemical containers are labelled, and if there are material safety data sheets (MSDS). We also check whether the MSDSs have been implemented, i.e. if workers have been trained in safe chemical handling, and if they use protective equipment. We require that factories with wet processes such as dyeing or washing use wastewater treatment plants. The sludge that the plants produce must be handled according to legislation. Finally, we check whether the factories handle hazardous waste in a responsible manner and send it to an authorised company.

The findings from this year's FAP audits are presented on page 37.

### ENVIRONMENTAL PROJECTS

#### Promoting cleaner production

H&M has incorporated sound chemical management in its CSR agenda. This includes our chemical restriction lists for textile, leather, plastic and metal products (see page 55), and for cosmetics and

hygiene products (see page 56). We also address the use of chemicals in the manufacturing processes by verifying compliance with our environmental requirements set out in the H&M Code of Conduct through audits at our suppliers' and their subcontractors' factories.

In the last few years, we have expanded our scope further by beginning to address production stages further up the supply chain, namely fabric production. We began by working with four vertically integrated suppliers<sup>1</sup> to evaluate the possibilities for reducing the environmental impact of fabric production, focusing on water pollution from fabric dyeing and other wet processes. We concluded that cleaner production (CP) is the most effective measure, both because it is a preventive approach, and because savings on energy, water and chemicals can create a financial incentive for fabric mills to participate without the commercial pressure from a direct buyer, such as ourselves.

### “H&M has incorporated sound chemical management in its CSR agenda.”

During 2004, we worked on developing both technical and management measures for cleaner production. The technical measures were suggested changes to production processes, whereas the management measures were necessary changes to the organisation, for instance the establishment of a responsible team and the introduction of measuring routines. We collaborated with the Dutch consultancy **Beco Group** and the **Wuppertal Institute** in Germany.

In March 2005, we held a workshop in collaboration with the local **UNEP/UNIDO National Cleaner Production Centre**<sup>2</sup> (NCPC) to introduce the CP programme to six textile mills in India that supply some of H&M's major garment suppliers. Next, H&M

<sup>1</sup> A company that controls two or more different stages in the production process of a product. In this context, it means that a supplier controls other steps (e.g. textile dyeing) in addition to garment manufacturing.

<sup>2</sup> The UNIDO (United Nations Industrial Development Organization)/UNEP (United Nations Environment Programme) National Cleaner Production Centre (NCPC) programme was established in 1994 to build local capacity to implement cleaner production in developing countries and economies in transition. There are 24 NCPCs, and about 50 local bilateral CPCs.

environmental representatives visited the mills in order to present the low-hanging fruit<sup>1</sup> (LHF) tool, and to evaluate the potential for improvement in each mill's use of energy, water and chemicals. The evaluation system that we use comprises 36 technical and five management measures that assess various processes within a fabric mill. The system also has protocols for monitoring the types and volumes of chemicals used. Subsequently, all textile mills but one submitted one-year action plans, where they specified their choice of cleaner production options based on the LHF tool. To begin with, H&M will track and evaluate progress made every other month for 12 months.

Later in the year, assisted by the **NCPC based in Beijing** and the Beijing Institute for Designing of Textile Mills, we investigated the possibilities of introducing the CP programme to fabric mills in China. We were able to engage six Chinese mills and duplicated the process that we had applied in India.

Our next step is to implement the CP programme in Bangladesh during 2006. We will also present the concept of cleaner production to vertically integrated H&M suppliers. In this way, we will familiarise ourselves with the supplier-textile mill interaction, which will enable us to encourage our suppliers to assume responsibility for introducing the CP programme to the textile mills that they source from. We will also revise the tools in order to enhance their applicability and ease of use. Finally, we will add a number of more challenging measures to motivate well-performing textile mills to improve even more.

<sup>1</sup> A tool to address the simplest, most readily solvable issues or objectives.

### **H&M participates in the BSR Apparel Water Quality Working Group**

H&M participates in Business for Social Responsibility's (BSR) Apparel Water Quality Working Group (AWQWG). The AWQWG is committed to responsible practices concerning water use and wastewater discharge in textile and apparel supply chains around the world. H&M takes part in the project to help secure a common and comprehensible wastewater quality standard intended for suppliers across the global apparel supply chain.

At present, the working group consists of seven global apparel retailers and brands. Using commonly developed Water Quality Guidelines, the group aims to lessen or mitigate the negative environmental impacts associated with water use and wastewater discharge.

During 2005, the working group received feedback from a range of external stakeholders, reviewed other legal and company-specific wastewater guidelines, conducted impact analysis of pollutant impacts, testing methods and feasibility, and completed the BSR Water Quality Guidelines. The guidelines are now to be endorsed by the participating companies.

The work began as early as in 1995, when BSR formed a first working group engaging several companies in the apparel industry to investigate how the environmental impact in the global textile and apparel supply chains could be reduced. Wastewater discharge was found to be a top priority. More precisely, the group discovered that there was no consistent policy or guideline covering wastewater quality requirements, and that regulation and enforcement varied substantially between countries. Therefore, the working group concluded that developing global water quality standards would be an effective way of reducing environmental impact.

The BSR Water Quality Guidelines clearly outline expectations for the environmental performance of fabric mills and laundries regarding wastewater. In order to encourage and facilitate responsible water and wastewater management, the AWQWG also developed guidance documents that outline effective testing methods, as well as so called Pollutant Fact Sheets. There is a fact sheet available for each pollutant included in the Guidelines that comprises a general description, causes and potential health and/or environmental impacts.

Read more about water issues at [BSR's website](#).

#### **H&M uses the EU eco-label "Flower"**

As of June 2005, H&M holds a licence to use the Flower, the official eco-label of the European Union. The Flower stands for restriction of hazardous substances and reduced water pollution throughout the production chain, from the raw cotton to the finished product. In addition, the label's quality criteria represent the garments' ability to keep their shape and colour. All products in the H&M collection will as always also be covered by H&M's own chemical restrictions in order to minimise or exclude the use of substances that may be harmful to the health and/or to the environment.

The following garments from our newborn baby range were labelled with the Flower: 2-pack helmet, 2-pack wrap body and 2-pack trousers in white and beige. Our plan for 2005 was to mark approximately 250,000 garments. However, as we only managed to receive a licence for one of two suppliers, the actual number of eco-labelled garments was lower than expected, about 75,000 pieces.

In 2006, we will expand the range of eco-labelled clothing for newborns. Helmets, wrap bodies and trousers will be available in blue, pink and yellow. We also plan to apply for a licence to use the Flower on products that will be manufactured by a supplier in India,

and investigate the options of labelling certain products of a Chinese supplier.

More information about the Flower is available at [www.eco-label.com](http://www.eco-label.com).



#### **H&M increases use of organic cotton**

We are aware of the negative environmental impact of conventional cotton farming. To support the increase in world demand for organically grown cotton, H&M continues to include five per cent certified organic cotton in certain baby and children's garments from Turkey. The yarn used for these garments contains five per cent organic cotton but the garments do not carry a special label.

In 2005, we planned to use at least 20 tonnes of organic cotton in our products, a significant increase on the five tonnes used in 2004. At the end of the year, we had exceeded this target by more than 100 per cent, having used over 40 tonnes of organic cotton in our products.

In November 2005, H&M launched a collection designed by Stella McCartney. We were very happy that one t-shirt in this collection, by her request, was made of 100 per cent organically grown cotton.

At the end of 2005, we were still working on a broader strategy for sustainable cotton, including H&M's participation in the Better Cotton Initiative (see next page). We had therefore not yet established a quantitative target for organic cotton use in 2006, but the ambition was at a very minimum to maintain the volume from 2005.

In October 2005, H&M co-sponsored and participated in the **Organic Exchange's conference** on organic cotton in Izmir, Turkey.

Although we are gradually increasing our use of organic cotton, most of the world's cotton is still grown using pesticides and

synthetic fertilizers. H&M wishes to contribute to improving conventional cotton farming practices. This is why we have signed up to the Better Cotton Initiative.

#### **Better Cotton Initiative**

H&M participates in the Better Cotton Initiative, which is a multi-stakeholder collaboration whose mission is to measurably reduce the key environmental and social impacts of cotton cultivation.

The Better Cotton Initiative will define, develop and encourage the adoption of practical, performance-based standards for cotton cultivation on a global scale.

The group recognises the wide array of issues connected with cotton cultivation and the need to relate such global standards to local circumstances. In order to effectively address the key impacts of cotton cultivation, the Better Cotton Initiative will initially focus on the most significant issues in cotton cultivation while striving for continuous improvement over time.

During 2005 H&M took an active role in the group as member of the Steering Committee.



## ENVIRONMENTAL PERFORMANCE

### Carbon dioxide data

We have included the following elements in our carbon dioxide data:

- Electricity in the entire company, where H&M purchases directly from the supplier
- Heating of distribution centres (DC), where H&M purchases directly from the supplier
- Transport of goods (by road, rail, sea, and air)
- Business travel and mileage reimbursement
- Fuel for vehicles owned by H&M

The stores where H&M purchases electricity direct from the supplier account for 87 per cent of annual turnover. For the remaining 13 per cent, the cost of electricity is included in the store leases. More information about data collection and calculation of carbon dioxide figures is available in the annex.

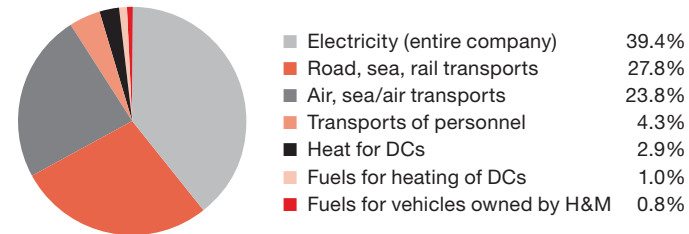
### Carbon dioxide emissions

The list and table below show carbon dioxide emissions caused by H&M operations. The bulleted list states carbon dioxide emissions 2001–2005. The table displays emissions in tonnes for 2005 and 2004, as well as the change in emissions between 2004 and 2005. The pie charts show each source's share of total emissions. The graph displays carbon dioxide emissions in relation to annual turnover.

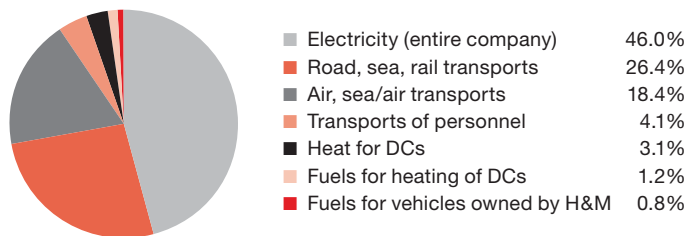
- 2001: 124,611 tonnes (excluding air and sea/air transport)
- 2002: 158,690 tonnes (excluding air and sea/air transport)
- 2003: 204,040 tonnes
- 2004: 241,583 tonnes
- 2005: 298,581 tonnes

CO <sub>2</sub> emissions in tonnes by source	2005	2004	Change
Heat for DCs	8,571	7,588	13.0%
Fuels for heating of DCs	3,028	2,900	4.4%
Electricity (entire company)	117,647	111,019	6.0%
Transports (road, sea, rail)	83,149	63,834	30.3%
Transports (air, sea/air)	71,131	44,349	60.4%
Business travel and mileage reimbursement	12,709	9,953	27.7%
Fuels for vehicles owned by H&M	2,346	1,940	20.9%
	<b>298,581</b>	<b>241,583</b>	<b>23.6%</b>

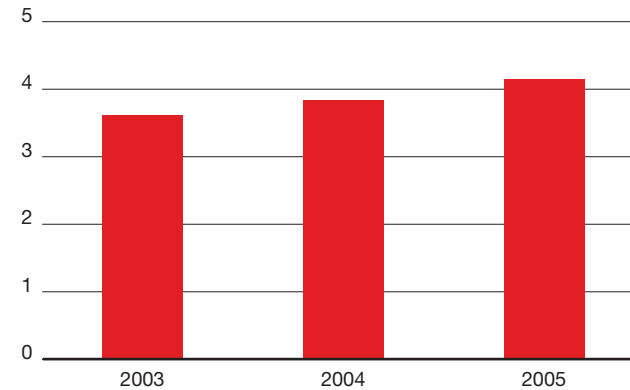
**Contribution to total carbon dioxide emissions by source 2005**



**Contribution to total carbon dioxide emissions by source 2004**



**Kilograms carbon dioxide emissions per SEK 1,000 turnover**



Carbon dioxide emissions increased from 241,583 tonnes in 2004 to 298,581 tonnes in 2005, i.e. by 23.6 per cent. During the same period, annual turnover including VAT increased by 14.1 per cent from MSEK 62,986 to MSEK 71,886. Consequently, H&M activities caused 4.15 kilograms of carbon dioxide emissions per SEK 1,000 turnover. This can be compared with 3.83 kg CO<sub>2</sub>/SEK 1,000 in 2004, i.e. an 8.4 per cent increase. During the year, the number of purchased pieces (excluding cosmetic and hygiene products) increased by 6.4 per cent.

Transportation of H&M goods accounts for about half (51.7 per cent) of total carbon dioxide emissions. Transport by road, sea, and rail represents 27.9 per cent, and air and sea/air transports make up 23.8 per cent of the total. The corresponding figures for 2004 were 26.4 per cent and 18.4 per cent respectively. Purchased electricity for the entire company makes up 39.4 per cent of total emissions, which is 6.6 per cent less than in 2004. This relative

decrease is mainly due to the consumption of cleaner electricity in Germany. The share of total emissions from all other carbon dioxide emission sources essentially remains unchanged compared with the previous year.

Seen in absolute terms, carbon dioxide emissions from all sources have increased. Emissions from fuels for heating of DCs and electricity increased by 4.4 and 6.0 per cent, respectively. However, as annual turnover has increased by 14.1 per cent, these figures represent a relative decrease in emissions. The CO<sub>2</sub>/turnover quotients for emissions caused by heat for DCs, transports of personnel, and fuels for H&M-owned vehicles remain practically the same compared to 2004. Emissions from transport of goods, by air and sea/air in particular, have increased noticeably. CO<sub>2</sub> caused by air and sea/air transports increased from 44,349 tonnes in 2004 to 71,131 tonnes in 2005. However, nearly half of the increase (10,474 out of 26,782 tonnes) is due to improvements in data collection. More information about data collection is available in the annex.

#### Bringing carbon dioxide emissions into focus

In our previous CSR report, we announced that we had set a target to reduce CO<sub>2</sub> emissions by 10 per cent (on comparable figures) between 2005 and 2009. Looking at this year's figures it is obvious that we have moved in the opposite direction in the first year.

During 2005, we decided to concentrate on one of the major emission sources, energy. We analysed the potential for reduction of energy use in our stores and distribution centres, and found substantial scope for savings. We will carry out a number of activities to reduce CO<sub>2</sub> emissions during 2006. These efforts should have a positive effect on the emissions figures in our next CSR report.

Emissions caused by transport, the other major source, have increased substantially. During 2006, we will therefore focus our

attention on ways to reduce emissions from transport, in particular air and sea/air transport.

#### Direct energy use

Energy use is continuously on the agenda, not least from a cost perspective. In addition, there is a clear link between cutting energy use and reducing carbon dioxide emissions. The table below shows H&M's direct energy use in gig joules.

Direct energy use in GJ by source	2005	2004
Heat for distribution centres	94,572	86,198
Fuels for heating of distribution centres	30,607	29,967
Fuels for vehicles owned by H&M	31,720	26,260
Electricity (entire company)	1,540,167	1,302,087
	<b>1,697,066</b>	<b>1,444,512</b>

#### Waste management

Solid waste is a significant aspect in our stores and at our distribution centres. Waste handling in our stores differs depending on sales country. In Norway, for example, the vast majority of the stores use the waste handling system of the shopping centre or landlord. In the USA, on the other hand, more than half of the stores have a separate contract with a waste handling company. In Germany, over half of the waste is sent back to H&M's warehouse. As a result of this complexity, we find it difficult to measure, compare and report on how different types of waste are handled.

We are however able to present figures on recycled cardboard and clothes hangers, as these types of waste are mainly collected at our distribution centres. The increase in cardboard collected and recycled at our distribution centres was 5.4 per cent, which can be compared to a 6.4 per cent increase in volumes.



Year	Cardboard in tonnes	Change
2002	12,342	–
2003	13,502	9.4%
2004	15,207	12.6%
2005	16,028	5.4%

In 2005, we recycled 3,142 tonnes of hangers, which corresponds to 67.1 per cent of purchased hangers. We reuse the rest in our stores. Hangers can be recycled in various ways. Our DCs send the hangers to e.g. recycling plants, or directly to hanger manufacturers that grind them and use the scrap to produce new hangers. We manage this process with the environment in mind. In Sweden for instance, we compress the hangers to achieve transports that are more efficient. Consequently, we are able to transport about 12–14 tonnes of hangers at one time, compared with 3–5 tonnes per transport if the hangers are not compressed.

#### Omitted environmental aspects

H&M sells garments and accessories to the consumer market. At present, it is not feasible to monitor and measure emissions generated by use and disposal of our products. Nor is it possible to measure the emissions caused in our supply chain. The sewing and assembling of garments alone employs approximately 2,000 production units, and it is not feasible to collect and report reliable figures from these production units.

Use of water and emissions to water are significant aspects in the production and use of garments. We gather information regarding the use and discharge of water in the course of production in connection with our audits, but we are presently not able to aggregate and report on these figures.

Nitrogen oxide (NO<sub>x</sub>) and sulphur oxide (SO<sub>x</sub>) emissions are mostly related to transport. Evaluating features like engine type and fuel type is at this point too complex. Nevertheless, we strive to reduce the emissions by setting minimum requirements for our transport service providers' engine and fuel types. ■

## ENVIRONMENTAL TARGETS 2005: FULFILMENT

These are the targets that the CSR department had set for 2005. The table shows our progress against these targets.

OBJECTIVE	TARGET	TIME FRAME	RESPONSIBLE	COMMENT/SCOPE	FULFILMENT
Environmental awareness	Key group education	31 January 2005	Eva Skytt	Package designers will be educated in 2005.	Done within time frame.
	Develop environmental education programme aimed at our suppliers.	31 December 2005	Henrik Lampa	The programme will include waste water treatment, chemical handling and waste management.	In progress. The education programme will be rolled out during 2006.
Respect for nature	Reduction of CO <sub>2</sub> emissions from H&M direct and indirect sources by 10 per cent.	31 December 2009	Eva Skytt, Ingrid Schullström.	Read more on page 54 in the 2004 CSR Report.	In progress; during 2005, we have focused on electricity consumption in stores.
Sustainable resource use	Chemical ban list and phase out list is to be used in store and distribution centre build and rebuild projects.	31 December 2005	Project managers in the sales countries.	–	Done within time frame.
	Updated version of H&M's chemical restrictions (applies to H&M products).	30 June 2005	Elin Robling	The restricted substances list is to be updated to contain additional chemical substances.	Done in October 2005.
Healthy products	Include 20 tonnes of organic cotton in our products.	31 October 2005	Ingrid Schullström	Read more on page 54 in the 2004 CSR Report.	Done within time frame. Read more on page 68.
Clean supply chain	Start to sell EU Flower labelled baby garments.	31 December 2005	Eva Skytt	The use of the EU Flower label will be evaluated during the year.	Done within time frame.
	Cleaner production programme for fabric mills.	31 December 2005	Ingrid Schullström	Initially, our aim is to research the pilot fabric mills in order to identify areas where improvements can be made.	Done within time frame.
Green transports	Include traffic safety questions (regarding e.g. drug and alcohol policies) in our environmental declaration for road transports.	31 December 2005	Eva Skytt	The update of the environmental declaration will be done during 2005. The declarations will be distributed to our transport service providers in early 2006.	Done within time frame.

## ENVIRONMENTAL TARGETS 2006 AND ONWARDS

The targets described here are the ones that are specific to the CSR department at a corporate level. Each production office has targets and activities relevant to their own market.

OBJECTIVE	TARGET	TIME FRAME	RESPONSIBLE	COMMENT/SCOPE
Environmental awareness	Roll out the chemical and environmental education programme aimed at our suppliers.	31 December 2006	Henrik Lampa	Wastewater treatment and safe chemical handling workshops will be adapted according to type of production and target audience.
Respect for nature	Reduction of CO <sub>2</sub> emissions from H&M direct and indirect sources by 10 per cent on comparable figures.	31 December 2009	Mikael Blommé, Ingrid Schullström.	Measured in kilograms of carbon dioxide emissions per SEK 1,000 annual turnover. The base year has been set to 2004. During 2006, we will focus our efforts on targeting energy use in our stores.
	Integrate chemical phase out list, ban list and the other environmental requirements in building description.	30 April 2006	Mikael Blommé	The chemical lists were formulated during 2005 but implementation has been partially delayed.
Sustainable resource use	Test H&M plastic consumer bags made of biodegradable material in at least one sales country.	31 December 2006	Eva Skytt, Viveca Kleebinder.	–
Healthy products	Update the H&M Restrictions for Cosmetic and Hygiene Products (H&M Products).	31 December 2006	Karin Sundberg	The revised restrictions for H&M's own cosmetic and hygiene products will include e.g. additional restrictions on preservatives, metals and fragrances.
Clean supply chain	Increase the scope of the cleaner production programme by including vertical suppliers in China, India and Bangladesh.	30 June 2006	Harsha Vardhan	–
	Endorse Business for Social Responsibility (BSR) Water Quality Guidelines.	31 March 2006	Henrik Lampa	The BSR Water Quality Guidelines will be part of H&M's requirements on production units with wet processes.
Green transports	Map the potential for reducing CO <sub>2</sub> emissions caused by transportation of H&M goods.	31 December 2006	Anders Tell, Mikael Blommé.	–

**H&M**  
**ANNEX**

## ABOUT THIS REPORT

### The GRI guidelines

In preparing this report we have relied on the Sustainability Reporting Guidelines (2002) issued by the Global Reporting Initiative (GRI). The GRI index on page 79 helps readers to identify the location of reported information listed in the GRI Guidelines.

### Reporting period

This report covers the year of 2005, unless stated otherwise. Financial data refer to H&M's fiscal year, which began 1 December 2004 and ended 30 November 2005.

### Reporting boundaries

The information provided in the "About our company" section refers to the H&M group as a whole, and provides basic facts about the company. The information presented in "Our social responsibility" covers our monitoring and remediation efforts in the supply chain, whereas "Our environmental responsibility" accounts for H&M's environmental projects in the supply chain, certain aspects of the environmental performance of our transport service providers and H&M distribution centres and stores in our sales countries.

### Previous reports

H&M's CSR reports for the years of 2002, 2003, and 2004 are available at [www.hm.com/csr](http://www.hm.com/csr).

### Additional information

Additional information about economic, social and environmental aspects of H&M's activities can be obtained from the following sources:

- **H&M's website**
- **Annual Report 2005**
- **Fact sheets and list of restricted chemicals**
- **Previous CSR reports**
- H&M's CSR department (see contact information below)

### Independent assurance

The H&M CSR Report is an integral part of our CSR work. The reporting process helps us to highlight the areas that we need to focus on within our organisation, and helps us set and follow up targets.

We recognise that external assurance would add credibility to our reporting and we do not exclude the possibility of having the report verified in the future. However, we currently prefer to focus on improving our CSR performance rather than spending resources on an external assurance process.

We have an open attitude towards stakeholders who contact us with follow-up questions. In an effort to make this report more trustworthy, we invited four different stakeholders to provide feedback on our CSR reporting. Read their statements on page 43.

### Contact persons for this report

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## CARBON DIOXIDE EMISSIONS: DATA ACQUISITION

We have included the following emission sources in our carbon dioxide figures: electricity in the entire company (where H&M purchases directly from the supplier), heating of distribution centres (where H&M purchases directly from the supplier), transport of goods (by road, rail, sea and air), business travel and mileage reimbursement, and fuel for vehicles owned by H&M. The stores where H&M purchases electricity direct from the supplier account for 87 per cent of annual turnover. For the remaining 13 per cent, the cost of electricity is included in store leases. At present, we are not able to obtain carbon dioxide figures for stores where we do not purchase electricity ourselves.

### *Data collection and calculation of emissions*

Our electricity suppliers provide us with records of electricity consumption in kilowatt-hours (kWh) and conversion factors<sup>1</sup>. We use this information to calculate carbon dioxide emissions from our electricity consumption.

Our road transport service providers either submit figures for carbon dioxide emissions caused by transport of H&M goods, or distances in kilometres and average diesel consumption. Based on these figures, we calculate CO<sub>2</sub> emissions from road transport. Some of our suppliers are also able to report on H&M's share of each transport, which makes the calculations more accurate.

We calculate carbon dioxide emissions caused by sea transport in the same way as road transport. However, our sea transport suppliers submit figures on heavy fuel oil purchased and volumes of H&M goods transported.

The majority of our rail transport service providers present data about H&M's part of their carbon dioxide emissions.

Our air transport providers provide information on routes and the weight of the goods transported on our behalf. Based on this information and the calculation template NTMCalc from the

**Network for Transport and the Environment**, we are able to estimate carbon dioxide emissions caused by our air transport of goods.

### *Improvements in data management*

One of our sea transport suppliers had previously submitted data that was not fully accurate. The error has now been corrected, and as a result, this particular supplier has provided figures that indicate a 68 per cent increase in carbon dioxide emissions between 2004 and 2005, even though the increase in volumes was merely 20 per cent. This supplier's transports of H&M goods caused 8,820 tonnes of CO<sub>2</sub> emissions in 2004, and 14,799 tonnes in 2005, i.e. an increase of 5,979. Taking the 20 per cent increase in volumes into account, the aforementioned calculation error accounts for 4,215 tonnes, i.e. two thirds of the increase in CO<sub>2</sub> emissions.

Another of our sea transport service providers has improved its method of calculating distances. As a consequence of this, the reported CO<sub>2</sub> figures are 72 per cent higher, although volumes have increased by only 22 per cent. This supplier's transports of H&M goods produced 6,689 tonnes of CO<sub>2</sub> emissions in 2004, and 11,500 tonnes in 2005, i.e. an increase of 4,811 tonnes. Given the 22 per cent increase in volumes, 3,335 tonnes of the increase are due to improvements in data management.

Furthermore, 1,080 tonnes of the increase in carbon dioxide emissions caused by road transport is due to a data entry error last year.

CO<sub>2</sub> caused by air and sea/air transports increased from 44,349 tonnes in 2004 to 71,131 tonnes in 2005. However, nearly half of the increase (10,474 out of 26,782 tonnes) is due to improvements in data collection. More precisely, we have added four points of departure to our CO<sub>2</sub> reporting, which means that we now report on twelve points of departure. ■

<sup>1</sup> Conversion factors can be used in order to convert energy consumed in kWh to kilos of carbon dioxide.

## GRI CONTENT INDEX

The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. These guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products and services.

The table identifies the location of each element of the GRI Report Content, by section and indicator. The purpose is to allow the reader to locate a specific piece of reported information listed in the Guidelines.

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