Toward a More Responsible Supply Chain: The HP Story

By Sonali Rammohan

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Hewlett-Packard’s Supply Chain Social and Environmental Responsibility (SER) program has evolved steadily in recent years. Today, it’s not only about complying with labor, environmental, and health and safety standards, but also about helping suppliers make continuous improvements and building capabilities to make long-lasting changes. Here’s a closer look at HP’s SER journey toward a more responsible supply chain.

When Mike Turner first visited supplier factories in developing countries, he encountered some eye-opening labor practices. “I saw living conditions that were pretty ugly,” recalls Turner, the social and environmental responsibility (SER) business liaison manager for Hewlett-Packard’s Personal Systems Group. At one China supplier, he found factory workers were taking turns using the same dormitory bed—one person slept while the other worked. At another supplier, Turner found hundreds of bunk beds set up for workers in a big hall (many workers come from rural areas to work at industrial parks). The supplier had recently received more orders, and hadn’t built up its worker dormitories fast enough.

Turner’s discoveries are neither unusual nor surprising. He and his counterparts at other companies find a host of unacceptable practices at their offshore suppliers. They may hear of workers being docked pay as a disciplinary action, employees racking up hours beyond what’s allowed, factories conducting testing to avoid hiring pregnant women, and factory stairwells piled up with pallets of materials, making it impossible to exit in the event of a fire. The list goes on and on. And while the number of “nonconformances” has declined significantly over the last few years, HP’s Supply Chain SER program continually faces new challenges.

Why SER Matters

A company’s behavior in terms of social and environmental responsibility is now central to its reputation. Detailed scrutiny of those practices by a range of stakeholders—by nongovernmental organizations (NGOs) and the media as well as customers and investors—is also holding businesses to task for the practices of their suppliers…and their suppliers’ suppliers. Yet it is not easy for businesses to assess whether those suppliers...
are following accepted SER standards, especially as supply chains grow longer. When SER practices fall short, companies can face product disruption problems, legal difficulties and other business risks.

Hewlett-Packard’s experiences are a good proxy for the challenges that many large companies face when trying to improve the SER standards of their supply chains. Although HP was an early adopter of SER practices and although it helped establish the Electronic Industry Code of Conduct (EICC), its SER managers have learned that SER is a marathon, not a sprint; as one challenge is reined in, a new one leaps forward.

When electronics companies were expanding outsourcing in the late 1990s, some industries were already experiencing a growing movement by the media, NGOs and others toward monitoring human rights in factories. Stories surfaced of children as young as five years old working full-time to produce soccer balls in Pakistan. Other reports emerged detailing “sweatshop” conditions in the garment industry. By 2004, the electronics industry was beginning to encounter similar scrutiny. The Catholic Agency for Overseas Development published a report titled “Clean up your Computer,” which exposed stories of workers in IT supplier factories working more than 100 hours per week, being paid below legal minimums, and getting fired for becoming pregnant, among other things.

HP already had a long history of SER activity; for more than two decades the company has used SER factors in many of its supplier evaluation criteria; by 2004, the Electronic Industry Code of Conduct was being used. (Exhibit 1 highlights key provisions of the EICC.)

Today, the notion of responsible supply chains is well established, and consumer interest has been growing. A 2007 McKinsey & Co. global survey of 7,751 consumers in eight major economies showed that 87 percent of these consumers were concerned about the environmental and social impacts of the products they buy (yet, interestingly, only 33 percent said they are ready to buy green products or have already done so). Supply chain managers are also showing increased interest in SER. A survey conducted by the Institute for Supply Management reported that more than 60 percent of respondents now have sustainability as part of their job responsibilities, and 44 percent reported that sustainability is affecting the ways that suppliers are selected and managed at their companies.

Since most of HP’s electronics suppliers are located in China, much of this article covers efforts there. However, the company’s SER outreach mirrors work its managers are doing in other parts of the Asia Pacific region as well as in Central Europe and Latin America. HP collaborates on its SER efforts with various NGOs, governments, and academic and industry members. For example, it recently engaged with Stanford University’s Socially and Environmentally Responsible Supply Chains Program to conduct a review of three suppliers with operations in China: Flextronics, AU Optronics (AUO) and Delta Electronics, Inc. The goal was to capture the supplier’s perspective on SER-related business benefits so that electronics suppliers throughout the industry could be encouraged to improve their own efforts.

**Tough Implementation Challenges**

Like other technology companies, HP has a heavily concentrated supply base. Instead of dropping a supplier that doesn’t meet standards, the company prefers to resolve the issues and preserve the relationship with that supplier. Here are some of the toughest challenges the company has faced in building its SER program over the last nine years:

1. **Buy-in at the factory level.** According to Judy Glazer, director of HP Global Operations Social and Environmental Responsibility, “Some suppliers were uncomfortable with the Code of Conduct when it was first implemented.” With respect to labor, for example, Chi-Luen Lee, country operations manager for HP’s Global Procurement Services in Asia, says: “It was a real challenge to convince suppliers and their workers to change their mindsets about working standards. Managers thought the consumer wanted low-cost labor, and workers wanted to work as much as possible to earn more money.” Employee health and safety is also better understood today. A few years ago, one supplier in China brought in chemicals that had not been evaluated against prevailing health and safety standards. Almost 50 workers developed...
posed skin problems from handling the chemicals. (After a full investigation, the supplier has addressed the problem by using an improved chemical introduction procedure, improved factory ventilation and now provides workers with more protective gloves.)

2. Communication. In the past, HP delivered audit findings to suppliers’ headquarters instead of to the factory. Today, findings are delivered to key factory contacts; for example, a human-resources manager may receive the report if findings are primarily related to labor issues. Also, purchasing staff are more actively reinforcing SER during quarterly business reviews of suppliers. However, this can be a challenge, since, as HP’s Mike Turner says, “SER can be less of a priority to procurement than price and delivery.” Turner adds that staff often looks to him for guidance in this area. Although some companies conduct surprise audits, HP has not taken this route because it does not want to be in a policing mode, which can hamper communications.

3. Making the business case for SER. Suppliers can see Social and Environmental Responsibility as an expensive proposition. According to Glazer, “some suppliers think everything we ask for is going to involve a cost increase.” She equates this with the arguments against quality initiatives often heard in earlier times. “Suppliers used to think ‘this will cost a lot.’ But the earlier in the process you catch a quality issue, the cheaper it is to deal with, and you haven’t made lots and lots of units that have the same problem… I’m not naive enough to think everything we’re asking people to do [with SER] is going to deliver big cost savings, but I do think there are real returns.”

Suppliers have also wondered why they aren’t being rewarded for good SER performance. As one supplier’s factory manager said, “If we have really good SER, give us more orders!” HP’s response has been to increase SER weighting on supplier scorecards from 4 percent to 10 percent. Still, the critical link between strong social and environmental practices and better products (which can lead to increased orders) hasn’t been made convincingly yet.

4. Pushing SER upstream. Promoting SER to HP’s thousands of sub-tier suppliers remains an especially tough task. According to Glazer, “Suppliers need to communicate with their own suppliers, who may not have the right expertise to really understand SER requests. It’s one thing to say you understand and respect a request, and it’s another to know how to meet it.” SER concepts need to be pushed upstream: In 2007, HP was the target of NGO reports alleging social and environmental violations at its supplier facilities (and at suppliers to these suppliers) in China and other Asia-Pacific countries. These were the first reports in which HP and several competitors were held accountable for the performance of sub-tier suppliers.

5. Systemic issues persist. Major nonconformances can be difficult to eliminate altogether. (Exhibit 2 shows the distribution of nonconformances in major EICC categories in a recent audit of suppliers.) In China, issues persist around excess overtime (See sidebar: “Managing Working Hours in China”), emergency preparedness and management of hazardous substances. In Central Europe, many of HP’s suppliers still find it hard to meet occupational safety and emergency preparedness code provisions. In Latin America, working hours and emergency preparedness remain challenging. Some issues are difficult for one company, or even one industry, to tackle. In China, for example, managers often believe that having fewer workers putting in more hours is cheaper than reducing overtime, making the issue hard to resolve fully.

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<td><strong>Major Nonconformances in Audits of Suppliers Worldwide (2005-2008)</strong></td>
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To date, there have been no “show-stoppers” that would make HP consider dropping a supplier. The company does have several zero-tolerance items such as the use of under-age child workers, forced labor, health and safety issues that pose immediate danger, and violation of environmental laws that could seriously harm the community. Although not common, HP has indeed found such instances at some of its sole suppliers. However, in these cases, the company has chosen to work with the supplier to resolve the issue, and then monitored the situation closely thereafter.

Positive Experiences to Date

Although challenges persist, real changes have taken place around the world. In the most recent HP audits, 70 percent of past major nonconformances had been resolved.
At the same time, the average number of major nonconformances per supplier facility decreased 35 percent from the first to the most recent audit. In China, many suppliers now have freely chosen employment provisions. In the Asia Pacific region, improvements have been made in industrial hygiene and labor management system assessments. In Latin America, there has been a reduction in occupational injury and illness, and improvements in the management of hazardous substances.

Today, HP SER chief Judy Glazer feels that since suppliers hear a consistent message from many customers, the importance of SER has become clearer to them. And progress is being made in terms of pushing responsibility practices upstream. HP sometimes partners with suppliers to audit sub-tier suppliers. At other times, it conducts industry-specific training sessions, such as the workshops it targeted at disk drive manufacturers and their suppliers in 2008, communicating EICC awareness and legal labor requirements.

Many of HP’s suppliers are already working to disseminate SER practices to the next tier. One example: Taiwan-based AUO has held supplier SER forums since 2006 and has been conducting supplier audits for some time. With the help of capability-building programs, HP expects that by 2012, suppliers representing 75 percent of its procurement spending will be using SER programs with their own suppliers. Those that don’t have such programs get a corrective action request on their audit reports.

Managing Working Hours in China

For years, Hewlett-Packard and other technology companies have raised flags about excessive working hours during their audits of Chinese suppliers. Suppliers sometimes push back by saying that customers like HP ask for unrealistic production turnaround times, making high overtime levels necessary. While working hours have been declining in many cases to conform to the EICC’s limit of 60 hours per week, they often do not meet China’s new law (introduced in 2008) requiring that workers limit overtime to 36 hours per month. Simply requesting corrective actions has not resolved the problem, as repeat verification audits often turn up the same issue.

Significant cultural hurdles make this a tough problem to solve. For one, workers want longer hours so they can save up or send money home (one supplier found its workers wanted 90 hours of overtime a month). There is resistance from managers to move from a two-shift to a three-shift system, and dormitories and canteens may be sized for set numbers of employees. And contrary to what one might expect given the global recession, overtime hours have sometimes been increasing because factory managers are making do with fewer workers.

Given the size, scope and history of its SER program, HP has developed a track record from which other companies can learn. Here are some key lessons:

• **Proactive engagement with several stakeholders can yield positive change.** HP’s Glazer believes her company has benefited from the expertise of local NGO training partners. In one instance, SACOM, a Hong Kong-based NGO, had concerns about worker rights, living conditions, pay, and working hours at HP supplier Chicony. HP convened Chicony and SACOM and facilitated the development of a worker hotline program (a unique program for the industry), along with awareness training about labor rights. Because employees now better understand how to calculate overtime pay and can receive counseling through the hotline, both SACOM and Chicony report that they are starting to see greater trust between management and workers.

• **Developing industry-wide SER standards can have several benefits.** First, it enables the sharing of resources and knowledge. For example, shared EICC audits are helping suppliers avoid “audit fatigue” (see sidebar titled “Combating Audit Fatigue”) and both suppliers and customers can save on audit costs. Second, tools and processes can be standardized. For example, third-party auditors can apply standard principles across companies. Third, the industry can develop consistent approaches to challenges, such as the EICC’s responses to the issue of metals mined for electronics use.

According to HP’s Judy Glazer, “Some of the areas where there is most room for improvement are also the areas where the progress, though gradual, has been most hard-won...In some cases the binary standard of meeting the code or not meeting the code doesn’t represent the progress that might be happening. For example, overtime hours have fallen from ‘grossly exceeding’ limits downward toward the desired level.” Some observers believe the new China labor law has helped to reduce hours worked.

Those factors should help, especially when combined with HP’s constant repetition of its expectations with suppliers, its work to help suppliers build new capabilities, and with efforts to address root causes by an EICC working group. One positive outcome: HP supplier AUO has developed a timekeeping system that flags any worker who has worked over 50 hours in a week, which has helped better manage hours. The reduced hours per worker didn’t require an increase in staffing last year—increased productivity took care of the need for output.
Engaging companies upstream can strengthen weak links in the supply chain. HP expects more suppliers to promote SER programs to their suppliers over the next five years. In its audits, HP asks detailed questions about the supplier’s supplier management program, about the number of audits conducted, the findings uncovered, and how auditors are certified. Sometimes, it can help to engage upstream suppliers directly. Recently, Hoya Glass Disk, an HP sub-tier supplier in Thailand, was involved in a dispute in which employees who wanted to form a union had been let go. HP worked with its first-tier disk drive suppliers to initiate direct dialogue with Hoya factory management, and also arranged a meeting between Hoya Thailand and the local trade union. Eventually, an agreement was reached reinstating 35 dismissed workers, although the union claims that there have since been breaches in this agreement. (HP is still working with all parties to monitor the situation.)

Ultimately, forging partnerships to build capabilities is the key to long-lasting improvements. HP has, for the most part, gotten beyond the awareness-building phase with its direct material suppliers; most of them have been audited and re-audited. (Exhibit 3 shows the four-phase approach used by HP to manage its suppliers.) A big lesson learned, however, is that long-lasting change involves a real partnership with suppliers to get at root causes and to build capabilities. Glazer cites the example of finding during an SER audit that a fire sprinkler is out of place. “If I say it’s in the wrong place, and you put in a work order to relocate it, what are the chances that it will be in the right place in a new building? If you dial back to the root cause of why the sprinkler wasn’t properly positioned, you might find that the person who sites them doesn’t have the appropriate expertise. If you identify and address this underlying issue, your odds of not seeing this issue in the next building are much greater.”

A good example of effective capability building is the Focused Improvement Supplier Initiative (FISI)
launched in 2006 in Shenzhen and Kunshan, China. A collaboration between Business for Social Responsibility and several training groups, FISI provides monthly training on working hours, increasing productivity, wages and benefits, communication skills for factory supervisors, management systems, root cause analysis, Chinese laws and regulations, and more. The training sessions last anywhere from five to 14 days, depending on the topic.

One FISI session addressed why workers were not wearing masks when working near a pungent gas. The supplier used root cause analysis to get at the problem, then developed an action plan: communicate requirements on protective gear to workers, ask the line manager to check the use of gear every day, provide written instruction on usage of gear, and conduct audits on usage. Non-use of protective gear declined from 77 percent to zero in three months.

Of the eight factories that HP has surveyed under the FISI initiative, five now have an EICC management system in place (up from three before the training), all have updated employee handbooks, all use updated labor contracts, and six of the eight factories have significantly improved employees’ housing and dining conditions. (Exhibit 4 shows the reductions achieved.)

How to Speed Up the Success of SER
Based on learnings from the HP story, we have identified practices that can create a well-integrated Social and Environmental Responsibility program, particularly in industries with heavy concentrations of suppliers.

1. Reinforce SER interactions with first-tier suppliers. In some technology companies, the SER audit function is outsourced entirely. In others, centralized corporate social responsibility groups manage suppliers. At HP and many other companies, procurement staff is integral to supplier SER programs. Since the relationship manager holds the contract with the supplier, that manager’s involvement reinforces the message that SER does matter. When the sourcing staff participates, customers can also learn about the very real business challenges that often are involved with implementing a SER process or policy.

2. Seek ways to encourage SER that deliver mutual, sustainable benefits. Promoting SER practices shouldn’t be seen as a win-lose proposition. Some suppliers have voiced concern that, if and when they do uncover SER savings, they will be asked for price reductions. As suppliers begin to find such opportunities, they should be encouraged to share that information with customers. It’s helpful for customers to encourage their suppliers to reinvest any savings in their SER programs. Depending on the relationship between customer and supplier, another method is to split SER-related savings. Finally, just as companies may co-invest on manufacturing projects with shared benefits, they can explore co-investment models for SER-related projects.

Making SER sustainable also means integrating meaningful “carrots” or “sticks” into a SER evaluation. One electronics company uses a 100-point supplier scorecard, with up to 10 negative points given for non-compliance. This “stick” approach is very clear, and shows that the customer is serious about the weight it gives SER when deciding how to award business. HP has grown the size of its “carrot,” increasing its SER weighting from 4 percent to 10 percent of supplier scorecards.

3. Enable suppliers to push SER practices further upstream. One HP supplier recently discovered that a factory was requesting that only females apply to certain jobs. This was uncovered and resolved only after the supplier began conducting its own internal EICC audits, and it points out how improved supplier capabilities can help reduce overall risk. Companies should capitalize on shared tools (such as E-TASC in the electronics industry) that can help customers and suppliers at any tier to identify risks. When suppliers are better equipped, they are better able to monitor and eventually train their own suppliers.

4. Highlight and prioritize SER wins that are also wins for business. In Stanford’s review of three HP suppliers in China, we found that, while the costs of

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*Based on 124 follow-up audits compared with initial audits at same sites for provisions with highest initial rates of nonconformance. Does not include new items identified.
many SER activities are unavoidable, there may be excellent opportunities to get high returns on investment from certain SER activities. These “golden nuggets” should be brought under the spotlight. For example, AU Optronics (AUO) recently invested in water recycling and reduction of water use, dormitory solar panels, and other projects. Most of the investments were outweighed by the savings they produced in the first year. AUO also expects that designing for the environment will soon help boost revenue. Since components such as power cords and printed circuit boards contribute to an electronic product’s energy consumption, designing products that cost the consumer less can drive sales.

Elsewhere, suppliers interviewed believed that better labor practices could improve retention over time. Chinese suppliers’ employees interviewed, for instance, mentioned that dormitory conditions, canteens and a good work culture were part of their decisions to work where they did. As one Flextronics worker reported, “I heard that benefits here were good, and I like the food and working environment.” Given the real costs of attrition, even slight reductions can yield significant savings. One influential report estimated that vacancy, replacement, training and opportunity costs from lost productivity totaled around $340 per Chinese worker. Based on that figure, a factory of 15,000 workers could see up to $310,000 in cost savings per year for just a 0.5 percent reduction in monthly attrition.

**What Lies Ahead**

Today, HP has several new initiatives in the works focused on attaining long-lasting improvements in Social and Environmental Responsibility. SER standards are being implemented among indirect suppliers (labor agencies, service suppliers, call centers, and so forth.), and the number of third-party and shared EICC audits will continue to grow. Other projects include supplier training on fire preparedness, expanding the Health Enables Returns project (which helps female workers monitor their health regularly), and piloting SER key performance indicators with five suppliers.

In the future, HP believes that more “super codes” may develop that extend beyond any one industry (for example, the CIES Global Social Compliance Program). Also, the company’s SER leaders foresee an increased focus on SER by retailers as well as the incorporation of SER standards in bilateral and multilateral trade agreements.

Whether companies use carrots, sticks or a combination of both to improve standards, it’s important to recognize that SER involves developing strong partnerships with suppliers—and that it is much more a journey than a destination. As SER programs are strengthened and disseminated to more first-tier suppliers and beyond, we will continue to explore whether a stronger connection can be made between better SER and better supply chain performance.

**Sources:**

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