



**PHILIPS**

Supply chain

Supplier Sustainability Performance

**Beyond auditing**

# Healthy people, sustainable planet



Continuous improvement in supplier sustainability requires an approach that extends beyond simply auditing compliance

To this end...

**We want** our supply chain to be sustainable in every sense of the word

**We take** a systematic approach to improve the sustainability of our supply chain

**We drive** continuous improvement and measure impact in a structured way

**We focus** on collaboration, increased transparency, and clear commitments, supporting suppliers to meet agreed targets

**We encourage** our suppliers, industry peers and cross-industry peers to join our approach



# Introduction

At Philips, we strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025. As we progress on this journey, adherence to our Supplier Sustainability Declaration requirements remains fundamental.

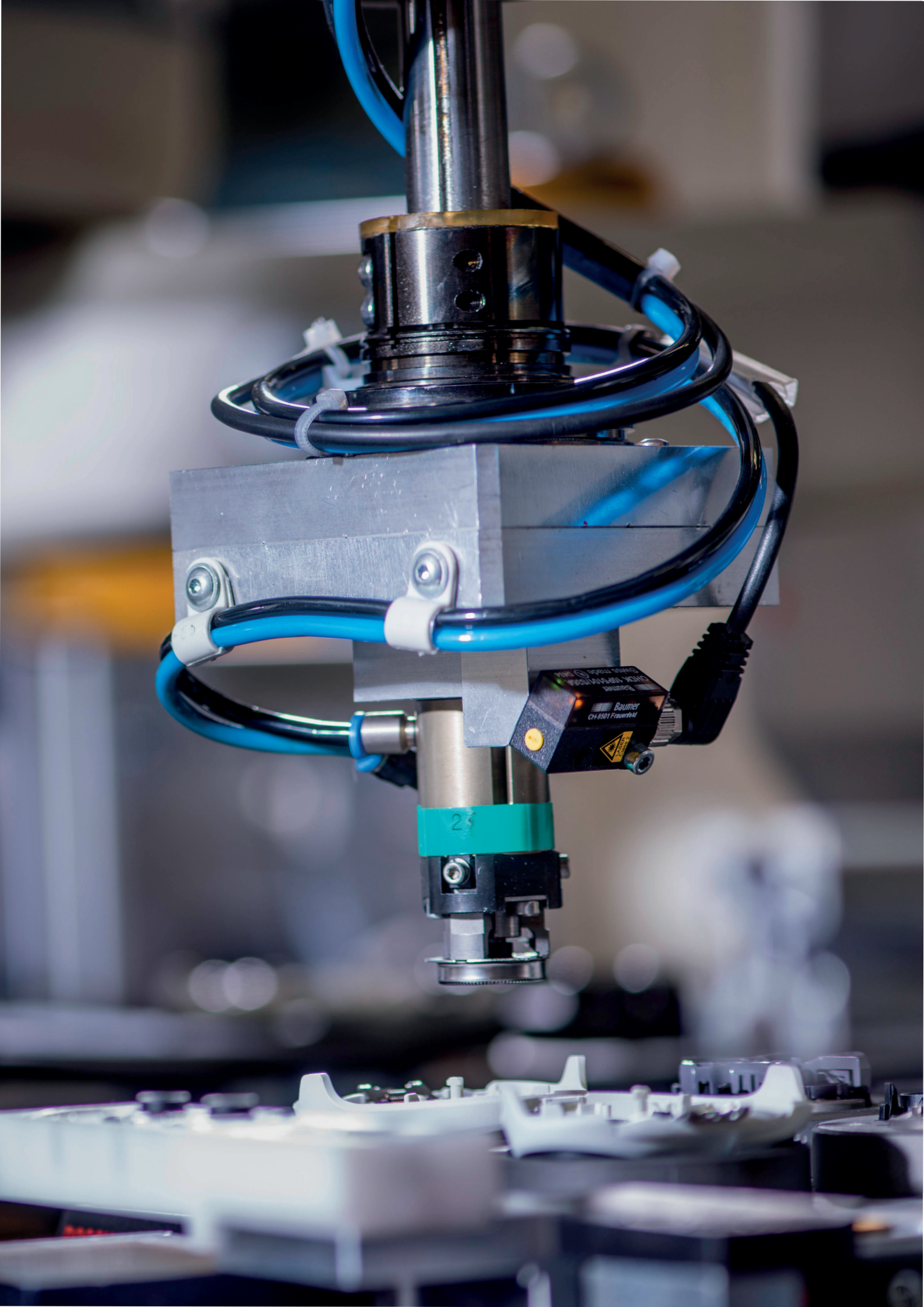
To support this adherence, we developed the Supplier Sustainability Performance (SSP) program. This program was created in dialogue with our key stakeholders, through which we gained significant insights into how to create value and anticipate risks. Accordingly, we are equipped to understand society's needs and translate them into our supply chain strategy and goals. The SSP program is designed to help our suppliers improve their social and environmental performance in a structural way.

We utilize nine elements to qualify maturity levels on sustainability. Suppliers are encouraged to explain and evidence their approach regarding: Policies, Procedures, Implementation, Management Responsibility, Communication, Risk Control, Target Setting and Tracking, Corrective Actions, and Supplier Management. Depending on maturity levels, we co-create a tailor-made approach that supports sustainable improvement.

The focus of the program is to secure sustainable improvements on topics like Environment, Health & Safety, Business Ethics and Human Capital. We support suppliers through training and sharing of best practices. Creating structural improvements will however only work if suppliers are transparent and share reliable and credible information. We consider the commitment and willingness to collaborate with Philips as the key to success.

We believe our program drives improvements in sustainability performance. To achieve this, we are eager to work with like-minded and committed organizations. We are convinced that shared responsibility, openness and transparency create a strong business relationship and safeguards business continuity for all stakeholders involved. We want to improve the lives of people in our supply chain and have a positive impact.

Fredrick Spalcke,  
Chief Procurement Officer Royal Philips



Baumer  
CH 801 Fraunhofer

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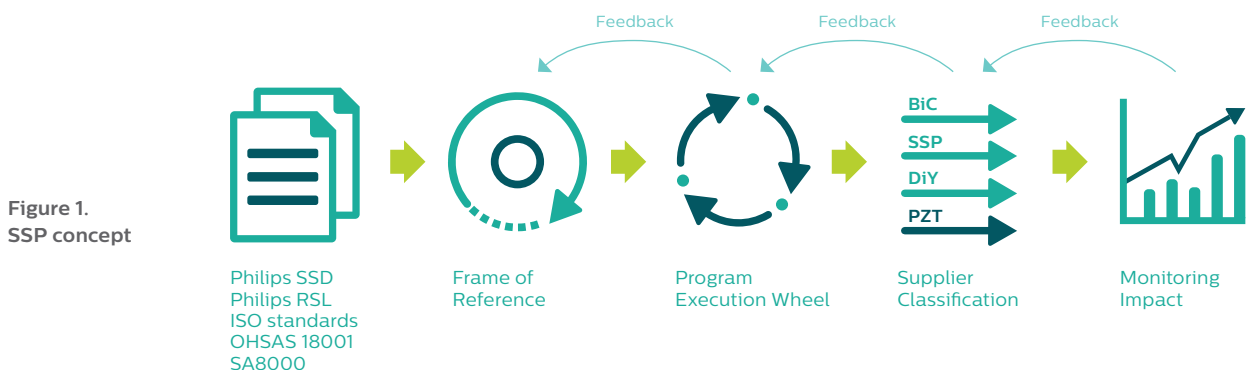


# SSP program structure

The SSP program entails a systematic approach which helps drive continuous improvement at suppliers in scope. It enables Philips to gradually advance the sustainability performance of its supply base. All aspects are related to a set of boundary conditions that need to be met by potential suppliers, before being allowed to enter the Philips supply base.

Managing structural improvements requires a systematic approach, using a set of recognized and global references, an executable process, customized actions, a set of KPIs, ambitious targets and of course a group of suppliers in scope. This systematic approach is depicted in the figure below (Figure 1) and is a high-level representation of the SSP program. At first, a set of references (e.g. RBA code), international standards (e.g. ISO) and Philips requirements (e.g. Sustainability Agreement) are used to develop the 'Frame of Reference', covering management systems, environment, health & safety, business ethics and human capital. For each, the maturity level is identified in

the 'Program Execution Wheel', which assesses suppliers against the Plan–Do–Check–Act (PDCA) cycle. Suppliers are then categorized using a 'Supplier Classification' model, which differentiates on supplier maturity and results in supplier-specific proposals for improvement. The SSP process is monitored and adjusted through continuous feedback. The building blocks help ensure that the SSP program is robust and reliable, specific controls and results can be integrated in the procurement processes, execution is structured, and any kind of improvements and activities are clearly described to ensure results can be monitored and influenced.



# Frame of Reference

The Frame of Reference addresses two different axes, which outline predefined requirements and subjects used to identify the maturity level of a supplier. The matrix capturing the summarized information enables mapping and monitoring of the sustainability maturity level of individual suppliers over time. One axis refers to aspects as defined and addressed in the Philips Sustainability Agreement based on a cross-industry code of conduct.

The second axis sets clear directions for identifying and measuring the maturity across nine different elements. Combining both areas into one schematic (see Figure 2) makes it possible to identify each aspect's maturity level. The overall combination gives an impression of the organization's and sustainability capabilities.

### The Frame of Reference is based on

- the Philips Sustainability Agreement (SA), which is based on an industry code of conduct
- learnings from the past decade, such as former third-party audits (approx. 2,700 audits) and capacity building programs
- benchmarks and external studies on 'beyond auditing'
- international standards such as ISO9001, ISO14001, ISO45001 and SA8000

### Key areas for attention during the execution of the SSP program are:

- Workers' health & safety
- Remuneration and benefits
- Workforce turnover

Besides these three key areas for attention, all other topics described in the Philips SA will be covered during the execution of the program.

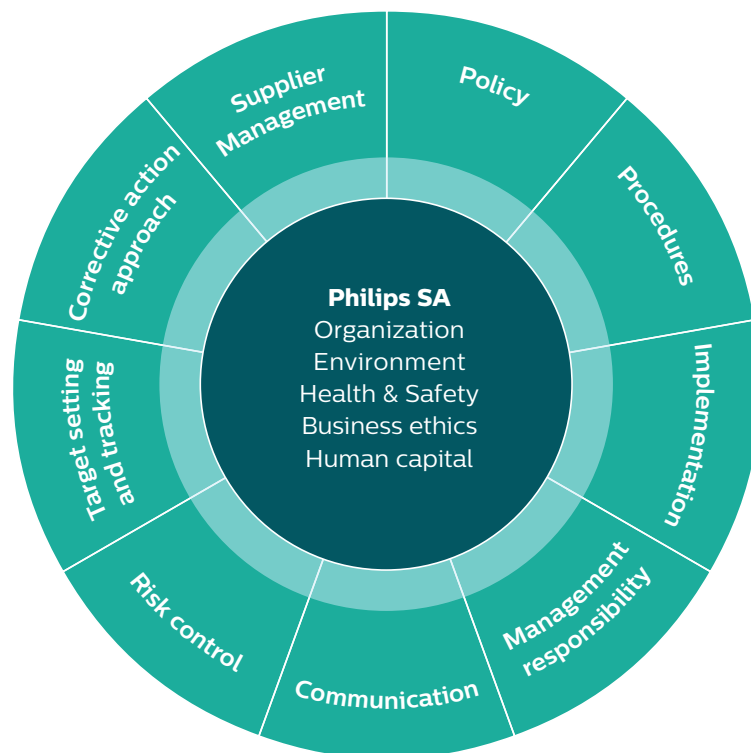
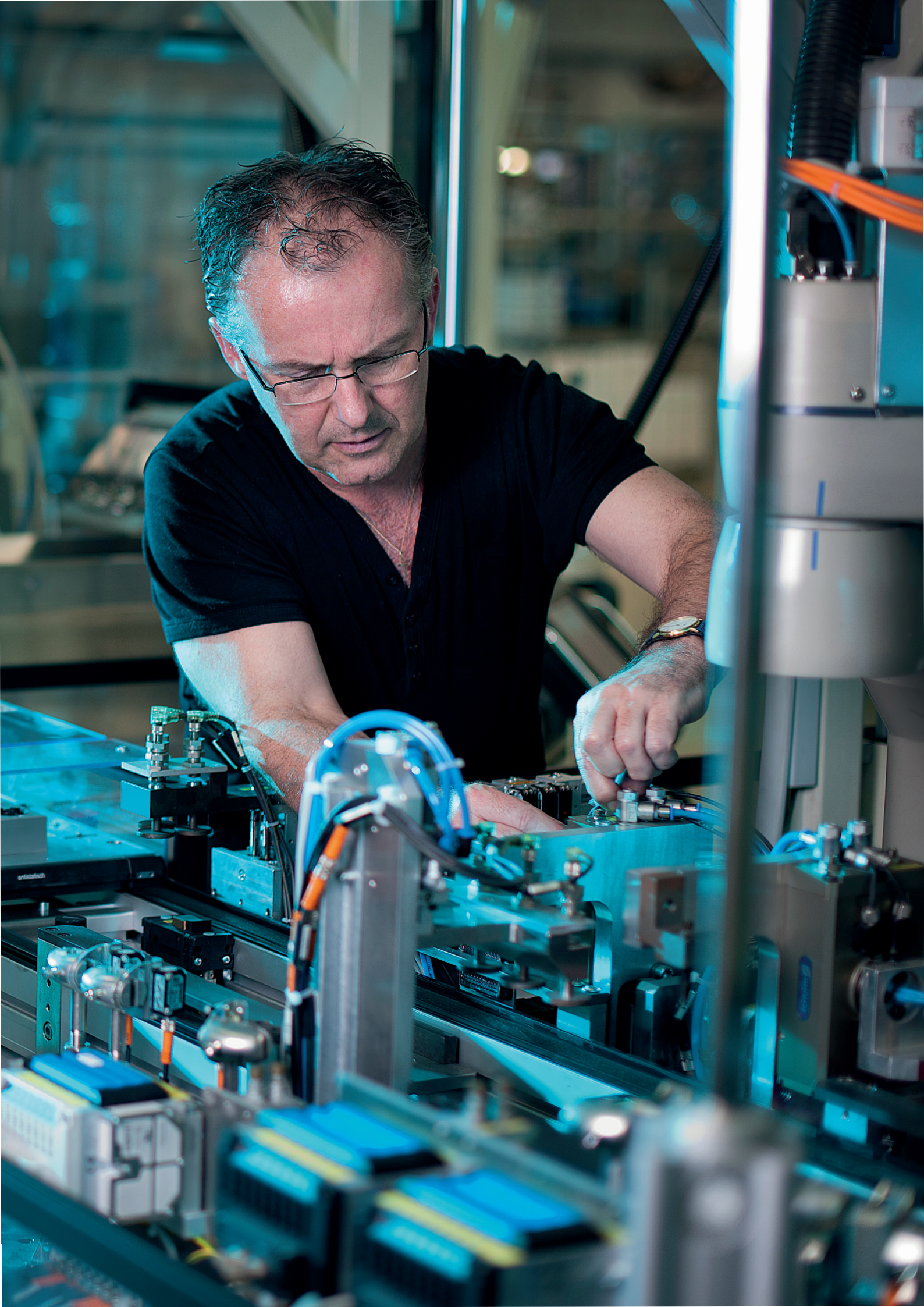


Figure 2. Core aspects and nine elements







# Program execution

For each supplier within the scope of our approach, the core elements as described in the Frame of Reference will be identified and measured in an annual cycle through a structural process based on four key stages (see Figure 3).

1

The first stage, **'Select'**, defines which suppliers will be in scope and clarifies expectations to all relevant stakeholders through an annual process covering BOM (Bill of Material) suppliers and IMS (Indirect Materials and Services) such as Logistic service providers or Human Resource service providers. Scoping is an annual process.

2

The second stage, **'Identify'**, invites suppliers in scope to complete a Self-Assessment Questionnaire (SAQ) and provide sufficient supporting evidence enabling subject matter experts to perform a validation based on predefined criteria. This validation results in clarification of supplier sustainability maturity over all core aspects and a draft SSIP (Supplier Sustainability Improvement Plan). All suppliers in scope are required to maintain the SAQ and evidence after the first year.

3

The third stage, **'Agree'**, assigns the suppliers to different supplier statuses. The minimum requirement, a pre-requisite to be met by all active suppliers in scope and all potential suppliers, is defined as PZT<sup>1</sup> (Potential Zero Tolerance). The easiest to identify are suppliers that are BiC (Best in Class), who score extremely highly after validation because they have integrated sustainability in their business and manage sustainability in a structural manner. Another group, suppliers that are aware, capable and above a certain maturity level, is identified as DIY (Do It Yourself) and these will be remotely guided and supported. The most promising and impactful group of suppliers is assigned to SSI (Supplier Sustainability Improvement). This group of suppliers is often unaware of sustainability requirements to improve their sustainability performance and seems to be highly engaged and committed.

Through an SA (Site Assessment) executed by Philips or a third-party subject matter expert the supplier is guided to develop a detailed Improvement Plan, including targets and objectives. Both supplier and Philips agree on the SSIP within a reasonable time after the SA, which means that the supplier commits to executing the plan and meeting agreed targets.

4

The fourth stage is about the **execution** of the agreed SSIP. Suppliers allocate resources, maintain the improvement plan, track the progress of the plan, and measure how their actions are influencing the local situation through monthly KPIs against a predefined baseline. Suppliers have access to various online resources (EICC e-learnings), get remote support from Philips' subject matter experts, who visit at least twice a year.

<sup>1</sup> Potential Zero Tolerances: describes the process of how to manage one or more of the six defined Zero Tolerances which restrict suppliers from new and/or future business with Philips.



Figure 3. Program Execution Wheel



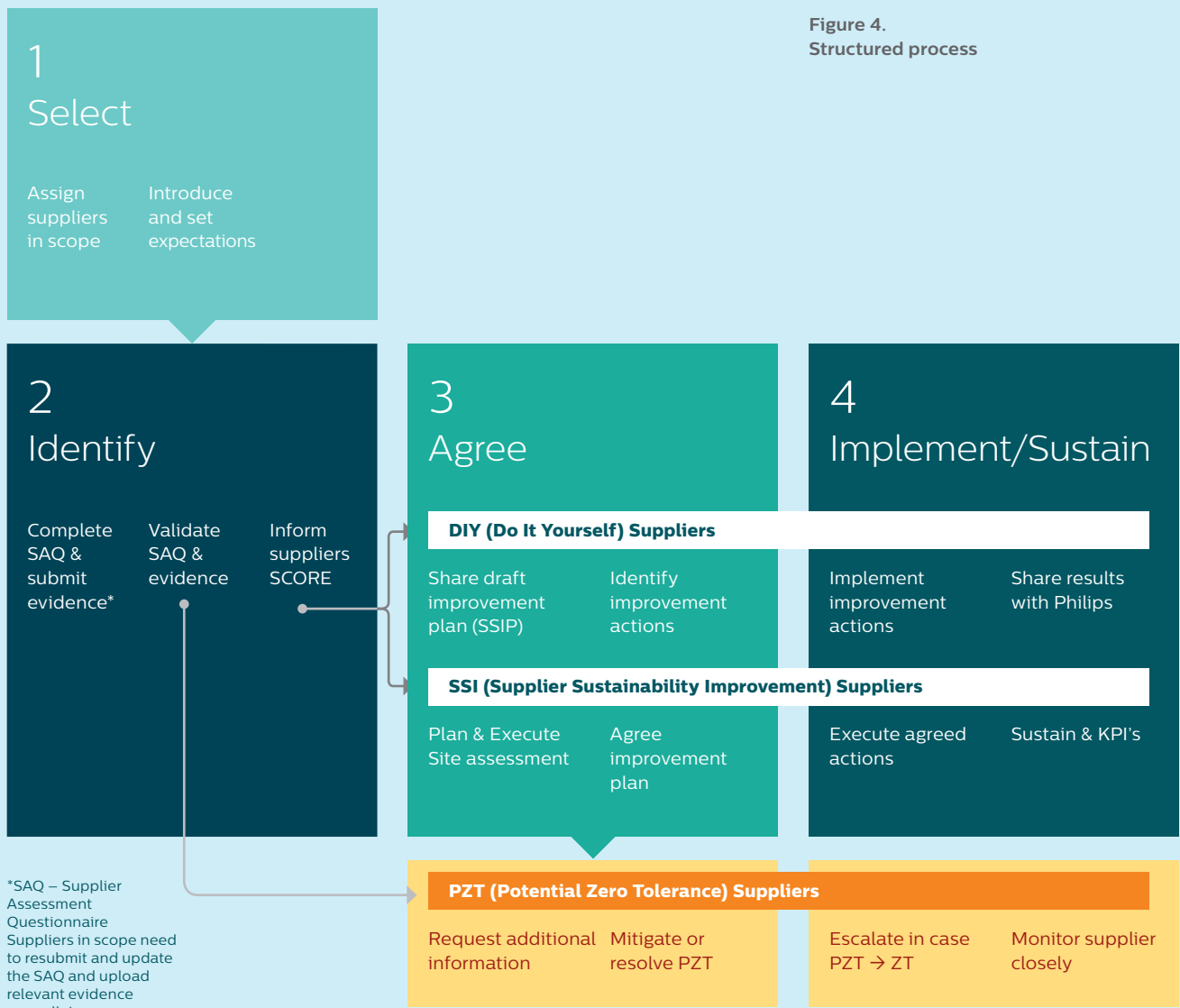


Figure 4. Structured process

The execution of the SSP program is started by assigning suppliers in scope. The program applies to selected existing 'active' suppliers and new 'potential' suppliers that will be on-boarded via Philips' e-sourcing application. Figure 4 shows a detailed description of the process and key activities in each of the four stages.

Each stage has at least two milestones that need to be passed by a supplier before it can move to the next stage. Additionally, this structure enables program management and subject matter experts to track individual suppliers and overall progress and performance against set targets.

Suppliers will be validated against the five aspects for each of the nine elements (Figure 5). Validation can either be a desk-based validation to review the SAQ and provide supporting evidence or an on-site assessment in which desk-based validation is continued at the supplier site. The outcome of any type of validation will be captured in a kind of dashboard using a colored indicator.

Figure 5. Example of SSP Supplier Dashboard score card

Dashboard							
Topics	Weighted Section Scores	Policy	Procedures	Implementation	Management Responsibility	Communication	Risk control
Quality	81%	100%	100%	65%	65%	99%	65%
Environment	77%	100%	83%	58%	100%	82%	99%
Health and Safety	55%	30%	48%	71%	48%	81%	40%
Business Ethics	31%	100%	30%	30%	0%	76%	12%
Human Capital	58%	100%	68%	49%	65%	98%	49%
Weighted average	61%	88%	69%	55%	56%	86%	50%

# Supplier classification

Four different categories are used for assigning suppliers in scope after validation of the SAQ. These four stages are BiC (Best in Class), SSIP (Supplier Sustainability Improvement Plan), DIY (Do It Yourself) and No Zero Tolerance. The status of PZT (Potential Zero Tolerance) is supposed to be a temporary status and requires immediate attention and action. Depending on the supplier assignment, suppliers will be engaged in different ways to improve their sustainability performance.

### BiC – Best in Class:

these suppliers have an overall score greater than 90% after validation. These suppliers are very mature and leading examples to other suppliers.

- At this moment in time these suppliers only need to complete the self-assessment on an annual basis

### SSIP – Supplier Sustainability Improvement:

these suppliers are strategic to Philips and intended to be in our supply base for at least the next few years; they often have a lower sustainability maturity level

- After the desk validation a site assessment will be conducted to verify the actual situation and to create an improvement plan in close collaboration
- Philips offers support and training to increase levels of awareness

### DIY – Do It Yourself:

these suppliers do have the basics in place, though not all elements are achieving the perfect score. Their maturity level and capabilities are sufficient to manage the improvement areas themselves

- The focus is on cross-learning and sharing in a kind of peer-to-peer supplier network

The mandatory requirements that need to be met before a potential supplier enters the Philips supply base are the same as those for the active suppliers within the scope of this SSP program. We refer to these requirements as Potential Zero Tolerances, which are unacceptable violations of the Philips SA and therefore not accepted by Philips. As a consequence, for potential suppliers this means no entry into the Philips supply chain.

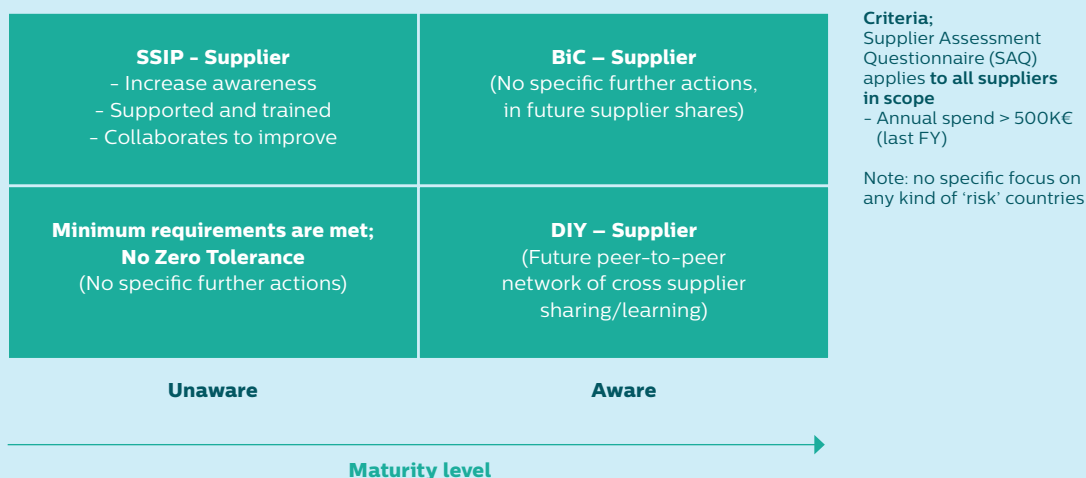


Figure 6. Supplier classification







## Zero Tolerance approach

If during the execution of the SSP program at any specific period in time a (Potential) Zero Tolerance has been identified, immediate and further action will be taken. The main objective of the immediate actions is to collect sufficient evidence to verify whether there is a structural Zero Tolerance. If the requested additional information and evidence lead to the conclusion that there is no structural Zero Tolerance the supplier status will be changed and the supplier will go back to the original track in the program.

If the conclusion gives rise to a structural Zero Tolerance the supplier will be required to:

- Propose a plan of how to mitigate and/or resolve the identified Zero Tolerance(s)
- Commit to structurally resolving the Zero Tolerance
- Provide regular updates and evidence
- Avoid quick-fixing

Zero Tolerances will be internally reported to the procurement commodity leads, procurement leadership team and the corresponding business units so that appropriate measures can be taken when necessary.

Philips has defined six Zero Tolerances (ZT), which are:

- Fake or falsified records (structural)
- Child and/or forced labor (structural)
- Immediate threat to the environment, violations of regulatory requirements such as but not limited to the following cases:
  - No evidence can be provided to prove supplier is in compliance with regulatory requirements
  - Environmental violation reported by governments or NGOs (e.g. IPE in China)

- Immediate threat to workers. Unsafe working environment for workers without appropriate protection for reducing the health and safety risks of workers who are directly exposed to them, including but not limited to:
  - Explosion risk
  - Toxic environment
  - Open machinery/electricity
- Failure to comply with regulatory and/or Philips requirements with regard to such areas as RoHS, REACH, and Conflict Minerals
- Workers' monthly income (covering salary for regular hours and overtime, tax deductions, social insurance) structurally failing to meet regulatory requirements







## Structural improvement increases supplier performance

### Measuring Impact

The impact of improvements, in other words the results of our joint efforts, is measured as a single number based on a scale varying from 0 to 100%. This single value is calculated at individual suppliers, combining the values of the nine elements per aspect into one overall number. Each aspect is reflected through nine element scores (see Figure 5). Individual cells in the table are calculated using a predefined ratio between self-assessment and validation. The system-generated value based on the self-assessment provided by the supplier counts for only 30% of the total score. On the other hand the validation score, either a desk validation or an on-site validation, counts for 70% of the total score.

After the first desk validation has taken place the 'validated score' will become the 'baseline' score. This baseline score will be frozen and used as the point of reference during the execution of the program to measure the improvement over time against it.

The ultimate goal is to achieve a perfect score. However, the main focus at this moment is to identify improvement based on the agreed improvement plan.

### Communication to our stakeholders

Through this more specific and customized approach we noticed that suppliers are showing higher levels of commitment and willingness to raise their awareness and improve their sustainability maturity in a structural manner. During the execution of the SSP program we aim to be as transparent as possible and as such we will regularly share results and learnings. We have set ambitious targets to move beyond auditing and strive for a structural long-lasting improvement in our supply chain.

Details will be provided and updated on our supplier sustainability website (<http://www.philips.com/a-w/about/company/suppliers/supplier-sustainability.html>)

Once a year Philips will produce an integrated report on the SSP program at a high level and in particular look back at what has been achieved. (<http://www.philips.com/a-w/about/investor/financial-reporting/annual-reports.html>)



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