



**PHILIPS**

Supply chain

Supplier Sustainability Performance

**Beyond auditing**

# Healthy people, sustainable planet



Continual improvement in supplier sustainability demands an approach – and a commitment – 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 improving the sustainability of our supply chain

**We drive** continuous improvement and measure impact through a structural phased approach

**We focus** on collaboration, increased transparency, clear commitments and suppliers meeting agreed targets

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

# Introduction

At Philips, we are on a mission to improve people's lives. This goal goes beyond our innovative products, systems and services and to our supply chain. One of the three pillars of Philips' Healthy People, Sustainable Planet program is to multiply its impact by driving sustainability through the supply chain. We invest in our relationships with suppliers who provide a safe working environment, treat workers with respect, and work in an environmentally sound way. Our vision is to lead the change towards a more sustainable supply chain through innovation and by moving beyond audits so that the focus is on how to ensure structural improvement instead of on what goes wrong in the area of sustainability.

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

We expect our suppliers to take responsibility and to look to constantly improve in this area. Philips is keen to support this process and help its suppliers to work on such issues as health and safety, remuneration, benefits and workforce protection and turnover, just as we do ourselves. Such collaboration requires openness, transparency and honesty. Philips believes this joint approach is in all our interests and will bring its own rewards.

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

By being transparent and engaging with a wide variety of stakeholders – ranging from customers, governments and NGOs to suppliers, employees and investors – we are able to identify issues and opportunities and gain insights that we can use to refine our supplier sustainability strategy. We then translate this strategy into dedicated programs designed to help our suppliers improve their social and environmental performance. One of these programs is called SSP (Supplier Sustainability Performance).





### **We drive continuous improvement and measure impact through a structural approach**

We use Philips' Supplier Sustainability Declaration (SSD) as a foundation, or in other words as the core of our frame of reference. The core aspects which we address are: Organization at site level (e.g. manufacturing or operations), Quality, Environment, Health & Safety, Business Ethics and Human Capital. Besides these core elements we have defined nine elements to identify and rate the maturity level of a specific supplier site regarding their sustainability performance. Suppliers are encouraged to provide answers and evidence on how they have identified their materiality and implemented sustainability in relation to these core aspects within their own operations. We ask them to explain their approach against the following nine elements: Policy, Procedures, Implementation, Management Responsibility, Communication, Risk Control, Target Setting and Tracking, Corrective Action Approach, and Supplier Management.

### **We focus on collaboration, increased transparency, clear commitments and suppliers meeting agreed targets**

By setting clear expectations at the beginning, we aim to take away from our suppliers the burden of being afraid of not meeting our SA (Sustainability Agreement). When moving beyond compliance, suppliers are rated and classified in



different categories. These categories ultimately determine the ability to implement an impactful program that will ensure selected suppliers are able to meet predefined and agreed targets. These targets are met via intensive support from Philips, remote support from Philips, peer-to-peer networking and/or based on suppliers' own ability to act appropriately. We emphasize that the creation of an improvement plan is not about quick-fixing but about long-term sustainable improvements. Focusing on one of the three priorities (1) Health & Safety, (2) Remuneration & Benefits or (3) Workforce Turnover creates attention, raises awareness in a structural way, secures commitment from suppliers and embeds the improvements structurally in the organization.

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

We, as well as our suppliers and their suppliers, increasingly face rapidly changing customer demands, resulting in a wide variety of codes of conduct. This wide variety may be found within an industry and/or be company-specific and, as such, gives rise to audit fatigue, disruption to operations, and a lack of structural improvement due to a 'quick fix' mentality. Through a kind of controlled open-source approach, individual suppliers should be able to extend their performance and improvement actions to a broader group of known customers. Through such an approach, all relevant stakeholders benefit from an increased level of transparency, while they accept that a supplier has strict focus when executing an agreed improvement plan and respectfully decline the right to audit. We encourage not only vertical collaboration in our supply chain but we also strive, even more, for horizontal collaboration.

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

Fredrick Spalcke,  
Chief Procurement Officer





# SSP program structure

The SSP program is a structured and systematic approach which drives continuous improvement in different ways for suppliers within the scope of the program. Identification of areas for attention, resulting in a structural long-term implementation of improvement actions, enables Philips to gradually improve the overall sustainability maturity level of its supply base and at the same set a clear threshold. 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 improvements structurally over time requires a systemic approach, using a set of recognized and global references, an executable process, specific customized agreed actions, a set of KPIs, ambitious targets and of course a group of suppliers that will be in scope. This systemic approach is shown in the figure below (Figure 1) and is a simplified high-level representation of the overall SSP program. At first a set of references (e.g. EICC code), international standards (e.g. ISO) and Philips requirements (e.g. Sustainability Agreement) is used to develop the content. The 'Frame of Reference' captures the relevant aspects covering organization, management systems, quality, environment, health & safety, business ethics and human capital. For each aspect except organization, the maturity level can be identified based on a PDCA (Plan – Do – Check – Act) approach. The most important tool for executing the SSP program is the 'Program Execution Wheel': this process is based on four

stages. Start by selecting suppliers in scope until they are secured and then structurally implement, monitor and sustain improvements. Suppliers in scope will be classified using a 'Supplier classification' which differentiates them based on supplier maturity and/or potential zero tolerance, resulting in a supplier-specific proposal for improvement. The SSP progress and performance will be continuously monitored and used to inform both internal and external stakeholders about results, amend the requirements when applicable or adapt the approach through a controlled change management process.

The building blocks are defined to 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.

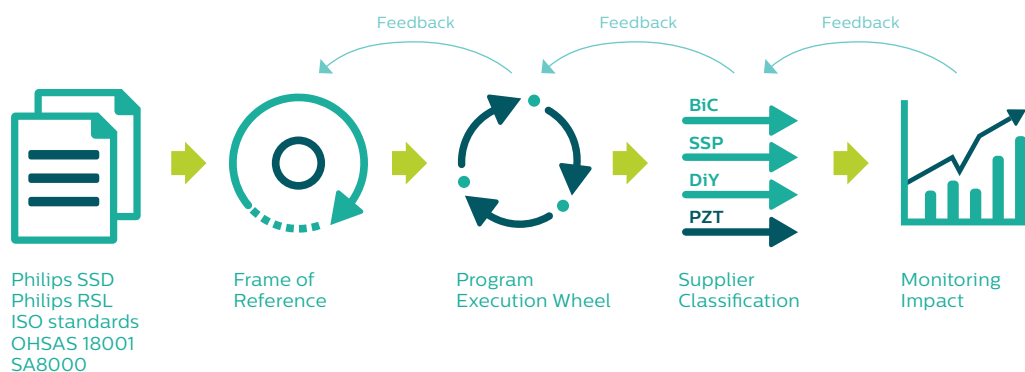


Figure 1.  
SSP concept

# Frame of Reference

The Frame of Reference addresses two completely different axes, which outline predefined requirements and subjects that can be 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 in this Frame of Reference sets clear directions for identifying and measuring the maturity of the level across nine elements. Combining both areas into one schematic (see Figure 2) makes it possible to identify each core aspect's maturity level. However, the overall combination gives both an impression of the organizations and sustainability capabilities.

## The Frame of Reference uses such references as:

- the Philips SA (Sustainability Agreement), which is based on an industry code of conduct
- learnings from the past decade, such as former third-party audits (approx. 2500 audits) and capacity building programs
- benchmarks and external studies on 'beyond auditing'
- international standards such as ISO9001, ISO14001, OHSAS18000 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.

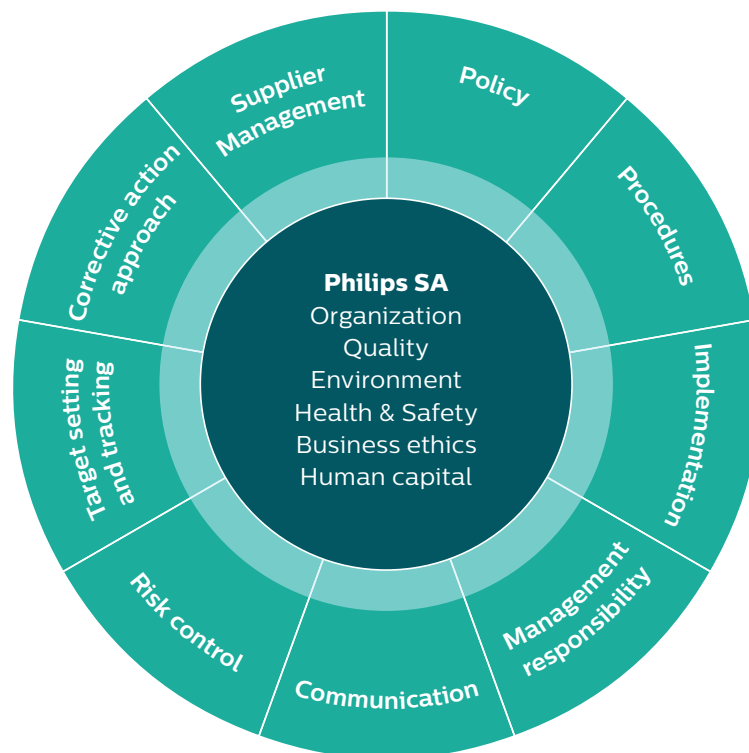
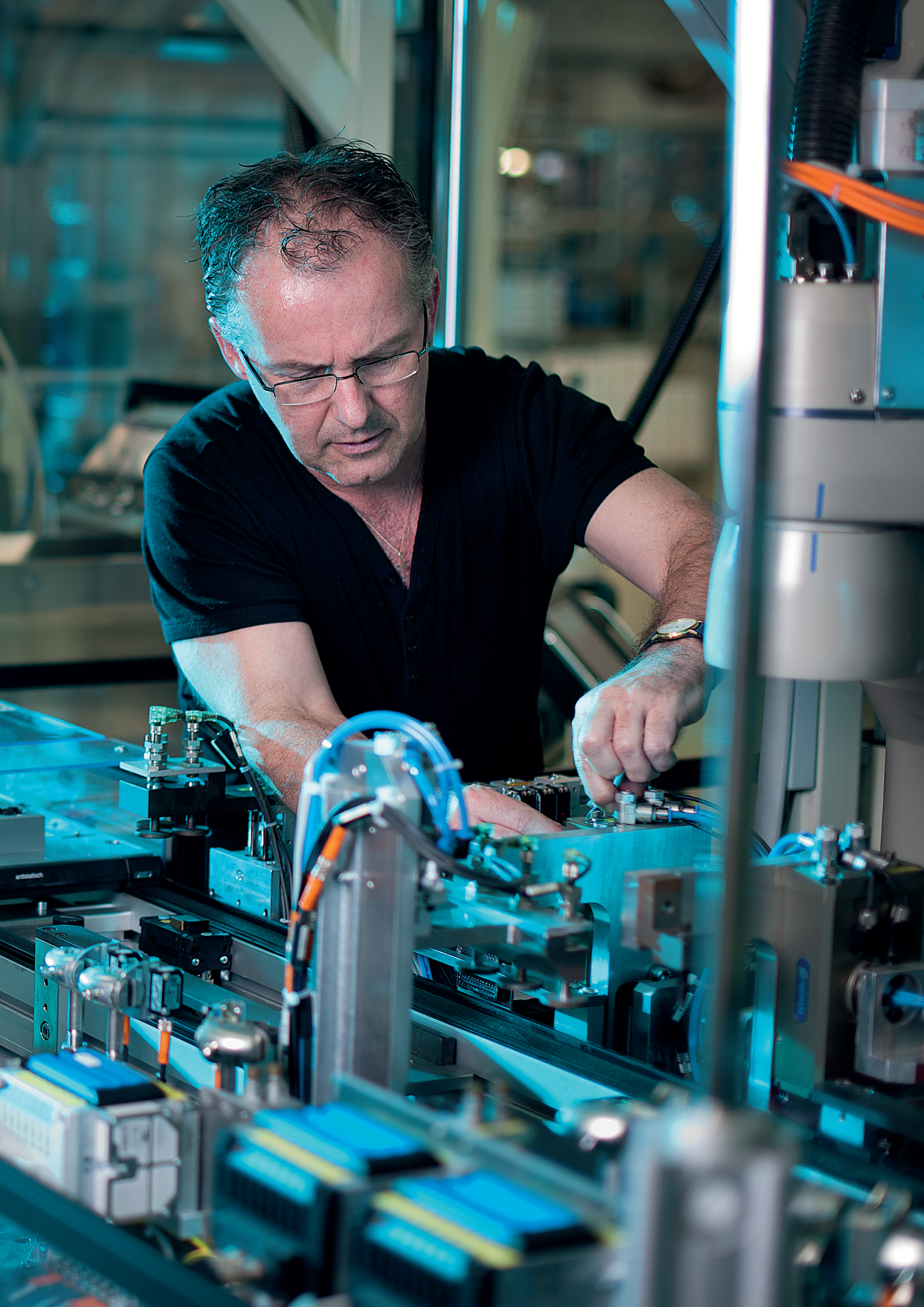


Figure 2.  
Core aspects and nine elements







# 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.

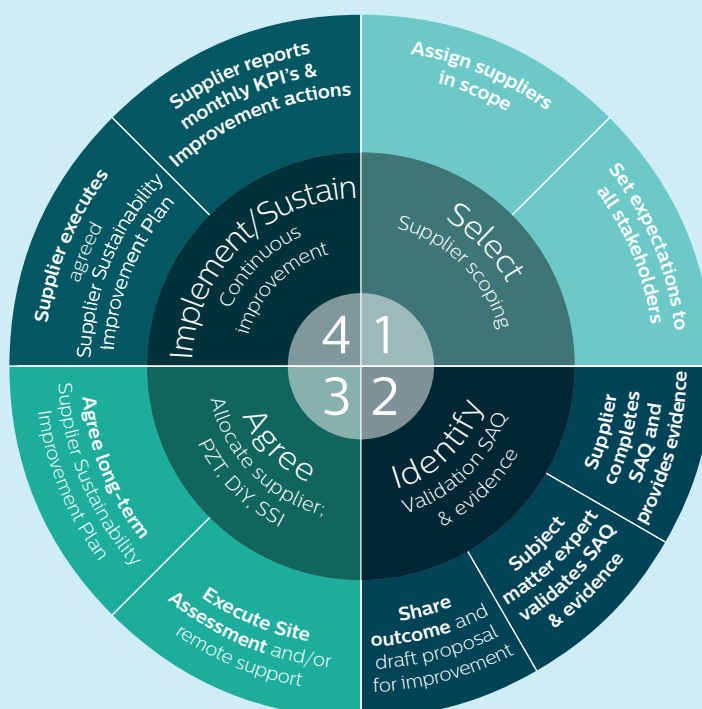
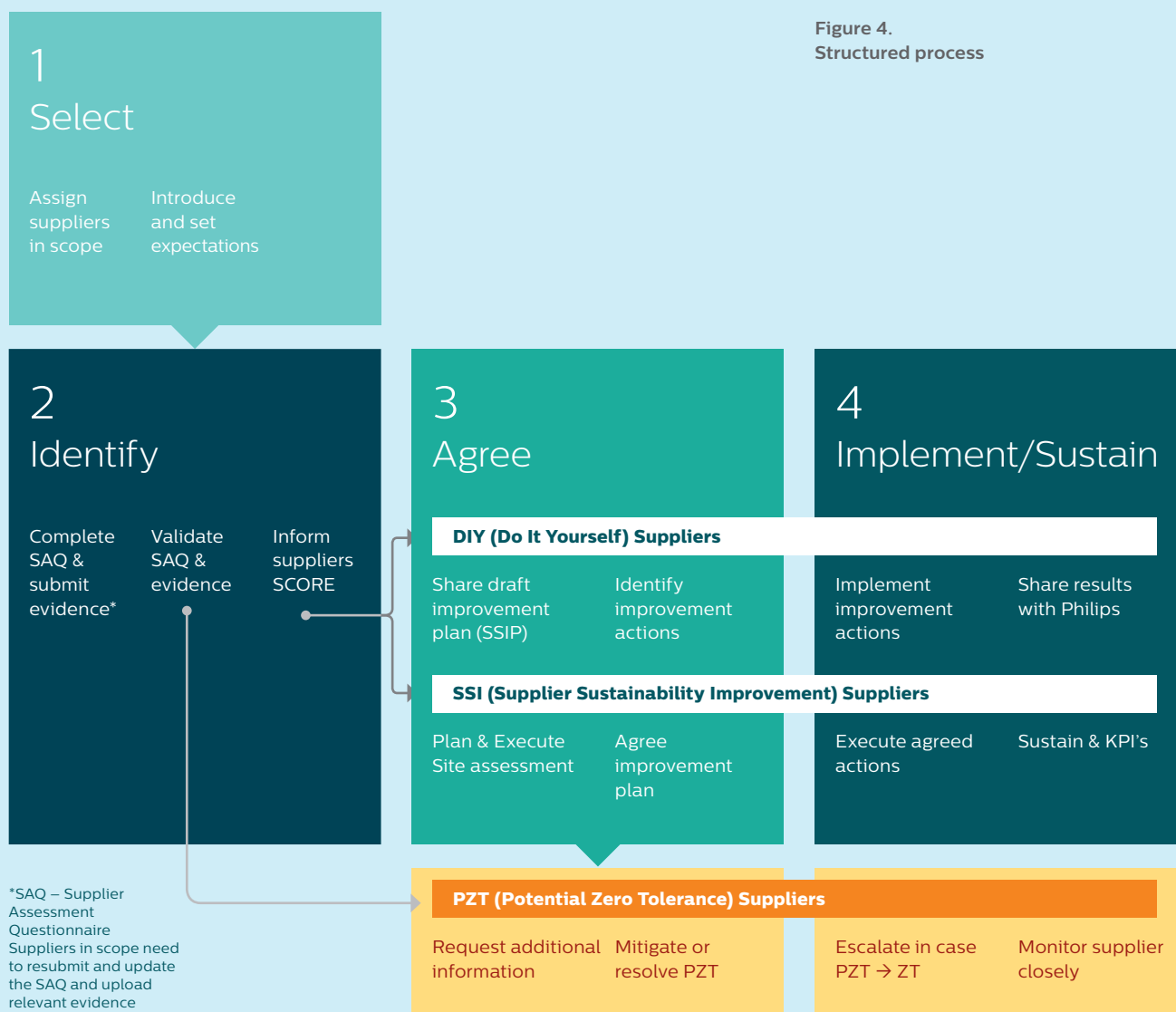


Figure 3.  
Program Execution Wheel





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.

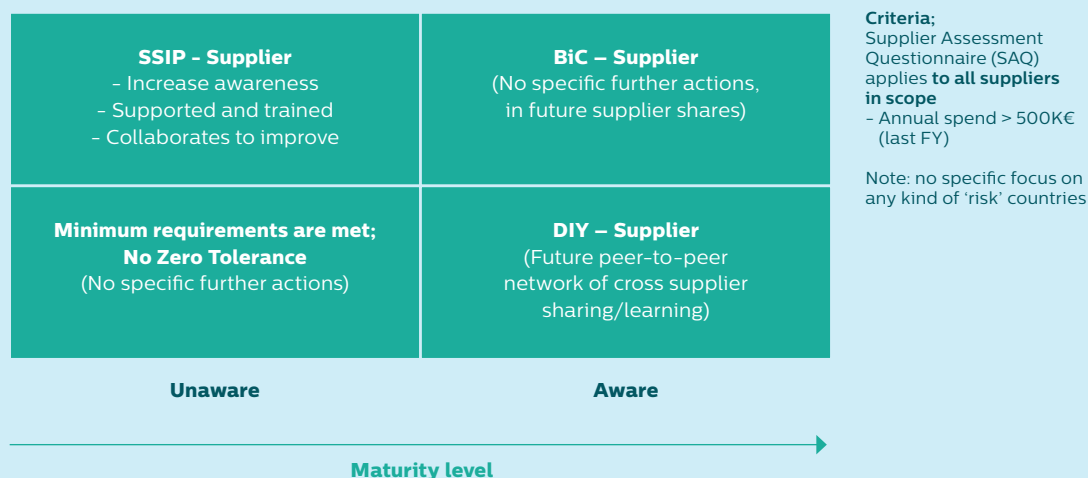


Figure 6.  
Supplier classification







# 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>)



