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SUPPLIERS

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Workers in our suppliers' factories play a central role in our programme. It was concern for their working conditions and well-being that led us to write our 'Workplace Standards'. Our suppliers must also safeguard their workers' health and safety and ensure environmentally sound factory operations. To explain how we expect our suppliers to live up to our Standards, we have produced a number of supporting guidelines that further define expectations for fair, healthy and safe workplace conditions.

Our supply chain is large, multi-tiered and varied. We have a detailed approach to managing the relationships with our suppliers and we continue to develop approaches for engaging suppliers who are part of indirect sourcing models. Monitoring compliance is carried out by the adidas Group's SEA staff and commissioned third party experts while independent auditors verify compliance or evaluate our Workplace Standards' programmatic activities. We are committed to facilitating workplace improvements and work with others to achieve this, so we continue to invest in training our suppliers and reaching out to stakeholders and third party service providers. We have a process for enforcing compliance with our Standards and an innovative system for rating suppliers. This rating then informs the Sourcing team's decision about whether we continue the business relationship with that supplier.

OUR SUPPLY CHAIN

The adidas Group has outsourced most of its production. We work with more than 1,200 independent factories from around the world that manufacture our products in 69 countries. Many of these are in one of the following five countries: China, India, Indonesia, Thailand and Vietnam.

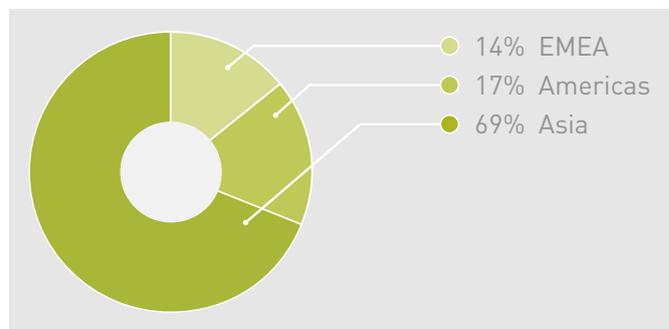
Our supply chain is global and multi-layered, with many different types of business partners, some of whom are directly contracted and others who are not.

In 2010, the top five countries per region by number of supplier sites were:

- The Americas: United States, Brazil, Canada, Mexico and Argentina
- Asia: China, India, Indonesia, Vietnam and Japan
- EMEA: Germany, United Kingdom, Italy, Spain and South Africa/Turkey

Our influence in terms of social and environmental compliance is linked to the strength of our partnerships, and is often proportional to the scale and stability of the orders placed with our suppliers.

Supplier factories by region in 2010



DIFFERENT SOURCING RELATIONSHIPS

DIRECT SOURCING MODEL

The adidas Group holds direct contractual relationships with its core suppliers who are centrally supervised by Global Operations. Global Operations manages product development, commercialisation and distribution and also supervises the manufacture of apparel, footwear and accessories for the adidas, Reebok and TaylorMade-adidas Golf segments. In addition, Global Operations leads our Group's efforts in supply chain optimisation.

These suppliers produce the predominant share – approximately 75% of the total sourcing volume of the Group – and can be characterised as our 'direct supply chain'. There are other parts of our business that have direct sourcing arrangements which lie outside of the central control of Global Operations. These include Rockport footwear, CCM Hockey sticks and TaylorMade clubs.

INDIRECT SOURCING MODEL

The other part of our product volume is sourced by agents or is made under licence. Agents place orders with their preferred suppliers. Licensees may either place orders directly with their suppliers or use agents as intermediaries.

Our indirect supply chain complements our direct sourcing by meeting specific requirements that cannot be serviced through Global Operations.

LOCAL MARKET PRODUCTION

In order to quickly seize short-term opportunities in their local markets, to satisfy a niche market requirement, or in some cases to react to certain trade regulations, adidas Group subsidiaries may also source from local suppliers that are not overseen by Global Operations but do require its authorisation. Local purchases, however, account only for a minor portion of the Group's total sourcing volume.

The multiple sourcing relationships are recorded and tracked through the Fair Factories Clearinghouse (FFC), the adidas Group's primary factory compliance tracking system.

Read more about how we work with the FFC on page 46.

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The adidas Group is one of the very few companies in the industry that has fully disclosed its global supplier list on its corporate website. The list is updated twice a year can be found at http://www.adidas-group.com/en/sustainability/suppliers_and_workers/default.aspx.

TYPES OF SUPPLIERS

Our suppliers fall into five broad categories:

- Main suppliers
- Subcontractors
- Material and other service providers
- Licensees
- Agents.

MAIN SUPPLIERS

These are suppliers that have a direct contractual relationship with the adidas Group for the supply of products, whether for export or domestic market consumption. We call these Tier 1 suppliers. The largest of these have multiple factories and manufacturing sites across several countries.

SUBCONTRACTORS

These are factories that have been subcontracted by our suppliers. Although they have no direct contractual relationship with the adidas Group, we do require them to be compliant with our Workplace Standards before authorising them as subcontractors.

MATERIAL AND OTHER SERVICE PROVIDERS

These suppliers may not have a direct business relationship with the adidas Group, but supply goods and services to our main suppliers. Within this category, there are nominated material suppliers with whom we work to develop specific fabrics and components.

LICENSEES

Independent companies which manage the design, production and distribution of specific products, under licence to the adidas Group. In 2010, the adidas Group worked with 45 licensees whose suppliers sourced products from 307 factories in 45 countries.

AGENTS

Independent companies that act as intermediaries. They determine where products are manufactured, manage the manufacturing processes, and sell finished products to the Group.

Supplier relationships overview



MAJOR TRENDS IN OUR SUPPLY CHAIN IN 2010

In response to the 2009 global economic crisis suppliers significantly reduced their production capacities, only to face pressure when 2010 saw an upswing in demand for athletic footwear and sports apparel. This caused considerable production peaks at many of our suppliers' factories, with associated working hours' issues. The additional hours however also increased workers' pay through overtime premiums.

We see several major trends in our supply chain that have a direct bearing on the scale and focus of our social and environmental programme:

- Growing business with our strategic suppliers producing for the international export market. These suppliers have invested in additional production capacity and operate factory facilities in multiple countries.
- Growth in licensee and agents business as the adidas Group develops new business segments and product lines.
- Growth of athletic footwear production outside of China, as a result of trade restrictions. New factory capacity has been developed in Indonesia and Cambodia, which are highly unionised countries.
- Relocation of suppliers from southern China and coastal areas to inland provinces continues as business partners look for lower fixed operating costs and access to new sources of labour.
- With stakeholders increasingly concerned about primary material sources, including cotton production, there is a growing demand for more transparency along the supply chain and improvements in tracking materials.

WORKPLACE STANDARDS

The Workplace Standards are rules we apply at our own sites and our suppliers' factories to cover health and safety, labour rights and environmental protection. The Standards draw from international law and the International Labour Organization conventions, and follow the model code of conduct of the World Federation of Sporting Goods Industry. We revised the Workplace Standards in 2001 and 2006 in consultation with labour rights groups.

We expect all our suppliers to live up to these Standards. They are a contractual obligation under the manufacturing agreements the adidas Group signs with its main business partners.

Read our Workplace Standards on our corporate website at http://www.adidas-group.com/en/sustainability/suppliers_and_workers/code_of_conduct/default.aspx

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SUPPORTING GUIDELINES

To explain how we expect our suppliers to live up to our Standards, we have produced a number of supporting guidelines that detail our expectations for fair, healthy, safe and environmentally sound workplace conditions. They make the Workplace Standards understandable and practical, provide additional guidance for our suppliers, and help us work together to find effective solutions to workplace problems.

Our guidance materials are:

- Health and Safety Guidelines
- Guidelines on Employment Standards
- Environmental Guidelines/Guide to Best Environmental Practice
- Worker Cooperative Guidelines
- Enforcement Guidelines
- Guidelines on Sustainable Compliance
- Termination Guidelines.

In 2010, we issued revised versions of some of the guidelines following a comprehensive review. Our guidance materials are publicly available in full on our corporate website.

NEW HEALTH AND SAFETY GUIDELINES

The adidas Group's new Health and Safety (H&S) Guidelines have been developed in two parts. The first part describes occupational health and safety fundamentals, and is based on our previous Health, Safety and Environment Guidelines. We have incorporated international best practices and standards such as fire extinguisher coding, exit route requirements and extended the number of banned chemicals. We have also taken the opportunity to clarify areas of uncertainty which have been raised in the past.

The second part of the new H&S Guidelines focuses on 'Technical Application' and brings together previous Guidance Notes and Advisory Notes issued to our suppliers, including such topics as: Personal Protective Equipment (PPE) Requirements, Occupational Hazards Risk Assessment and Ergonomics.

The guideline was distributed in March 2010 after it had been translated into our business partners' key languages.

SECOND EDITION OF THE GUIDELINES ON EMPLOYMENT STANDARDS

Since the launch of the adidas Group's first Employment Guidelines in 1999 there have been many developments on the industrial relations front, as well as increased expectations about our suppliers' own ability to better manage their staff resources. To reflect those changes, we undertook a comprehensive review of our previous guidance and prepared a new set of updated Employment Guidelines. We have termed the new guidelines our second edition.

In the second edition, the key do's and don'ts in relation to the seven employment standards remain the same. In most cases, we have simply updated the case studies to reflect more recent practices in factories, and have provided more relevant sample documentation.

As with the first version of our Employment Guidelines we have sought to build on our rich and varied experiences in tackling worker complaints and remediating specific factory issues. Hence, the guidance seeks to clarify our expectations around some core requirements, such as wage payment, working hours and leave. It also covers the protection of workers against harassment and management retaliation, as well as their fundamental rights, such as the right to strike and privacy issues. We set out our position on some of the more complex and often intractable issues, such as fair wages and migrant labour and the use of employment agencies and middle men which may exploit workers and remove the security of employment. We have also taken the opportunity to integrate guidance on layoffs and redundancy which was first developed in response to the 2008 financial crisis.

NEW ENVIRONMENTAL GUIDELINES

These Guidelines complement the guidance offered in the 'Guide to Best Environmental Practice' (BEP) that was launched in 2005. The BEP, as the title implies, is all about best practices, whereas the Environmental Guidelines describe minimum requirements in terms of managing and reducing the use of resources and materials and ensuring that the resulting waste, discharges and emissions are also minimised and meet regulatory requirements. The Environmental Guidelines are the benchmark for environmental assessments conducted at selected supplier sites.

GROUP-WIDE STANDARD OPERATING PROCEDURES

To ensure adherence of the adidas Group businesses with the Workplace Standards in terms of supplier inspections, selection and authorisation, Standard Operating Procedures are in place that are mandatory to all entities of the adidas Group.

Core policies and procedures that are part of the adidas Group's policy manual include:

- A Factory Approval Policy, which describes the procedures for getting SEA authorisation for all production
- External Monitoring Policy, which outlines requirements for external monitors conducting factory assessments on behalf of adidas Group business entities and licensees
- A Termination Guideline, which describes our approach to ethical termination of suppliers
- The Fair Factories Clearinghouse procedure, which describes the responsibilities for disclosing and maintaining data in the Group's supply chain database.

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MANAGING OUR SUPPLIERS

Beginning with the foundation of our programme – our Workplace Standards – these are the steps we go through to manage our supply chain and improve workplace and environmental conditions:

2010 HIGHLIGHTS

IMPROVING WORKER-MANAGEMENT RELATIONS

In 2010, we continued to improve the management of relationships with workers and employers. We participated in two mature activities with workers and employers in our direct and indirect supply chains. Workers from 400 Chinese factories have access to confidential reporting channels and the outcomes of the hotlines are encouraging. Fifteen more factories joined the management training initiative to learn about Human Resources Management Systems (HRMS), bringing the three-year total to 75 factories in China and Vietnam. Please see the interview and case study for more information about Worker Hotlines on page 50 and the HRMS project on page 46.

There are other key projects that looked at worker-management relations and trade union relations in particular, including developing a freedom of association protocol in Indonesia on page 14. We also funded the ILO translation of industrial relations guidance material in Vietnam.

CLUSTERING OUR SUPPLY CHAIN

Another highlight from 2010 was an improvement in how we monitor supply chain compliance by customising programmatic activities with three new (and redefined) clusters of the supply chain. These clusters stressed more value-added practices by the fair, good and best compliance performers. The highest performing suppliers implemented 'Self-governance' activities, including more sophisticated reporting. Fair, good and best performers participated in the 'Partnership' cluster, focusing on collaboration with multiple buyers in shared factories (such as the Sustainable Compliance Initiative and the Brown Shoe Collaboration), and suppliers' participation in multi-stakeholder initiatives (such as the FLA and Better Work). The poorest performing suppliers are in the 'Risk Management' cluster.

DRIVING ACCOUNTABILITY

2010 saw an increase of adidas Group business entities which are embedding compliance practices in their sourcing and procurement policies. Fifty-five Group entities follow three-year strategic compliance plans and receive annual performance reviews. Monitoring those entities' supply chains was leveraged with more collaborative practices and data sharing through the Fair Factories Clearinghouse.

Read more about this in the Strategic developments section on page 54.

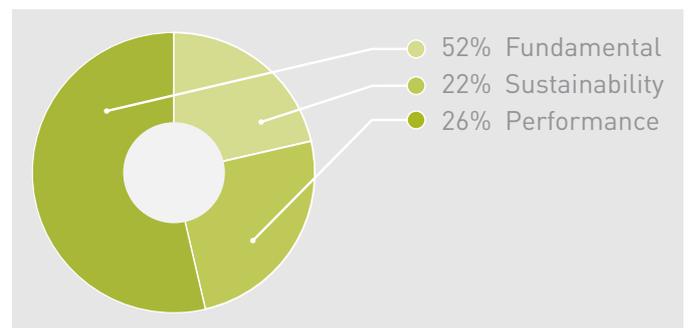
TRAINING SUPPLIERS

In 2010, we continued our intensive efforts to provide training for our suppliers, licensees and employees from the adidas Group's operational departments.

We have three main types of training:

- **Fundamental training:** includes introductory training for the Workplace Standards, Fair Factories Clearinghouse (FFC) data entries, the new factory approval process and the SEA operating guidelines
- **Performance training:** includes detailed training on specific issues on labour, health, safety, and environmental practices, as well as initial assessment monitoring methods
- **Sustainability training:** includes training in the KPI and rating tools, sustainable compliance planning and supplier self-assessment methods.

Supplier trainings



In 2010, 193 training sessions were conducted by the SEA team. Included in this total number are 73 group training sessions where there is more than one supplier participating:

Americas - there were 80 training sessions provided to more than 170 adidas Group staff and suppliers' compliance personnel.

EMEA - there were 14 training sessions for more than 80 adidas Group staff and suppliers' compliance personnel.

Asia - there were 99 training sessions for more than 1,960 internal staff and suppliers' compliance personnel.

Read on for some training initiatives from 2010:

FFC training on page 46.

Human Resources Management Systems training on page 46.

Better Work on page 46.

EHS Academy on page 47.

Occupational Health and Safety Officer programme on page 48.

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FFC TRAINING

Since 2006, the adidas Group has used the Fair Factories Clearinghouse (FFC) platform as the Group's internal compliance database. The FFC platform facilitates the management of compliance data from all adidas Group suppliers producing footwear, apparel and accessories. A key feature of the FFC database is sharing audit data, and the adidas Group has shared audit and monitoring information with other FFC member companies since November 2008. All SEA internal and commissioned external monitoring reports are archived and open to sharing. This has facilitated our work with other brands to develop harmonised corrective action plans and joint auditing activities.

There are clear benefits in collaboration, including:

- A reduced number of compliance assessments which is more efficient for both brands and suppliers
- More streamlined communications between FFC member companies and suppliers
- Increased leverage to drive remediation according to common agreed actions.

All adidas Group business entities are required to disclose supplier data on the FFC prior to the start of production. Bi-annual reviews and maintenance ensure that supplier data is correct and current. Audit reports, findings and performance ratings are regularly uploaded to suppliers' FFC accounts, allowing SEA and Sourcing departments to track progress and corrective actions. Photos, documents and other forms of record-keeping are also uploaded and maintained as verification of compliance activities.

SEA continuously trains the Group's user community in all aspects of the FFC's functions. Selected factories in our supply chains are given FFC training to encourage them to take responsibility for their own compliance. As a result, the FFC system and functions drive detailed, transparent reporting which in turn allows the increasingly effective management of compliance performance in our diverse, global audience of business entities and supply chains.

HUMAN RESOURCES MANAGEMENT SYSTEMS TRAINING

After years auditing in factories, the adidas Group recognised there was a lack of fundamental HR systems in Asia Pacific region factories. The introduction of more sophisticated production set-ups such as Lean manufacturing required more sophisticated HR practices.

COLLABORATING TO CREATE THE TRAINING PROGRAMME

The Human Resources Management Systems (HRMS) approach was initiated in 2006 on a collaborative basis by adidas, Reebok, Nike, Puma, New Balance and Columbia Sportswear. Consultant TÜV Rheinland developed human resources management training materials with the brands and their suppliers. Core elements of the HRMS address job descriptions, recruitment policies, compensation and benefit systems, training and job development systems, target

setting and performance evaluations. At launch, the HRMS process included one year's practical training sessions, milestone setting, presentations and sharing sessions, peer educator development and feedback sessions.

The HRMS was launched in China in 2006 by adidas, Reebok, Nike and Puma working with TÜV Rheinland. That year, four training groups comprising 27 factories participated. During 2008–2009, two additional groups of 33 factories went through the training. The HRMS was launched in Vietnam in 2008 by adidas, New Balance, Columbia and Puma. In the last two years, 15 suppliers have completed the training programmes. The government agency Vietnam Chamber of Commerce and Industry (VCCI) contributed financial support for language translations of the training materials.

MAKING A DIFFERENCE

Suppliers in both target countries commented on the effectiveness of the interactive training approach. The HRMS training has encouraged the development of HR manager networks which share good practices and collaborate on continuous improvement. Many participating suppliers saw increased operational efficiencies once the HRMS was implemented. And the SEA team's key performance indicators reflect significant improvements where suppliers implemented HRMS.

LATEST DEVELOPMENTS

To promote stronger executive management commitment at the factory level, the programme was re-designed in 2008 to include one-day workshops for executive management. That made a notable difference in 2009 and 2010 activities, especially in Vietnam.

In 2011, the HRMS China project will focus on self-training as well as customised training in self-governance practice. In Vietnam, the plan is to gradually turn the project over to the joint IFC-ILO Better Work initiative which is developing a service platform for the apparel industry.

In addition, in 2011, we will ensure the fundamental elements of the HRMS are benchmarked within the Sustainable Compliance Initiative's (SCI) monitoring tool.

BETTER WORK

THE PROGRAMME

Better Work (BW) is a global programme, which is a unique partnership between the International Labour Organization (ILO) and the International Finance Corporation (IFC). It unites the expertise of the ILO in labour standards with that of the IFC in private sector development. Launched in February 2007, the programme aims to improve both compliance with labour standards and competitiveness in global supply chains. BW involves the development of both global tools and country-level projects, with a focus on scalable and sustainable solutions that build cooperation between governments, employers' and workers' organisations and international buyers.

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ADIDAS GROUP ENGAGEMENT WITH BETTER WORK

The adidas Group has been involved with BW since the launch of Better Factory Cambodia (BFC), the predecessor of BW in Asia. The project grew out of a trade agreement between the United States and Cambodia. Under the agreement the US promised Cambodia better access to US markets in exchange for improved working conditions in the garment sector. The ILO project was established in 2001 to help the sector make and maintain these improvements.

Since the programme began, all adidas Group garment factories in Cambodia have been monitored by BW on a regular basis. BW has its own training and capacity building programmes to support factory workers and management. The training topics range from ILO core labour standards and workers' rights to human resources management, supervisory skills and occupational safety and health, among others. The training programmes have been quite successful and one that has been particularly popular amongst our suppliers has been the supervisor skill training. A video of it can be seen on at <http://www.youtube.com/watch?v=YQRbrEN1EJY>

OUTSTANDING ISSUES IN CAMBODIA

BFC has been highly successful in promoting Cambodia as a responsible sourcing country, but sourcing from Cambodia has not been without its challenges. In the last few years there has been a rapid growth in the number of trade unions within the apparel sector, with many smaller unions competing for attention from the same pool of workers and from management. With a weak national registration system many of the newly formed unions are not well organised and their operations are not always transparent. In 2010, there was a series of major strikes triggered by trade union demands for a higher minimum wage in Cambodia. BFC played an important role in keeping brands abreast of government views and reporting on progress with the tripartite negotiations. For more information please see our stakeholder engagement on page 11.

SLOW TAKE-UP IN VIETNAM

In June 2009, BW launched its programme in Vietnam, transferring the experience and knowledge from BFC. The adidas Group has supported BW Vietnam, but has faced some challenges in securing the participation of our suppliers. Challenges are that:

- BW Vietnam is a voluntary programme, unlike the government mandated arrangement in Cambodia
- The scope of BW Vietnam is confined to apparel, whereas in Cambodia our suppliers include large footwear and accessory operations
- Perhaps most importantly, the monitoring conducted by the adidas Group's own internal compliance team is free of charge, whereas there is a fee attached to monitoring under BW.

As a result by the end of 2010, only four adidas Group suppliers had joined the BW programme. We are hopeful that more suppliers will sign up for BW-run skills training planned for 2011.

NEXT STEPS

In November 2010, the adidas Group in partnership with H&M and other multinational companies formed a brands' working group to improve buyer engagement and support for the roll-out of BW in Vietnam and prospective BW countries in the region, such as Bangladesh and Indonesia. The working group activities will feed into a BW industry task force that has been established by the ILO and IFC.

We are considering signing up factories in Haiti, Nicaragua and Jordan to be exclusively covered under the BW programme.

Find out more about Better Work at www.betterwork.org

Ms. Vu Thi Hoang Yen, Production Manager at Vinh Hung Co. Ltd., Vietnam:

"I have to say this is the best training I have ever attended. It is useful and applicable for my managerial level and middle management as line supervisor. The knowledge gained from this training is useful for me and my other colleagues in the company."

Mr. Kim Young Woo, Hansoll Vina, Vietnam/Cambodia:

"Hansoll factories in Cambodia had already joined the Better Factories Cambodia programme several years ago according to the Cambodian government's policy; hence we have had an interest in the Better Work Vietnam (BWV) programme as well. The BWV programme started due to the success of BFC, and we joined with the persuasion of adidas and other brands. The benefit is that for Hansoll factories that joined BWV, brands are now accepting ILO audit reports as a substitute for their own audits."

EHS ACADEMY

The recruitment and retention of qualified occupational health and safety staff has been an ongoing challenge for our suppliers, especially in those countries where there is a lack of trained professionals. To address this concern, in 2006, the adidas Group launched the Safety Officer Programme, both mandating that suppliers retain safety personnel and also providing the necessary training to build their internal capacity. The results however were mixed. Although there were short-term improvements to workplace conditions, the factory-appointed safety officers used their newly acquired qualifications to find better paying employment in other industries. Faced with the high turnover in safety officers, it became apparent that the adidas Group-led training was not sustainable and a more institutional approach was needed; one that would build capabilities at an industry level.

FORMING THE ACADEMY

In 2007, the International Sustainable Community (ISC) – a US-based development NGO – approached the adidas Group, General Electric (GE) and a number of other global companies, with the idea of creating an Environment, Health and Safety (EHS) Academy, to expand the pool of qualified EHS managers in southern China. The initiative had the backing of USAID and the GE Foundation. A partnership was formed with Lingnan (University) College's Business Faculty in Guangzhou, who offered to host the EHS Academy.

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In 2009, the Academy received official endorsement from the Guangdong Bureau of Labour and Social Security and is now developing a professional, government-sanctioned EHS certification.

THE ADIDAS GROUP'S CONTRIBUTION

From the outset, the Academy drew on adidas Group's industry leadership in supplier-focused health and safety training and our extensive knowledge and experience in working with suppliers in southern China. One of the major contributions made by the adidas Group to the programme was the sharing of our health and safety training modules and our subsequent work with the ISC/EHS Academy team to refine these materials into the EHS Academy's core curriculum. We continue to be deeply involved as a key partner of the EHS Academy and a member of the Academy's Steering Committee.

DEVELOPMENTS IN 2010

Since the launch of the Guangzhou-based EHS Academy, a second facility was opened in Jiangsu Province in 2010 to cope with the demand for building the capacity of EHS managers in northern China. The Jiangsu Academy has focused in particular on environmental aspects and energy management. Building on the lessons learned from the setting-up of the two EHS Academies in China, the adidas Group has been liaising closely with ISC over the prospect of establishing a similar training centre in other sourcing countries in Southeast Asia.

OCCUPATIONAL HEALTH AND SAFETY OFFICER (OHSO) PROGRAMME

The adidas Group's Social and Environmental Affairs (SEA) department launched a Safety Officer programme in 2006 to support internal health and safety within the supplier base in Asia Pacific. Over the past four years that programme has continued to mature, integrating additional practices and requirements and building on the lessons learnt in the delivery and uptake of the training by our suppliers. In October 2010, we launched a new and upgraded Occupational Health and Safety Officer (OHSO) programme to strengthen the technical capability of the safety teams within our key business partner's factories.

COURSE DESIGN

The new OHSO initiative has been designed as a three-year programme and is aimed at the occupational health and safety practitioner or other key individuals in a factory who are responsible for delivering health and safety in the workplace. With due consideration to the various types of manufacturing facility in the supply chain, a standard OHSO Guideline document was developed in which the minimum number of qualified OHSO personnel required by factory size (defined by worker numbers) and pre-qualification requirements are stipulated, and an outline of the individual courses provided. It also caters for different levels of knowledge and reflects the required participation from different management levels (from basic committee, to coordinator, to management level) to help ensure the flow of knowledge and encourage discussion between the different members within the same factory.

The courses are categorised in one of three modules, with topics ranging from Fire Safety to First Aid, Communications to Chemical Management. These courses include topical elements drawn from our revised and updated Health and Safety Guidelines which were launched in April 2010, as well as more technical aspects such as Crisis Management. The training materials have been developed by our own in-house technical specialists and translated into key local languages to help both trainer and trainees.

GETTING PEOPLE ON THE COURSE

As some countries have their own formal safety officer training and recognition schemes, SEA reviews each applicant, to assess the level and extent of training that is appropriate for them.

At the end of December 2010, we had over 250 trainees, representing 174 suppliers, in Asia Pacific attending the Module II – OHS Sustainability and Management, with another 150 trainees to participate in the second round of the first course topic in Q1 2011.

MONITORING COMPLIANCE

Over the past ten years, we have continually refined our methods, tools and techniques to monitor and promote social compliance in our supply chain.

We have adjusted our methodologies and tools to the different sourcing relationships the adidas Group has in place with supplier factories. The two models, direct sourcing and indirect sourcing are summarised below.

Approach	Sourcing model	
	Direct supply chain	Indirect supply chain
Goal	Self-governance	Accountability and risk management
Factory Assessments/ Monitoring conducted by	adidas Group SEA team	External monitors commissioned by SEA
Assessment tools applied	Strategic monitoring tools	Performance assessments
	Compliance plans	Compliance plans
Subject of rating	Individual supplier factory	Business entity responsible for sourcing relationship
Rating tool	SEA KPI	Compliance scorecard

MONITORING OUR DIRECT SUPPLY CHAIN

The strategy applied to our direct suppliers is based on a long-term vision of self-governance in our supply chain where suppliers take ownership of their compliance programme. To achieve this, we need to act both as assessors and advisors – assessing management commitment to compliance and the effectiveness of the programme, and providing help and support to suppliers to ensure success in the long term. We promote effective human resources, health, safety and environmental management systems as an effective way to internalise continuous improvement. Strategy development and execution must be in the hands of qualified, committed and capable middle managers who are supported and empowered by senior management. The Lean manufacturing initiative and SEA activities strive to be collaborative and ensure that suppliers establish systems that support fair, healthy and safe work conditions and deliver improved efficiency and productivity.

Factory inspections are conducted by members of the SEA team. By applying innovative monitoring practices they assess risks and identify root causes of non-compliances. This approach evaluates the effectiveness of factories' compliance systems and in turn leads to a more precise evaluation of training needs.

Factories are required to develop strategic compliance plans (SCP) in which they outline their strategies to meet our Standards. The plans include targets, programmatic actions, planned investments and timelines.

Factory performance is measured annually through a key performance indicator (KPI) which is linked to our Sourcing organisation management and tracking systems.

MONITORING OUR INDIRECT SUPPLY CHAIN

While the major product volumes are sourced through our direct supply chain, some adidas Group business entities follow their own sourcing arrangements. Normally these business units do not establish direct supplier relationships but source products through intermediaries such as agents. We also develop new market opportunities for certain product categories through agreements with licensees who independently manage production.

Business entities are obliged to commission external audit firms to carry out initial assessments in their supplier factories. Business entities or licensees choose external monitors from a list drawn up by the adidas Group.

We have developed detailed guidance so external monitors can conduct assessments in a consistent way. Where these assessments identify the need for remediation processes, they are overseen by the SEA team.

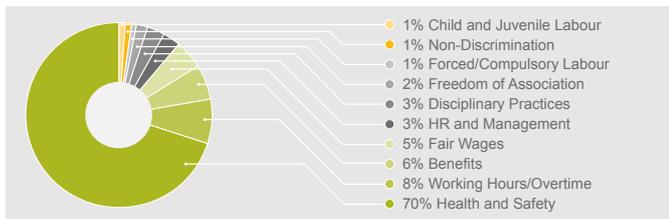
Business entities and licensees are required to submit an SCP to SEA on a regular basis. Similarly to our direct suppliers, these plans outline their strategies, programmes and action steps to ensure compliance in their supply chains. The compliance plans help us track and evaluate the commitment and effectiveness of our business entities' management in ensuring sound compliance practices. SEA then reviews annual progress against the SCP, measures the results, and issues a Business Entity Report Card. Find more information in the Strategic developments section on page 54.

RECORDING NON-COMPLIANCES

All inspection records including factory audit reports, assessment results and remediation plans are centrally stored in the Fair Factories Clearinghouse database, which has been specifically designed as a sharing platform. We share our findings and develop common agreed action plans with other brands in order to reduce audit fatigue for our suppliers, to standardise and harmonise remediation efforts and to create leverage to drive sustainable compliance.

The following graph illustrates the common non-compliances in our supply chain. The reported non-compliances are dominated by health and safety issues, largely as a result of Initial Assessments identifying and requiring the remediation of occupational health and safety practices to meet our minimum requirements. This results in a high frequency of non-compliance in what can be viewed as safety fundamentals, such as the presence and storage of chemicals in the workplace, fire safety and electrical and mechanical safety

Non-compliances at our existing suppliers by issue type



The ten most occurring health & safety issues are:

1. Chemical Storage
2. Hazardous Chemicals in Production
3. Architectural Considerations: Emergency Exits & Aisles
4. Management Systems for Safety & Health
5. Emergency Preparedness
6. Electricity & Electrical Hazards
7. Machinery & Proactive Equipment
8. Fire Safety: Fire Extinguisher, Hose Reel & Hydrant
9. Housekeeping
10. First Aid

WORKER HOTLINES Q&A

More than two years ago, the adidas Group engaged independent Chinese NGOs to act as contact points for workers employed in the adidas Group supply chain. China Labour Support Network (CLSN) launched their hotline in 2008, and Handshake – a newly formed NGO in southern China – launched the second hotline in 2010. Workers from more than 400 employers (including directly and indirectly sourced factories) have access to these hotlines.

Derek Wang is a Senior SEA Compliance Manager based in our local office in Guangzhou, China, and he looks after the worker hotlines. Here he explains the importance of the hotlines for understanding the scope of non-compliances and helping workers.

Q: How do you feel worker hotlines help the adidas Group to protect the rights of workers?

A: The hotlines provide us with an opportunity to have the workers equipped with the knowledge of the law and health and safety so that they are aware of their rights and the right way to protect themselves from risks in the workplace. We can intervene when there are conflicts between the workers and management. The hotlines create a platform for workers to discuss solutions before pursuing legal action against a factory. We also guide the factory management with remediation plans to improve the internal grievance systems for handling individual cases, to mitigate the risk of conflicts and to prevent reoccurrence.

Q: How do you safeguard the workers against retaliation when they bring grievances forward to the hotline?

A: A confidential agreement was signed with the service providers. Workers' privacy must be protected. Workers can choose either anonymous reporting or to leave their details with the hotline service provider. When publicly reporting complaints, we remove specific details to protect the complainant.

Q: Can you list the most frequent grievances brought forward by the workers?

A: More than 60% are labour rights infringements such as excessive working hours, wage payment and overtime compensation, labour disputes etc. But workers also call up to share their personal issues, the break-up of relationships, homesickness and loneliness.

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Q: How can we be sure the hotline numbers are actually posted in the factories? Additionally, is there any other means of advertising that there is such a number to call?

A: We think that posting the hotline number is not necessarily a true indicator of good social and environmental performance on the part of the factory management. It is better to do a physical inspection and interview workers about their knowledge or use of the hotlines. Tracking the frequency of calls is another important indicator.

We advertise the hotline numbers by posting the phone numbers inside the factory, the dormitories or other areas within the compound and our business cards have the numbers on, too. In cases where we find management preventing the workers from using the hotline, we train employers and employees on hotline process and practice, and adjust the factory's KPI rating if they are not as open and transparent as we wish.

Q: Are there any other grievance channels for the workers to use?

A: We post SEA team email and postal addresses. The factories should maintain suggestion boxes, internal newsletters and communication notice boards. And there's always an opportunity for workers to raise issues with us during our audit interviews with them.

Q: In 2009, Juliana So from CLSN said that the hotline number in China has succeeded because of the commitment and partnership of CLSN and SEA field staff to resolve hard-to fix problems. What's your view on that?

A: Yes, some tough cases were resolved but there are relatively few lawsuits brought by workers in the adidas Group supply chain. The intention of the hotlines is not to prevent lawsuits, but to minimise grievances and urge the factory to abide by the law. But as we know, sometimes arbitration is the only way to resolve a conflict.

We have also seen cases where workers follow a lawsuit when they are not satisfied with internal compensation or settlements. This is particularly true for cases of physical injury. After recent legislation on tort liability law was introduced, workers can now claim civil rights as well as employment rights.

Q: Juliana So also said that another success story is the early interventions which reduce the need for legal actions between workers and factories, as well as providing workers with basic rights information and guidance.

A: It takes a long time to go through a lawsuit procedure. Most workers can't afford the time off or the lawyer's fee, so few of them pursue legal action. In the event where workers have decided to take legal action, the hotline's access to information and guidance on rights helped the litigating workers prepare their case and put them in a better position to negotiation with their employers.

Q: What improvement is needed from the hotline providers?

A: I find it critical to establish the workers' confidence in the hotline service, particularly for those who are calling in for the first time. Staff stability and turnover at the hotline centre is a challenge. Training is constantly needed to maintain acceptable qualities of service. It might be a good idea to have a standardised communications script for the hotline staff, too.

Q: What is the future of worker hotlines? What is the best scenario?

A: We would like to see additional services provided to build capacity for problem-solving, and expand the work that brings the complainant and the management together to solve problems. Our own internal SEA staff need more training to improve how we follow up incoming hotline grievances. More promotion of the hotline services is critical to increase uptake by workers and management.

VERIFYING COMPLIANCE

The adidas Group has played a pivotal role in the maturation of the Fair Labor Association (FLA), a tripartite organisation of companies, universities and NGOs dedicated to the sustainable improvement of workplace conditions.

Through the FLA, we seek to verify the efficacy of our programme activities and to publicly report those activities to stakeholders. As a participant in the FLA, the adidas Group commits to:

- Uphold the FLA's code of conduct and standards
- An extensive internal monitoring of our supply chains
- External monitoring and evaluation by independent monitors
- Remediate and prevent instances of non-compliance
- Participate in the FLA's third-party complaint system
- Public reporting.

The FLA accredited the adidas Group's compliance programme in 2005, and re-accredited the programme in 2008. The next review and accreditation cycle is scheduled for 2011.

For the past nine years FLA-accredited independent monitors have conducted monitoring visits to suppliers of the adidas Group. In 2010, FLA monitoring exercises included four monitoring audits and one external verification visit. Additionally, the adidas Group participated in FLA-sponsored activities dealing with fair wages, the Prepare Project in Bangladesh which develops worker-management communication mechanisms and the Sustainable Compliance Initiative and monitoring methodology.

More information can be found in the Performance section on page 72.

Read more about the FLA's monitoring activities on their website at http://www.fairlabor.org/what_we_do_public_reporting_b3.html

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ENFORCEMENT

The Enforcement Guidelines cover the principles of enforcement of the Workplace Standards, and those sanctions or remedies we will apply where the Standards are breached. Such sanctions or remedies include:

- Termination of the manufacturing agreement – in situations of severe or repeated non-compliance
- Stop-work notices – in life-threatening situations or where the manufacturing process is likely to have significant negative consequences for the environment
- Third-party investigations – where persistent or repeated violations of the Workplace Standards or local laws have become a matter of public interest
- Warning letters – in cases of ongoing and serious non-compliance
- Reviewing orders
- Commissioning of special projects – to remedy particular compliance problems.

TWO TYPES OF NON-COMPLIANCE

Breaches of the Workplace Standards are categorised into **zero tolerance** points and **threshold issues**. Zero tolerance includes prison labour, serious, life-threatening health and safety conditions and repeated or systematic abuse. Any finding or reported finding of a zero tolerance elicits an immediate and urgent engagement with a supplier. If the zero tolerance is verified, then the Enforcement Guidelines call for the supplier's disqualification from the adidas Group's supply chain.

Threshold compliance issues include serious employment issues, serious health, safety or environmental issues and any combination of the two. The Enforcement Guidelines for threshold issues can disqualify a new supplier from production or lead to enforcement actions with existing suppliers.

WARNING LETTER SYSTEM

We strongly believe in a partnership approach, and where a supplier is performing poorly in terms of Workplace Standards compliance, we will work closely with them to find solutions. However, where we find ongoing and serious non-compliances and a lack of commitment on the part of the management to address the issues, we will, when appropriate, issue a formal warning letter.

For threshold compliance issues, three warning letters will usually result in an immediate recommendation to terminate. In very serious cases or in cases of zero tolerance level non-compliance, a single 'stop work' letter will be issued advising the offending supplier that SEA has recommended the business relationship be terminated. Our Sourcing, Business Unit and Legal departments would then follow up with a formal notification to end the business relationship.

In 2010, issuing warning letters was the most common enforcement practice followed. No 'stop work' notices were issued.

Third party investigations were initiated in Central America to address the illegal discharge of workers, insufficient compensation and breaches to the freedom of association. In at least one case, these investigations were done at a

factory where we no longer had a business relationship, so warning letters would not have been an effective sanction. The investigations provided transparency and verification that the requisite corrective actions were taken.

See the tables showing numbers of warning letters, terminations and rejections on the Enforcement data page in the Performance section on page 84.

RATING SUPPLIERS

The SEA Key Performance Indicator (KPI) is a rating tool to evaluate our direct suppliers' social compliance resources, capability and performance in a comprehensive way.

The SEA KPI comprises six fundamental elements of social compliance that are described as Units of Measure (UoM):

- 1. Measuring management commitment and responsiveness** to a strategic compliance plan. This planning document defines each unit of measure from the supplier KPI so there is a direct linkage between 12-month compliance activities and opportunities for improvement identified during SEA monitoring. Additionally, the plan spells out details for employee retention, compliance-related investment, relationships with third parties and local government, crisis management and project development on critical compliance issues.
- 2. Measuring supplier management systems for HR and HSE** includes an evaluation of certifications for environment and health and safety, development of HR and HSE systems, retention of qualified professionals for those management systems and internal audit assessments of labour and HSE practices.
- 3. Measuring worker-management communication and industrial relations** focuses on the factory's ability to resolve disputes, respect forms of worker representation, develop effective grievance procedures and promote sustainable worker-management communication. There is an evaluation of the communication committee's effectiveness and sustainability and the training needs assessment used by the factory to develop worker and management training.
- 4. Measuring the delivery and effectiveness of internal training for factory staff** focuses on the process for a training needs assessment, the scheduling and execution of the training programme and the budget allocated for training. Trainers are evaluated for their skill, knowledge and experience. Factory records for training and the protocols for reporting these activities are also reviewed.
- 5. Measuring transparency in communication and reporting** focuses on pro-active factory reporting of self-assessment audits and action plan progress. There are additional benchmarks for determining if workers are coached, verification of document authenticity and communication of the Workplace Standards to the workforce and subcontractors.
- 6. Measurements for compliance activities** that focus on the factory's management response to findings of non-compliance, remediation or enforcement actions.

The factory UoM scores create a KPI cumulative score that falls in one of the following performance bands:

Grade	KPI score band	Performance description
1C	0-29%	There are numerous severe non-compliance issues. There are no compliance management and compliance practices in place. The factory has been given notice that business will be terminated unless there is immediate improvement.
2C	30-59%	There are some non-compliance issues and no compliance management systems. However, there are some effective compliance practices being delivered.
3C	60-79%	There are minor non-compliance issues. The factory has compliance management systems and some effective compliance practices in place.
4C	80-89%	Generally there are no non-compliance issues. The factory has compliance management systems in place, and most of the components are effective.
5C	90-100%	There are no non-compliance issues and all of the factory's management systems and practices are well delivered and effective.

These KPI ratings were used to inform the clusters approach we have developed this year (see overleaf).

The Performance section on page 82 contains the KPIs of our active suppliers and how these have developed over the last three years.

A separate Environmental KPI was piloted with selected factories in Asia during 2010. This KPI is described in the Environment section on page 33.

SOURCING DECISIONS

ALIGNMENT WITH SOURCING MANAGEMENT AND TRACKING TOOLS

The Global Apparel Strategic Alliance (GASA) is an ongoing programme aimed at building a world-class sports apparel supply base that is capable of meeting our business needs. GASA has been built on the principle of continuous improvement and rewards suppliers for their performance and fit with Global Apparel Sourcing's needs.

Embedded within GASA is a core requirement for qualifying Tier 1 suppliers to meet a minimum SEA Compliance KPI score of 60%. This is only one of a number of basic expectations established by GASA for qualifying suppliers; others include product availability, price and quality. GASA has also incorporated forward-looking strategic targets for the sustainability performance of our suppliers.

FIRST MILESTONES

It began in 2006 by communicating to the supply base a set of milestone targets, with an emphasis on operational results such as delivery performance and production capacity. Since then the milestones have evolved to cover more process excellence criteria and capabilities which are deemed to be essential to support speed, agility and connectivity with our brands and subsidiaries.

INVOLVING SUPPLIERS

To engage all key stakeholders in the setting of milestones, GASA established an Advisory Board which has met regularly since 2009 to formulate the blueprints for future milestones. The Board is made up of senior sourcing managers, brand representatives and other internal departments who work closely with the apparel supply chain, such as Continuous Improvement and Social and Environmental Affairs (SEA). In an effort to foster a genuine partnership with the supply base, the Board also comprises senior executives from our Tier 1 garment manufacturers and Tier 2 material suppliers.

FROM APPAREL TO FOOTWEAR

Building on the approach first adopted by the Apparel Sourcing team, in late 2009 the Global Footwear division launched its strategic initiative – the Footwear Advanced Capability Track Program, or FACT. As with GASA, FACT is a vehicle for establishing and communicating future capability needs to our Tier 1 and Tier 2 suppliers through the setting of milestones and mid- and long-term goals. It drives the development of a supply base with innovative and industry-leading capabilities to deliver adidas Group requirements now and for the future.

FACT is also seen as a transparent tool to qualify and segment the footwear supply chain. It aims to develop future potential with respect to such aspects as competitiveness, continuous improvement, speed/agility, connectivity, and sustainability to shape the future of the footwear supply chain as well as continue to deliver basic supplier performance around four core supply chain capabilities: quality, delivery, costs and SEA compliance.

Similarly to its apparel counterpart, the Global Footwear team formed an Advisory Board to help setting the vision for the future, develop a strategic roadmap and regularly review and update FACT milestones. The Board includes Footwear Sourcing management, key internal stakeholders such as brand representatives, Continuous Improvement, Social and Environmental Affairs (SEA) as well as senior executives from selected Tier 1 footwear manufacturers and Tier 2 material suppliers. The Board meets bi-annually.

To ensure consistency across the sourcing business, the sustainability milestones adopted for GASA and FACT are closely aligned and linked with the Group's 2015 Environmental Sourcing Strategy, which has identified specific energy saving, water and waste reduction targets, as well as SEA's strategic compliance model which promotes the development of internal systems and management capacity to achieve supplier self-governance. See Managing our suppliers on page 45.

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2010 OUTCOMES

In 2010, the selected milestones for delivering sustainability under GASA and FACT included:

- The suppliers' acceptance and review of environmental best practice guidelines
- Progress against implementing ISO 14001 and OSHAS 18000 management systems
- Preparation of environmental metrics to create a baseline of environmental performance data
- The completion of effective internal compliance audits.

By integrating basic compliance and long-term sustainability into the sourcing management tools and performance measurement systems, our key business partners are able to understand how their social compliance score is one factor in determining our ongoing business relationship together. They can see how they rate against each other, and this transparency and integration with sourcing decisions is fundamental to the success of our efforts to drive improvements in workplace conditions.

STRATEGIC DEVELOPMENTS

THREE CLUSTERS

To better use resources of our SEA team and achieve more effective and sustainable compliance outcomes, we spent 2010 fine-tuning our strategic approach to specific levels of supplier performance. We have identified three clusters of supply chain profile that are based on a factory's KPI compliance rating:

- The **Risk Management** cluster includes those factories scoring at 1C or 2C – about 67% of our supply chain
- The **Partnership** cluster includes 3C factories – about 25% of our supply chain
- The **Self-governance** cluster is composed of 4C and 5C factories – about 8% of our supply chain.

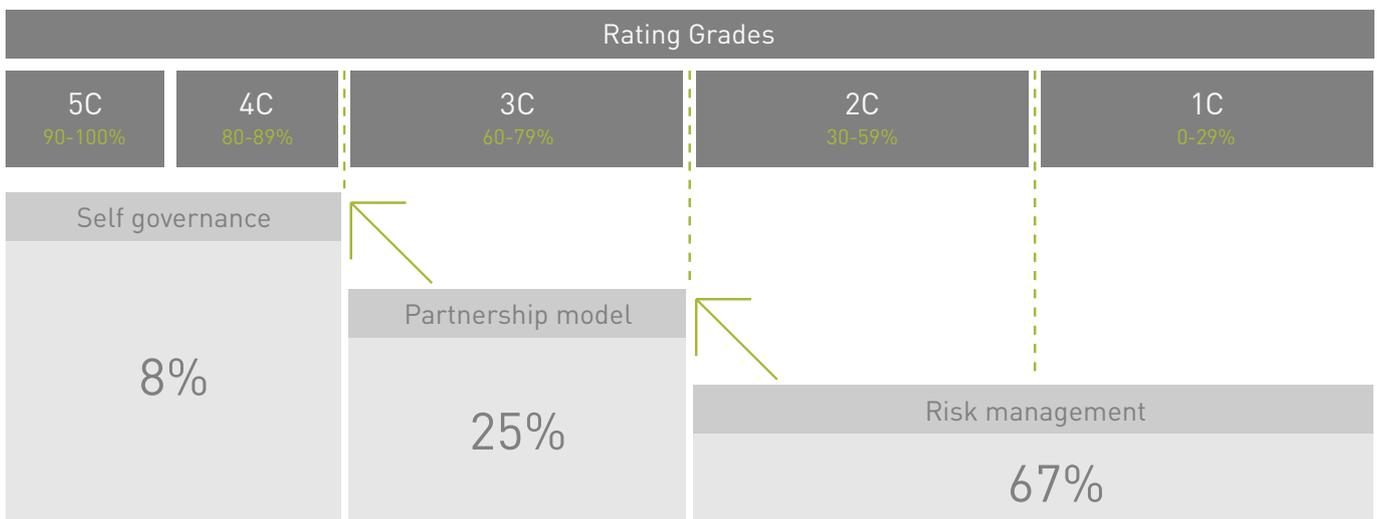
TAILORED APPROACHES

In the Risk Management cluster, factories have made little or no progress improving performance against the KPI units of measure. The compliance activities, if they are executed, are generally ineffective or weak. In 2010, we have focused our monitoring on identifying and managing threshold and zero tolerance compliance issues. The future outlook for suppliers in this cluster includes dedicated attempts to transition them to the partnership cluster or identify exit strategies for the lowest performers who do not improve their performance.

In the Partnership cluster, factories have shown acceptable compliance performance. Our approach here is on collaborative monitoring activities with other brands and multi-stakeholder initiatives. Noteworthy in 2010 was the rollout of harmonised corrective action plans, where all buyers from a factory agree to one set of remediation activities. The future outlook for suppliers in this cluster is a strong capacity-building programme to improve compliance performance and further harmonised auditing activities with other companies and multi-stakeholder initiatives.

Factories in the Self-governance cluster manage their own compliance activities in a verifiable and transparent manner. These suppliers have all shown a strong commitment to compliance and are guided by three-year Strategic Compliance Plans. They have effective management systems in place for employment and health and safety, and employ a capable compliance organisation. They promote good industrial relations and employer-employee communications as well as train their employees in sustainable compliance policy and practice. They embrace a transparency mindset. Notable 2010 self-governance activities included factory participation in the ILO's Better Work programme and as FLA participating companies.

Three compliance performance clusters of our supply chain (2010)



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OTHER OUTCOMES THIS YEAR

- In 2010, we started to link our Human Resources Management Systems approach with the emerging audit methodology for the Sustainable Compliance Initiative (SCI). The SCI focuses monitoring on the stages of the employment life cycle, from recruitment through to leaving employment.
- We issued 55 Business Entity Report Cards this year, more than double the previous year's number. This reflects our commitment to embed SEA and sustainability policies and practices in the business entities of the adidas Group. The activities that informed the Report Cards show an extension of our monitoring coverage of the indirect supply chain and the Report Cards themselves track and measure the success of the business entities in sourcing responsibly.
- The Strategic Compliance Plan (SCP), a rolling three-year roadmap for compliance activities, was simplified and expanded to more of the supply chain this year. At the end of 2010, there were more than 330 suppliers working on SBPs. 85% of these suppliers are in China, Indonesia, Thailand and Vietnam. This not only increased the integrity of the Key Performance Indicator scores (factory ratings) but helped guide collaboration activities with other buyers in shared factories.
- We increased collaboration with other brands in shared factories and focused more attention on harmonising or creating common corrective action plans, specifically in Brazil, Indonesia, and Mexico. In China, we led a brown shoe industry partnership with nine other global brands to harmonise our guidance to Stella, one of the world's largest shoe manufacturers, so they could deliver one set of corrective actions to satisfy all their major customers.
- Supporting the direct field work were numerous engagements with governments to more rigorously enforce their national laws or trade agreements, especially in El Salvador, Indonesia, USA, Honduras, Madagascar, Mexico, and increased support from the commercial and business units of the Group to communicate and enforce SEA expectations and compliance.

Read more about our engagement with stakeholders on page 11.

SHARING COMPLIANCE INFORMATION

Here Selcuk Buyukozer, SEA programme operations manager in the Americas region, discusses sharing supplier compliance information and collaborating with other brands.

Q: How do you manage the compliance performance data of your supply chain?

A: We have been using the Fair Factories Clearinghouse (FFC) as our compliance database since 2006. All the factories are added to this system by our Sourcing colleagues and the factories are audited either by our team or by an authorised External Monitoring (EM) company. All these audit reports are archived in the FFC.

Q: How do you share compliance data and reports, and with who?

A: The FFC developed a new feature in 2008, enabling its member companies to share information regarding factory audit reports, corrective action plans and other related documents. Besides the adidas Group, there are major US retailers and brands like Wal-Mart, Nike, Levi's and Timberland using the FFC sharing platform. We started sharing audit information in November 2008, and we have been sharing our audits in the system with all the other FFC members since then.

Q: What are the benefits of sharing compliance data with other companies?

A: Some of the major ones are that suppliers receive more consistent code of conduct communication from FFC member companies and fewer audits are needed, saving resources for both companies and suppliers.

Q: Is there any compliance information that you do not share?

A: Yes. We do not share:

- Any information regarding worker names and other confidential information that can be harmful to workers
- Pricing and sanctions, production volumes, sales forecasts
- Factory ratings, compliance approval and designations
- Any other competitive information.

Q: What does it mean to collaborate on supply chain compliance?

A: For the compliance world, I can define collaboration as partnership activities among brands to improve the workplace conditions in shared factories. Collaboration can happen in many different areas such as sharing audit reports, conducting joint audits, working together on remediation and capacity building.

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Q: What does the adidas Group actually do to promote collaboration on compliance?

A: We believe that collaboration is a step forward from just sharing audit information. We prefer to develop harmonised Corrective Action Plans (CAP) for a factory working together with the other brands and the factory itself. The FFC provides a very effective structure for that. With the involvement of the factory, CAPs from different brands can be combined in the FFC and a harmonised CAP can be developed.

Q: What is the benefit of a harmonised Corrective Action Plan?

A: First of all, the factories do not need to respond to different CAPs anymore. By reporting their remedial actions into the harmonised CAP, factories will be able to fulfil all the brands' CAP requirements.

Going forward, brands might also choose to do audits consecutively and update the harmonised CAP. That will again avoid multiple audits and CAPs done at the same time identifying similar issues.

Collaboration is also very beneficial for the brands because we are using our resources in a smarter way.

Q: What else would you like to say about collaboration and compliance data sharing?

A: In addition to the audits, we are also evaluating the compliance performance with the Key Performance Indicator (KPI) scorecard. As a result of the KPI assessment, the factory gets a score out of hundred. Factories with a score of 80% and higher are managed through our new Self-governance model (read more on page 54 in the Strategic developments section).

These factories already have established human resources and health and safety management systems and have internal audit programmes. We decided not to audit these factories any more but to focus on evaluating and improving their self-governance performance. By doing that, we are able to prioritise our team's time and effort to support those factories which scored less than 30%.

We are also ready to collaborate with organisations who have credible compliance programmes such as the Fair Labor Association or multi-stakeholder initiatives such as Better Work.

IMPROVING COMPLIANCE PERFORMANCE IN INDIA

The following case study looks at our 2010 efforts to improve performance with the lowest scoring suppliers (1C) in our Indian supply chain.

In the past few years, India has enjoyed strong economic growth. Over that period the adidas Group has increased its sourcing activities in India, for the international export market but even more so to fulfil domestic demand.

CHALLENGE TO IMPROVE COMPLIANCE LEVELS

We have faced an ongoing challenge to upgrade the compliance performance of our suppliers in India. Some of the challenges arise because too few suppliers appreciate the importance of sound compliance practices for their operation, nor do they recognise them as a competitive

advantage in their industry. The slow pace of improvement in workplace conditions shown by the majority of the suppliers there has become a real concern for us. It is supported by the fact that the numbers of suppliers with the lowest compliance KPI rating of 1C in India are higher in proportion compared to other countries in the region.

DEVISING A PROGRAMME WITH SOURCING

These challenges prompted us to develop an approach based on partnership, transparency and establishing mutual trust. Supported by our Sourcing organisation we devised a 15-month improvement programme which was launched in September 2010 and will be implemented in several stages through 2011.

The short-term goal of this programme is to ensure all suppliers will reach at minimum a 2C compliance rating by the end of 2011. The longer-term goal is to establish a firm foundation of partnership working and build the capacity of the suppliers so that they can continuously improve their compliance performance in a sustainable way.

The compliance improvement programme is structured as follows:

1. PREPARATION STAGE
 - Supplier summits: a high-level briefing about the programme for the suppliers' top management and the local sourcing management
 - Suppliers are to develop comprehensive action plans to address chronic non-compliance issues and upgrade their overall compliance management system
 - SEA staff to provide consultation for each supplier on their action plan.
2. IMPLEMENTATION STAGE
 - Suppliers are to execute the action plans as per the agreed timeline
 - Progress Pulse-check: KPI assessment will be done to measure the progress in December 2010/January 2011
 - SEA is to monitor the progress of the implementation, provide technical advice as needed and engage external consultants should there be a need for additional resources to support factory improvement.
3. MEASUREMENT AND EVALUATION STAGE
 - Suppliers are to execute the action plans as per the agreed timeline
 - Ongoing consultation with SEA on the progress of factories' action plans
 - Final evaluation – KPI assessment will be conducted by the end of 2011 in all factories.

We strongly believe that direct collaboration between SEA, our Sourcing organisation and suppliers is the most effective way to deliver a sustainable compliance model at the factory level. It fosters a stronger partnership with our suppliers and provides them with the necessary support and encouragement to improve workplace conditions.