



**This report is about the efforts we make every day to meet
the different challenges we face around the world.**

It's about what it takes to make progress in all kinds of business conditions,
at every operating level. It's about striving to be better, by constantly improving
**our skills or adapting and developing our techniques – never
standing still and assuming that tomorrow will be the same as today.**

Above all, it's about having focus, being agile and having not just the passion,
but the commitment to keep moving forward.

Contents

adidas-Salomon is a global sporting goods company that outsources the majority of its production. This report describes our Group-wide goals, strategies, programmes and actions for improving working conditions in our supplier factories and reducing our environmental impact as a business.

Where it is not possible to report on the whole Group, we make this clear.

The report covers the calendar year 2004 and is issued with our annual financial report.

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CEO statement

Herbert Hainer, CEO and Chairman of the Executive Board, introduces the report and summarises our successes – and failures – in our journey towards becoming a sustainable business.

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Our business and how we operate

This section sets the context for the rest of the report. It first covers key facts about the Group and summarises our financial performance.

We then explain the way our core values underpin our approach to sustainability and how the challenges we face inform our corporate governance structures and management processes.

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Our stakeholders

We understand that our programme must address the concerns of our various stakeholders and are keen to hear their views.

Through worker dialogues, meetings with Socially Responsible Investment (SRI) analysts and collaborating with Non-Governmental Organisations (NGOs) and other sports brands we improve our understanding of the issues and how to address them.

The workers in our supply chain are the focus for much of our work. This year we have begun to explore new ways of engaging with them and hearing what they have to say about how our programme is – or is not – improving their working conditions.

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Improving the way we work with suppliers

To achieve sustainable compliance in our supply chain, we have adopted a strategic monitoring approach that evaluates more than compliance with our standards. It also evaluates the management systems in place and their effectiveness.

This year we have succeeded in revising our five-star factory rating system, which will now grade suppliers on how effective they are at delivering fair, safe and healthy workplace conditions.

Our footwear suppliers' factories have been working to reduce emissions of volatile organic compounds, which are chemicals that can cause breathing difficulties. In 2004, the level fell to an average of 22 grams/pair – below the 2007 European standard.

The Global Reporting Initiative's Sustainability Reporting Guidelines help us to identify, structure, evaluate and to present key issues of the report. On page 58 we provide an overview detailing where we already meet the recommendations and where there are gaps in our reporting. To show progress we have made in 2004 compared to previous reports, we have highlighted those GRI sections that are reported for the first time this year.

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Employment, health and safety performance

We will soon be requiring our suppliers to establish management systems for Human Resources (HR), Health and Safety, as they will help achieve self-enforcement and sustainable compliance. We continue to support our suppliers in implementing these systems, and with other brands we are developing an industry standard for an HR management system.

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Environmental performance

We aim to design out environmental problems although market demands need to be balanced with this ambition. We promote a management systems approach here too and provide specific training for our suppliers, such as help with identifying performance indicators.

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Community involvement

Our approach to community involvement is decentralised, which allows our Group entities to respond to local needs. We are introducing guidelines to help our headquarters and Group entities manage their community-giving programmes more effectively.

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Progress and next steps

This chapter summarises our progress against targets in 2004 and our targets for 2005. It also includes an index showing where we fulfil the requirements of the Global Reporting Initiative.

Scope of the report The report refers to the objectives and targets set out in last year's report, explaining where we have and have not made progress, and describes clear targets for 2005. In some instances we refer readers to further information available in the Group's annual financial report and on our corporate website. This report responds to legitimate stakeholder interest in the way we do business and this year our stakeholders told us that they want to know more about our internal processes. For this reason we have extended the scope of the report and incorporated basic information about the Group's internal social and environmental activities and the work of our Global HR team. This brings the report more into line with the Global Reporting Initiative requirements (see page 58).

Verification We recognise that some stakeholders want companies to ensure that the content and data disclosed in sustainability reports is independently verified. While we strive to continuously improve our reporting systems for supplier monitoring data, we feel that much of this data, in particular, data on labour conditions, is not always verifiable in a standardised way. Therefore, at this stage a report verification would not add value. We do, however, believe that independent verification of workplace conditions and of the processes and monitoring approaches we adopt in our compliance programme is important. For this reason the report does contain information that is subjected to an annual review by the Fair Labor Association. We also refer to data verified when supplier factories or our own facilities were certified to ISO, EMAS and OHSAS standards.

CEO statement

Successful sportspeople rise to the challenges they face whatever the circumstances are. In the same way, as we strive to be a global leader in the sporting goods industry, adidas-Salomon is committed to taking on challenges – at home or away – wherever we operate.

Internally, engaging the attention of employees and aligning policies and procedures in more than 100 countries is demanding. Externally, the end of the Multi-Fibre Arrangement (MFA) and the removal of apparel quotas are bringing significant structural changes to the apparel industry as a whole. We are convinced that we are well placed to manage this change.

In our fifth Social and Environmental Report we record our achievements against our 2004 social and environmental targets and publish our goals for 2005.

Listening to stakeholders is fundamental to our approach. This year, in all regions, we held intensive dialogues with workers in our suppliers' factories. The wellbeing of these workers is at the heart of our social engagement, and their feedback provides a true measure of its effectiveness.

We have improved how we enforce compliance with our standards by rigorously vetting new suppliers, publishing new guidelines and applying a system of warning letters. But the value of inspecting compliance with individual standards is limited – our suppliers need to manage the process and achieve 'sustainable compliance' proactively. We made significant progress in 2004 by defining a new set of performance indicators that measure the effectiveness of suppliers' compliance activities. To complement this strategy, we have adjusted the focus of our supplier training. Similarly, our revised performance evaluation and planning process for annual staff reviews not only identifies particular skills and competencies we need in order to do our jobs, it also aligns management and employees behind a shared commitment to continuous improvement.

Stakeholders require businesses to be accountable for their actions and we are committed to acting responsibly and reporting transparently. Since 1999 we have been a participating company within the Fair Labor Association, which independently audits a number of our suppliers and reports the results publicly. This year detailed HR information appears here in our report, bringing us closer to fulfilling the requirements of the Global Reporting Initiative (GRI). Our efforts have been registered by market indexes: for the fifth consecutive year adidas-Salomon is listed as a leading company in the textiles and apparel sector on the Dow Jones Sustainability Indexes and we are also included in the FTSE4GOOD Europe Index and on Ethibel's ESI Europe Index.

While we have achieved much in 2004 we did not meet all our goals.

Promoting continuous improvement throughout our supply chain is an ongoing challenge. Although we require our main suppliers to monitor the performance of those who supply them with materials and components, we have not yet fully established the tracking system and training programmes to help our suppliers achieve this.

We reviewed the community involvement activities undertaken by our Group entities and our suppliers, but developing a Group-wide strategy is taking longer than we expected. However, we continue to be responsive to needs. I personally enjoyed being part of a local charity event in Herzogenaurach during the EURO 2004 Football Championships, supporting leukaemia treatment. Along with many other companies and individuals around the world, adidas-Salomon and its employees contributed resources to aid the rebuilding of the communities so tragically affected by the Indian Ocean tsunami.

In 2005 we remain committed to meeting the challenge of achieving self-governance in our supply chain. We will be expanding our strategic monitoring approach to achieve more long-lasting improvements in workplace conditions. We will be launching new guidance materials to help our small- and medium-sized business partners internalise improved working practices.

We also need to integrate further our social and environmental affairs programme and other Group activities. For example, the new factory rating system will be incorporated into the overall supplier scoring scheme. We will continue to explore the synergies between our Lean efficiency programmes and the health, safety and labour rights of workers in our supply chain. Internally we will be further addressing work-life balance issues, promoting our diversity management and focusing on our goal to become a true Corporate Citizen.

On page 57 of this report you can read the targets we have set for 2005. These will not be easy to achieve, nor should they be. But with the commitment of our team and by working together with our stakeholders I am convinced that we can meet the challenges in the year ahead.



Herbert Hainer, CEO and Chairman of the Executive Board



Our business and how we operate

To form a view about our sustainability performance,
you need to have a clear picture
of our business, our values
and our approach to managing issues.

Group profile

With a share of around 15% of the world's sporting goods market, adidas-Salomon is a global industry leader. The Group consists of three major sports brands: adidas, Salomon and TaylorMade-adidas Golf. We serve wholesale and retail markets around the world, but also sponsor sports organisations, teams, individual athletes and sporting events.

OUR BRANDS adidas-Salomon offers consumers a broad range of sports brands across all sport categories, in all markets. adidas is a leading brand in the sporting goods market with strong positions in footwear, apparel and hardware.

The adidas brand is structured in three divisions: Sport Performance, Sport Heritage and Sport Style.

Salomon is our Freedom Action Sports brand. With leading positions in alpine, nordic and snowboard products, Salomon is actively expanding its presence in summer and alternative sports as well as soft goods. The Salomon family of brands comprises Salomon, Mavic-adidas Cycling, Arc'Teryx, Bonfire and Cliché.

TaylorMade-adidas Golf covers a full range of golf hardware, footwear, apparel and accessories. It markets products under the brand names TaylorMade, adidas Golf and Maxfli.

OUR OFFICES The Group and its more than 100 subsidiaries are directed from our headquarters in Herzogenaurach, Germany. Also based in Herzogenaurach are the business units for running, football and tennis as well as the major part of our research and development department. Other key corporate units are based in Portland Oregon, USA – the home of adidas America Inc, and the basketball, adventure and alternative sports business units. The golf business unit is based in Carlsbad, California, USA, and the winter and Freedom Action Sports business units are headquartered in Annecy, France. The Group also operates design and development departments in other locations around the world, corresponding to their business activity.

adidas-Salomon International Sourcing Ltd (aSIS), a fully-owned subsidiary with headquarters in Hong Kong, is responsible for worldwide sourcing. aSIS sourcing offices are located in Brazil, China, Indonesia, Korea, Pakistan, Taiwan, Thailand, Turkey and Vietnam.

OUR EMPLOYEES At 31 December 2004, adidas-Salomon employed 17,023 people. This represents an increase of 8.5% from the previous year.

adidas-Salomon employees represent a cross-section of cultures, ages and backgrounds. Women account for 45% of our employees. At our headquarters in Herzogenaurach, we have employees from over 40 countries. For more details about our employees, see pages 34-35.

SHARE LISTING The adidas-Salomon share is listed on the Frankfurt Stock Exchange as well as on all other regional stock exchanges in Germany. The stock is a member of the DAX-30, Germany's premier stock index.

SUPPLIERS adidas-Salomon works with more than 800 independent suppliers from around the world who manufacture our products in 65 countries. Of all factories, 60% are located in Asia, with 20% in the Americas and 20% in Europe and Africa. Together these factories employ over 430,000 workers, more than 85% of them live in Asia.

LICENSEES For some product segments or markets, adidas-Salomon has licensing agreements with independent companies that manage the design, development, manufacture and distribution of specific product lines. Currently, adidas has 19 licensees that source products from 136 suppliers in 24 different countries.

FINANCIAL PERFORMANCE Sustainability is as much about long-term financial stability and growth as it is about social and environmental performance. The tables on page 7 show our financial performance in 2004 and compare this with the previous two years.

adidas



Salomon



TaylorMade-adidas Golf



MAXFLI

Total number of adidas products manufactured¹

Product range	2004	2003	2002
Footwear (millions of pairs)	108.67	111.29	99.57
Apparel (millions of units)	157.64	146.72	129.30
Hardware ² (millions of units)	31.09	27.63	24.43

¹ international range excluding Salomon, TaylorMade and Mavic sports equipment

² accessories and gear

Total number of TaylorMade-adidas Golf products manufactured¹

Product range	2004	2003	2002
TAYLORMADE HARDWARE (MILLIONS OF UNITS)			
Woods	2.38	2.10	1.45
Irons	2.62	2.82	1.66
Putters	0.24	0.29	0.18
Kids' clubs	0.05	0.03	0.01

TAYLORMADE SOFTGOODS (MILLIONS OF UNITS)

Bags	0.26	0.33	0.17
Gloves	1.29	1.80	0.28
Balls ²	4.57 ³	4.46 ⁴	4.49 ⁴
Caps	0.60	0.61	0.32
Accessories	2.04	1.11	0.38

¹ excluding adidas Golf

² reflected as dozens

³ balls produced by Dunlop Slazenger and GTS

⁴ balls produced by Dunlop Slazenger

Total number of Salomon softgood products manufactured¹

Product range	2004	2003	2002
Footwear (millions of pairs)	3.07	2.99	2.34
Apparel (millions of units)	0.96	0.60	0.51
Accessories + gear (millions of units) (bags, gloves and caps)	0.90	0.87	1.02

¹ international range excluding Salomon hardgoods, for example skis, boards, bindings

Total number of Salomon products manufactured

Product range	2004	2003	2002
SNOWBOARD (MILLIONS OF UNITS)			
Board	0.11	0.11	0.12
Binding	0.14	0.13	0.12

ALPINE (MILLIONS OF UNITS)

Ski	0.69	0.72	0.74
Binding	1.22	1.21	1.30
Boots	1.20	1.19	1.14

CROSS-COUNTRY (MILLIONS OF UNITS)

Binding	1.10	0.83	0.68
Boots	0.45	0.46	0.46

TEC HIKING (MILLIONS OF PAIRS)

Boots	0 ¹	0 ¹	0.07
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INLINE SKATES (MILLIONS OF PAIRS)

ILS	0.46	0.46	0.31
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MAVIC (MILLIONS OF PAIRS)

Rims	1.41	1.56	1.70
Wheels	0.63	0.55	0.45

¹ number of Tec Hiking boots is included in Salomon softgoods/footwear

Net sales (euros in millions)

By brand	2004	2003	2002
adidas	5,174	4,950	5,105
Salomon	653	658	684
TaylorMade-adidas Golf	633	637	707

By region

Europe	3,470	3,365	3,200
North America	1,486	1,562	1,960
Asia	1,251	1,116	1,166
Latin America	224	179	163

By main product divisions

Footwear	2,700	2,767	2,851
Apparel	2,519	2,222	2,288
Hardware	1,259	1,278	1,385

Operating highlights (euros in millions)

	2004	2003	2002
Net sales	6,478	6,267	6,523
Income before tax	520	438	390
Net income	314	260	229

Key ratios [%]

Gross margin	47.2	44.9	43.2
Selling, general and administrative expenses as a percentage of net sales	36.7	35.6	34.4
Effective tax rate	37.8	38.0	37.9
Net income as a percentage of net sales	4.9	4.2	3.5
Equity ratio	36.8	32.4	25.4

Per share of common stock (euros)

Basic earnings per share	6.88	5.72	5.04
Dividend per share	1.30 ¹	1.00	1.00
Share price at year end	118.75	90.30	82.30

Number of shares outstanding	45,859,000	45,453,750	45,422,500
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Rounding differences may arise in percentages and totals for figures presented in millions, as calculation is based on figures stated in thousands.

¹ subject to Annual General Meeting approval

Living our values

Our core values define who we are, and what we strive each day to be – an *honest, committed* and *innovative* business, one which is *authentic* and is *inspired* by, and *passionate* about, sport. Our values are derived from sport and shape the way we act and interact with each other and with our stakeholders.

Our values are landmarks and signposts. In these times of rapid change, faced by global challenges and an increasingly complex and highly competitive world, our values are the compass points, against which we fix our place, take our bearings and decide our course.

If we are to be true to our values, then we have to live these through our everyday actions. As with sports, this requires dedication and perseverance. Our achievements are the sum of the days spent planning, training and perfecting our performance.

Our core values permeate every facet of our business and underpin:

- > our sustainability as a company, for example, through our innovative thinking on product development and our passion to make a difference in the world
- > our leadership position in managing social and environmental issues in the supply chain, and the authenticity achieved through our field-based and grass roots driven compliance programme
- > the development and retention of our employees, and our commitment to creating a secure, stimulating work environment and a performance culture
- > our interaction with communities and our honest and open communication with our own employees and with other stakeholders, whose feedback inspires us each day to do better.

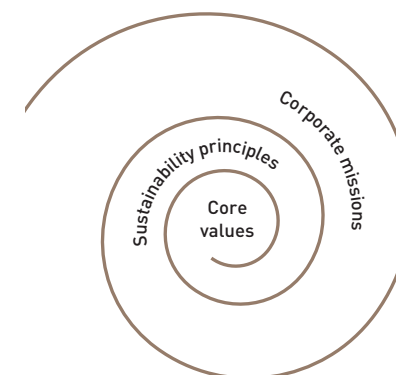
Each of these support our corporate mission, as we strive to be a global leader in the sporting goods industry.

SUSTAINABILITY Our principles of sustainability (opposite) outline the operational framework for becoming a more sustainable company, and inform our individual missions in Social and Environmental Affairs, Human Resources management and community involvement, described in the diagram opposite.

SOCIAL AND ENVIRONMENTAL AFFAIRS MISSION AND THE SUPPLY CHAIN Being a leader in terms of social and environmental affairs means we are dedicated to socially responsible, safe and environmentally sustainable practices in the Group and its supply chain, and to enhancing the value of our brands by:

- > guaranteeing the ideals of the company for the consumer and for those making our products
- > making the supply chain more effective
- > strengthening our image and reputation
- > helping to provide a long-term future for sport.

Our core values inform our sustainability principles and corporate missions



PRINCIPLES OF SUSTAINABILITY

Our principles of sustainability help us set standards for our own social and environmental performance. They are set out as follows.

Legislation We adhere to social and environmental laws, directives and guidelines while continually improving upon our own contribution to a sustainable society.

Management We aim to:

- > analyse, evaluate and assess the social and environmental impact of new products, technologies and processes at the design and development stage
- > set up clear targets, formulate an action plan and monitor progress
- > publish the results.

Supplier and customer relationships

We expect suppliers' activities to be compatible with our Standards of Engagement. We work in partnership with them to improve our collective performance. We encourage our business customers to take a proactive stance on the social and environmental impact of their own activities.

Support We support social and environmental projects and develop partnerships with businesses and organisations whose direct and indirect output contributes to a sustainable society.

Stakeholder dialogue We aim to listen, respond and interact with all stakeholders in an atmosphere of mutual trust and respect. We provide them with appropriate information related to the social and environmental performance of the Group on a regular basis.

As a company that outsources most of its production, but with strong experience in product manufacturing, we understand that some of our biggest challenges are related to fair, safe and environmentally sound working conditions in the factories that make our products. Operating through an international network of contractors and suppliers in no way absolves us of our responsibility for the conditions our products are produced under and how they are manufactured. In support of this mission, our goal is to enhance the social and environmental performance in the supply chain and to improve the lives of the workers who manufacture our products. Our approach is targeted to achieve self-governance in our suppliers' factories by increasing accountability and transparency, and striving for long-term sustainable compliance. Our efforts in these areas are further explained later in this chapter under 'Managing social and environmental issues in the supply chain', and in the Employment, health and safety performance and Environmental performance chapters.

BUILDING AND RETAINING A LEADING TEAM – HUMAN RESOURCES MISSION The success of the Group is a direct result of the commitment and talents of people who work for us. We are seeking to build the leading global team in the industry.

Our mission is to:

- > create a working environment that stimulates team spirit and passion, engagement and achievement
- > instil a performance culture, based upon strong leadership, setting the ground for winners
- > foster an understanding of social and environmental responsibility for the world in which we live – for the rights of all individuals, and for the laws and customs of the countries in which we operate
- > provide a secure working environment.

Our efforts to fulfil this mission are described in the Employment, health and safety performance chapter.

OUR MISSION ON COMMUNITY INVOLVEMENT PRACTICES We are convinced that our success in building and maintaining constructive relationships with local partners and being active in the community makes a significant contribution to our overall performance as a business.

It is our responsibility as a member of each community to act as a true corporate citizen and we are committed to doing this through a range of activities including corporate giving, volunteer work and community relations programmes. These activities are described further in the Community involvement chapter.

Managing social and environmental issues

Within the global business landscape of the sporting goods industry adidas-Salomon is continually confronted with a variety of challenges and risks. In terms of social and environmental issues, we face specific challenges regarding our accountability towards our employees, responsibilities towards the workers in supplier factories and the environment.

EXTERNAL CHALLENGES We continue to face business challenges that have grown more complex during the recent years. These challenges are illustrated in supply chain management, compliance transparency, and the verification of compliance performance.

Consumer product demand, with shortened lead times at competitive pricing, has made it difficult to enforce 60-hour work weeks, so we have promoted production efficiency programmes in the supply chain as well as the development of supporting HR and HSE management systems. While monitoring compliance in low-wage and migratory industries, we have had to meet tighter deadlines without cutting compliance corners, thereby necessitating the development of more strategic monitoring practices – see Improving the way we work with suppliers on pages 22-32.

The demand for increased transparency has driven stronger collaboration with stakeholders at all levels, including workers, and better mechanisms to respond to enquiries, complaints and allegations – see Our stakeholders on pages 15-21. To eliminate deceptive practices like double book-keeping (which some factories use to hide excessive working hours or non-payment of wages), we needed to substantially rethink not only our role and monitoring practices but also our factory rating system. The new and revised five-star factory rating system now strives to measure management commitment and responsiveness and to clearly report these results to suppliers and Sourcing decision makers – see Employment, health and safety performance on pages 33-41.

The end of the Multi-Fibre Arrangement (MFA) in December 2004 drew increased stakeholder attention to our sourcing practices, including supply chain growth and consolidation. While the elimination of the MFA has had minimal impact on our sourcing strategy, we have had to respond more frequently to groups questioning the integrity of that strategy – see Sourcing strategy on page 11.

As stakeholders demand verification of our work, we continue to fulfil the obligations of an FLA participating company and submit ourselves to independent auditing. We also engage independent experts to evaluate technical SOE projects, and we promote supplier implementation of compliance management systems such as ISO, EMAS and OHSAS that require external verification (see pages 30 and 37-39).

INTERNAL CHALLENGES Being a global player in a disparate world creates complex challenges with regard to the management of our employees. Our HR strategy therefore has to:

- > embrace diversity as a stimulus rather than a restriction
- > monitor demographic changes and respond with the appropriate recruitment and retention strategy and work-life balance initiatives
- > mirror the global marketplace with a global workforce and promoting mobility

- > comply with different local legislations and mastering cultural differences
- > listen to our employees, understand their needs and motivations and help them to realise their full potential.

Further details are given later in this chapter and in Our stakeholders chapter on pages 15-21, and Employment, health and safety performance chapter on pages 33-41.

CORPORATE GOVERNANCE PRINCIPLES At adidas-Salomon we believe that strong corporate governance is essential in providing a guiding vision of how the Group should be managed in an increasingly complex and globalised world. Corporate governance means standards of good and responsible corporate management, which have always been a major priority of our Group.

The adidas-Salomon Corporate Governance Principles were first published in 2003. They were developed according to our requirements and are based on the German Corporate Governance Code as well as on the recommendations of other internationally recognised codes of best practice. More information about corporate governance at adidas-Salomon can be found on our website www.adidas-salomon.com

RISK MANAGEMENT We consider risk as a threat that may impact on the achievement of short-term goals or the successful implementation of long-term strategies. Risk can be internal or external, and needs to be managed.

The success and accuracy of business planning in the volatile business environment of the international sporting goods industry depends significantly on a correct assessment of future trends and related risks. Therefore, our senior management is regularly provided with detailed information on expected financial results and a qualitative assessment of the future business outlook. More information about the Group's risk management including risk reporting and communication can be found on our website www.adidas-salomon.com

MANAGING HUMAN RESOURCES HR management is a core function within the Group's global organisation. It is managed by adidas-Salomon Global HR, the global head of which directly reports to the Executive Board member Human Resources. Within the Group, the Global HR organisation manages the following key functions:

- > HR management and support to key functions – Global Operations, Global Marketing, Corporate Services, Regions and Brands
- > Global Services, including reward management and mobility management
- > personnel and management development
- > company sports programme and work-life balance initiatives in Germany
- > corporate community programme in Germany
- > cross-functional issues, for example HR information systems, communication, personnel and marketing.

Global HR focuses on the following goals:

- > to create a working environment that stimulates team spirit, passion, engagement and achievement
- > to instil a performance culture based upon strong leadership
- > to elevate adidas-Salomon to become the employer of choice.

Works Councils Employee empowerment, participation and co-determination play an important role in managing employee-relations within adidas-Salomon. Works Councils representing employees' views and interests have been established at adidas-Salomon AG in Germany and other European subsidiaries. In 2004, the Works Council at adidas-Salomon AG focused on the following projects:

- > new compensation philosophy and structure
- > new Performance Evaluation and Planning (PEP)
- > further improvement of the internal agreement on flexible working hours
- > further improvement of the Group's pension/retirement schemes including our foreign nationals.

In 2003, a European Works Council (EWC) of 13 delegates from nine countries was constituted. At its annual summit in 2004, the committee discussed restructuring production locations in Europe, pay structure and the social responsibilities of the company.

Code of Conduct for employees Our Code of Conduct reflects the Group's values and sets standards for day-to-day behaviour in the workplace. It addresses issues such as bribery and corruption, anti-discrimination, protection of intellectual copyright and the disclosure of conflicts of interest. We are developing a reporting mechanism that allows employees to submit concerns and questions in a confidential and unbiased way. This will be reviewed by Legal, HR and other corporate departments.

MANAGING OUR SUPPLY CHAIN

Supply chain structure We work with independent suppliers from around the world who manufacture our products. Our supply chain is global and multi-layered, with many different types of business partners, some of whom are directly contracted, others who are not. Our influence in terms of social compliance is linked to the strength of our partnerships, and is often proportional to scale and stability of the orders placed with our suppliers. For this reason we aim to further consolidate our supply chain, using fewer, larger factories with higher order volumes.

Number of suppliers and our own factories in 2004¹

Region	Number of suppliers (excl. own factories)	Number of own factories	Total
ASIA			
adidas	459	1	499
Salomon ²	10	0	
TaylorMade-adidas Golf ³	28	1	
AMERICAS			
adidas	114	0	153
Salomon ²	17	1	
TaylorMade-adidas Golf ³	20	1	
EUROPE			
adidas	174	1	191
Salomon ²	13	3	
TaylorMade-adidas Golf ³	0	0	
Total	835	8	843

¹ includes licensee factories

² includes Bonfire, Mavic, Arc'Teryx and Cliché

³ includes Maxfli

adidas licensees in 2004

Product range	Total number of licensees	Total number of factories producing for licensees	Number of countries where production is placed
Apparel	12	93	18
Hardware ¹	4	15	7
Watches	1	25	2
Glasses	1	2	2
Cosmetics	1	1	1
Total	19	136²	

¹ accessories and gear

² in 2004 the 136 factories were placed in 24 different countries

Types of supplier Suppliers fall into four broad categories:

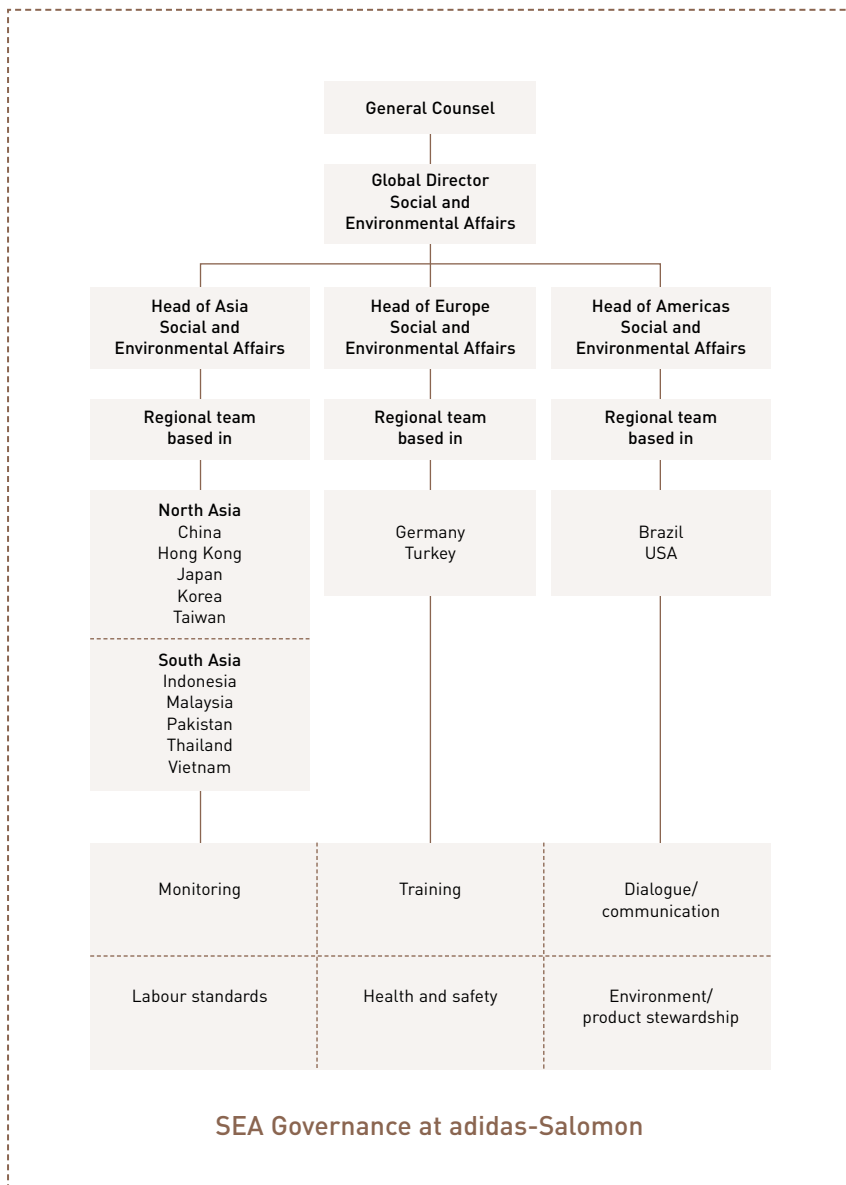
- > **Main factories** Factories of suppliers that have a direct contractual relationship with adidas-Salomon for the supply of products, whether for export or domestic market consumption. We call these Tier 1 suppliers. The largest of these have multiple factories and manufacturing sites across several countries.
- > **Subcontractors** Factories that have been subcontracted by our suppliers. They have no direct contractual relationship with adidas-Salomon. However, we do require them to be authorised for use and SOE-approved.
- > **Material and other service providers** These suppliers may not have a direct business relationship with adidas-Salomon, but supply goods and services to our main suppliers. We call these Tier 2 suppliers. Within this category there are nominated material suppliers with whom we work.
- > **Licensees** Independent companies that manage the design, production and distribution of specific products, under license to the adidas-Salomon Group.

Trends in our supply chain Progressively we are seeing fewer and larger factories in Asia, with new investment being made by our strategic business partners in more modern and larger factories. More than 800 factories manufacture adidas-Salomon products worldwide – 60% are in Asia, 20% in the Americas and 20% in Europe. From a total of these, the Group owns eight factories located in Germany, France, Italy, the United States, Canada and China. By comparing our supplier numbers with the previous year we can see the following trends emerging:

- > significantly fewer suppliers in 2004 than in 2003 in Korea (22), Mexico (17), Taiwan (17), Vietnam (11) and Brazil (9)
- > significantly more suppliers in Turkey (8), Russia (5), Thailand (4) and Italy (4).

Sourcing strategy The Group's sourcing strategy seeks to balance security with flexibility and growth. Export production for the company consists of a balanced portfolio of long-term, strategic business partners located in five key countries: China, Indonesia, Vietnam, Thailand and Turkey, with a sixth – India – offering future sourcing opportunities. Although China is dominant in the apparel and accessories sector and has potential for future growth, it currently represents no more than 30% of the Group's global orders for this business segment.

The maturity of the sourcing strategy and our focus on long-term relationships with strategic supplier partnerships has minimised the impact of the end of the MFA. For the last three years, we have placed special emphasis on continuous improvement initiatives to improve competitiveness, including efficiency programmes and the strengthening of management and cost-control systems. This has reduced the potential for 'cut and run' scenarios. While product costing is important, the sourcing key performance indicators are mainly designed to measure performance in quality, delivery, management systems, SOE, customer service and innovation.



MANAGING SOCIAL AND ENVIRONMENTAL AFFAIRS IN THE SUPPLY CHAIN

Our Standards of Engagement As a result of operating with suppliers based in countries with a less developed social and environmental infrastructure, or weaker regulatory enforcement, we are exposed to risks and challenges associated with work and environmental conditions in supplier factories. The Standards of Engagement (SOE), our code of conduct, play a key role in meeting these challenges. They are described in full on page 13. The SOE are based on the International Labour Organisation (ILO) and UN conventions relating to human rights and employment practices and follow the model Code of Conduct of the World Federation of Sporting Goods Industry. We expect all our suppliers to live up to these standards. They are a contractual obligation under the manufacturing agreements the Group signs with its business partners.

We want the SOE to be relevant and have discussed the revision of some elements with stakeholders. We have also produced guidelines with best practice examples to show our suppliers how to implement the SOE in practice.

Social and Environmental Affairs (SEA) SEA is tasked with ensuring compliance with the SOE within the supply chain and managing the wider corporate responsibility activities of the Group. The team is led by the Global Director, who directly reports to the General Counsel and the Executive Board of the Group.

In 2004, the SEA team consisted of 33 people. It is a diverse group of individuals – engineers, lawyers, HR managers, and former members of NGOs. The group is organised into three regional teams covering Asia, the Americas and Europe. In Asia the majority of the team is located with Sourcing in the Liaison Offices, near to the suppliers. In 2004, the following structural changes within SEA took place:

- > with the closure of the Liaison Office (LO) in Singapore and the opening of a new LO in Shanghai, two team members were relocated and a third person recruited in China
- > a new post was created in the Americas' SEA team following the decision to coordinate all FLA-related work from the US rather than Europe.

SEA collaborates closely with other global functions such as Sourcing, Marketing, Product Development and HR. It is directly involved in developing and updating corporate policies and operating procedures related to social accountability, product safety and compliance with environmental laws and regulations. By engaging directly with suppliers, government and other external stakeholders, SEA is informed about social and environmental issues at an early stage. It addresses any potential risks, and health, safety and environmental liabilities, in its monthly report to the Executive and Sourcing Management.

Standards of Engagement

Authenticity – Inspiration – Passion – Commitment – Innovation – Honesty

These are the core values of the adidas-Salomon Group. We measure ourselves by these values and we measure our business partners in the same way.

Consistent with these values, we expect our business partners – contractors, subcontractors, suppliers and others – to conduct themselves with the utmost fairness, honesty and responsibility in all aspects of their businesses.

The Standards of Engagement are tools that assist us in selecting and retaining business partners who follow workplace standards and business practices aligned with our policies and values. As guiding principles, they help identify potential problems so that we can work with business partners to address issues of concern as they arise. Business partners must develop and implement action plans for continuous improvement in factory working conditions. Progress against action plans will be monitored by business partners themselves, our internal monitoring team and external independent monitors.

Specifically, we expect our business partners to operate workplaces according to the following standards and practices.

GENERAL PRINCIPLE

Business partners must comply fully with all legal requirements relevant to the conduct of their businesses.

EMPLOYMENT STANDARDS

We will do business only with business partners who treat their employees fairly and legally with regard to wages, benefits and working conditions. In particular, the following standards apply:

Forced labour Business partners must not use forced labour, whether in the form of prison labour, indentured labour, bonded labour or otherwise. No employee may be compelled to work through force or intimidation of any form.

Child labour Business partners must not employ children who are less than 15 years old, or less than the age for completing compulsory education in the country of manufacture where such age is higher than 15.

Discrimination Business partners must make recruitment and post-hiring decisions based on ability to do the job, rather than on the basis of personal characteristics or beliefs. Business partners must not discriminate in hiring and employment practices on the grounds of race, national origin, gender, religion, age, disability, marital status, parental status, association membership, sexual orientation or political opinion.

Wages and benefits Wages are essential for meeting the basic needs of employees and reasonable savings and expenditure. In all cases, wages must equal or exceed the minimum wage required by law or the prevailing industry wage, whichever is higher, and legally mandated benefits must be provided.

Wages must be paid directly to the employee in cash or check or the equivalent. Information relating to wages must be provided to employees in a form they understand. Advances of, and deductions from, wages must be carefully monitored and comply with law.

In addition to compensation for regular working hours, employees must be compensated for overtime hours at the rate legally required in the country of manufacture or, in those countries where such laws do not exist, at a rate exceeding the regular hourly compensation rate.

Hours of work Employees must not be required, except in extraordinary circumstances, to work more than 60 hours per week including overtime or the local legal requirement, whichever is less. Employees must be allowed at least 24 consecutive hours rest within every seven-day period, and must receive paid annual leave.

Freedom of association and collective bargaining Business partners must recognise and respect the right of employees to join and organise associations of their own choosing and to bargain collectively. Where law specifically restricts the right to freedom of association and collective bargaining, business partners must not obstruct alternative and legal means for independent and free association or collective bargaining. Additionally, business partners must implement systems to ensure effective communication with employees.

Disciplinary practices Employees must be treated with respect and dignity. No employee may be subjected to any physical, sexual, psychological or verbal harassment or abuse.

HEALTH AND SAFETY

A safe and hygienic working environment must be provided, and occupational health and safety practices which prevent work-related accidents and injury must be promoted. This includes protection from fire, accidents and toxic substances. Lighting, heating and ventilation systems must be adequate. Employees must have access at all times to sanitary facilities, which should be adequate and clean. Business partners must have health and safety policies that are clearly communicated to employees. Where residential facilities are provided to employees, the same standards apply.

ENVIRONMENTAL REQUIREMENTS

Business partners must make progressive improvement in environmental performance in their own operations and require the same of their partners, suppliers and subcontractors. This includes: integrating principles of sustainability into business decisions; responsible use of natural resources; adoption of cleaner production and pollution prevention measures; and designing and developing products, materials and technologies according to the principles of sustainability.

COMMUNITY INVOLVEMENT

We will favour business partners who make efforts to contribute to improving conditions in the countries and communities in which they operate.

Working with suppliers – achieving effective compliance and self-governance Our strategy is to foster long-term self-governance and our goal is to promote effective and sustainable SOE compliance in supplier factories. Working with our suppliers we have identified the following as essential actions to achieve our goal:

- > support business partners to develop effective HR, health, safety and environmental management practices in their manufacturing operations
- > strengthen capacity building within our supply chain's workforce and its management
- > expand our network of local workers' organisations, NGOs and other representative groups so that we may better influence the working conditions in places where our products are made
- > raise environmental awareness and promote environmental best practices
- > support business partners in their local community activities through social programmes.

Developed from these key areas and the strategic business plan for social and environmental challenges, SEA's core projects plan has specific operational targets, actions and timelines designed to track the progress of individual projects. Project results and progress are regularly reported to other departments involved and to Executive Management. Results of these activities covered by the core projects plan are described in the Employment, health and safety, Environmental performance and Community involvement sections of this report.

MANAGING ENVIRONMENTAL IMPACTS Based on a review of where the greatest impact occurs in the lifecycle of our products, we focus our environmental programme on material supply and manufacturing. We aim to ensure that materials supplied to adidas-Salomon are in full compliance with local laws and regulations regarding environmental and product safety. We also actively encourage our business partners to reduce the environmental impact of materials and products. We ask that:

- > materials and components are non-toxic in use and disposal
- > use of materials in the manufacturing process does not involve toxic releases or damage of ecosystems
- > products and components are manufactured under the best possible environmental conditions using the best available technology.

Chapter summary

> Our values underpin our sustainability principles and our corporate mission.

> We have a responsibility for the wellbeing of our employees and to improve the conditions for workers in our supply chain.

> To help us meet external and internal challenges, we have strong corporate governance and management processes in place.

> We have Standards of Engagement – a code of conduct for our suppliers. Our SEA team works to ensure that these standards are complied with.



Our stakeholders

Within the global business landscape of the sporting goods industry, adidas-Salomon is continually confronted with a variety of challenges and risks. In terms of social and environmental issues, we face specific challenges regarding our accountability towards **our employees, responsibilities towards workers in supplier factories and the environment.**

Our stakeholders

Listening and responding to stakeholder feedback helps us improve our performance. We recognise that clear, effective and honest communications – both within our company and with our external stakeholders – are the hallmarks of transparency and underpin the success of the adidas-Salomon SEA programme and our efforts to become a sustainable company. We continue to search for new ways to enable dialogue and engage with our stakeholders.

WHO ARE OUR STAKEHOLDERS? Stakeholders are those organisations, groups and individuals whom we affect and who affect us. These effects may be positive or negative. Our stakeholders are a diverse group and include:

- > authorisers – government, trade associations, shareholders, Board of Directors
- > business partners – employees, unions, suppliers, workers, service providers
- > opinion formers – journalists, community members, special interest groups
- > customers – professional sportspeople, distributors, retailers, consumers.

WAYS WE ENGAGE WITH OUR STAKEHOLDERS The views of each and every stakeholder are important to us – not only those who are the most informed, the most influential, or the most outspoken. One of our constant challenges is reaching out and effectively engaging with those stakeholders who have a less active voice, namely the workers in our supply chain. This year, to address this challenge, we began to explore new ways of engaging with workers.

Stakeholder dialogues Stakeholder consultation meetings ('dialogues') involve an active process of engagement, of listening to our stakeholders' views and sharing opinions and ideas. Stakeholder dialogues and other group discussions were held last year in Asia, the Americas and Europe.

Asia Two stakeholder dialogues took place in Asia in 2004. The first dialogue was held for two days in October in Malaysia and focused on migrant workers. Factory managers, embassy officials, recruitment agents and migrant workers took part, and independent observers were also invited. A second Asian dialogue was held in Hong Kong in November and focused on the potential impact from the end of quotas on textiles and garments, and the exercise of Freedom of Association and collective bargaining in China.

Americas Two stakeholder dialogues took place in El Salvador and Honduras in September. These meetings brought together factory workers, representatives from organised labour, and SEA team members, and were facilitated by local NGOs. Details about these dialogues are described in the case study on page 17.

Europe In Europe we focused on engaging at all levels in our supplier factories. For example, in Turkey we organised a four-day workshop for workers, supervisors and managers to discuss effective communication systems, taking cultural aspects into consideration.

Lessons learned Based on the feedback from the 2004 meetings, the design of future worker dialogues will take into account the following:

- > use of less formal venues for the worker dialogues
- > extension of dialogue time to capture the views of more workers
- > use of alternative forms of engagement, such as commissioning a self-assessment report or opinion survey from the workers themselves.

Dialogue with socially responsible investment (SRI) analysts In 2004 we intensified our dialogue with the financial community, meeting with more than 40 SRI analysts from investment and rating organisations in London, Paris and Amsterdam. Participants were asked to submit feedback on our programme and rate us against industry peers. Focal points in the discussion included how critical reports issued by NGOs in 2004 affect the corporate compliance programme, how we cooperate with supplier management regarding SOE compliance and the effect of the end of garment quotas on our supply chain structure.

Employee engagement We recognise the need to build our employees' understanding of the SOE programme and we value their views as it continues to develop. This year we have communicated with employees in the following ways:

- > **Induction of new employees** In Asia, six new HR managers were provided with an orientation session on SOE. For 25 new employees in North America, quarterly HR orientations were conducted, including a history of the SOE programme. In April 2004, more than 30 new employees in the European Sourcing Liaison Office in Istanbul received an orientation session on SOE.
- > **Internal reporting** Our Social and Environmental Report 2003 was again communicated to all our employees via our global newsletters and our intranet. To make the SOE programme sustainable and efficient, collaboration with many different departments within the Group is required. We created a common working platform on the intranet where we share information with other departments. This works towards embedding the SOE programme in the wider business.

Workers' feedback on the effectiveness of codes of conduct and compliance programmes

One challenge we faced in 2004 was to find ways to get clear input from workers about the effectiveness of Codes of Conduct (CoC) and compliance programmes, in a manner that maintains worker confidentiality and trust. Feedback from this key stakeholder group is critical to verifying that our compliance activities in factories are relevant and meaningful to workers. The objectives of the engagement project were to organise the activity at a venue comfortable for the workers, to identify the gaps in their understanding of the CoC, and to develop more effective compliance and remediation tools. We also wanted feedback on how factories' compliance management systems could better address non-compliance, including management-worker communication, freedom of association, and blacklisting.

Two worker dialogues were held in El Salvador and Honduras in September 2004. We learned that there is a need for additional training of workers and managers to raise awareness of the CoC and local laws. Worker feedback stressed that remediation should encourage suppliers to internalise compliance programmes because there are benefits to maintaining good working conditions. Unannounced visits by auditors would encourage factories to assimilate CoC systematically and with sustainable impact rather than just cleaning up for the monitors.

The facilitators were NGOs local to each country – Grupo de Monitoreo Independiente de El Salvador and Equipo de Monitoreo Independiente de Honduras. They were responsible for creating the agenda, selecting participants, coordinating logistics, and producing a summary report. Representatives from organised labour, local NGOs, and the adidas-Salomon SEA team attended as observers. Each dialogue included approximately 16 worker participants from local apparel factories.

The dialogue facilitators agreed in the project summaries that worker engagement is essential since it enables factory workers to express their point of view about how the Codes of Conduct are being implemented, and what effect the compliance programmes are having so the effort truly influences the improvement of labour practices in their supply chain. The summary reports are on our website at www.adidas-Salomon.com

'Worker engagement is essential since it enables factory workers to express their point of view about what effect compliance programmes are having.'
Summary report of worker dialogues

Striving for transparency – third-party assessment of PT Panarub

For the past five years PT Panarub, a key footwear supplier to adidas-Salomon located in Indonesia, had been beset with industrial relations problems and breaches of the SOE.

These issues were reported by Oxfam Australia in *We Are Not Machines*, a report published in March 2002. Citing the findings of the Oxfam report, in September 2002 the Clean Clothes Campaign lodged a complaint with the Organisation for Economic Corporation and Development's (OECD) national contact point in Austria related to PT Panarub and another Indonesian footwear supplier, Pou Chen. The complaint was subsequently transferred to the OECD national contact point at the Federal Ministry of Economics and Labour in Germany for mediation. A concluding statement was issued by the Ministry in May 2004.

Since 2001, adidas-Salomon has maintained a dialogue with Oxfam Australia and in February 2004 an agreement was reached to allow a credible and independent third party, the Worker Rights Consortium (WRC), to enter PT Panarub and investigate SOE violations. A key driver to the agreement was the acceptance by all parties of the need for greater transparency, to establish root causes and bring about lasting change. A pre-condition of the WRC's involvement was the right to make public its findings, the details of which can be found at www.workersrights.org

PT Panarub has responded positively to the findings of the WRC report and has made improvements. The most significant of these was the reinstatement of previously dismissed workers and the introduction of medical insurance for all workers and their families. Despite these changes, management-union relations remain problematic; in October 2004 a bonus pay dispute led to a strike and the temporary closure of the factory. To further support transparency, at the end of 2004 we began to publish updates of the ongoing remediation efforts at PT Panarub. For more information see www.adidas-salomon.com

'The assessment team concluded that factory management illegally terminated workers' contracts and used coercive means to compel workers to resign'. Worker Rights Consortium Assessment re PT Panarub (Indonesia), summary of findings and recommendations, 7 September 2004, page 16.

Internal SOE training The following training sessions were carried out:

- > Americas – there were five training sessions for regional quality control staff including three sessions in Mexico, one in Canada and one in Brazil. There was one training session given to Liaison Office staff in the US, and three SOE trainings for Continuous Improvement – Lean staff, including two sessions in Mexico and one in China
- > Europe – SEA team members held eight training sessions with quality control staff and sourcing liaison staff from Bulgaria, Morocco and Turkey, and with subsidiary employees from France, Italy, the Middle East and Russia
- > Asia – the SEA team provided nine training sessions for internal staff in Guangzhou, Shanghai, India, Indonesia, Thailand and Vietnam. A two-day SOE training workshop was hosted in Hong Kong in May for all Asia Pacific subsidiaries.

STAKEHOLDER FEEDBACK The goal of every dialogue is to obtain feedback and to understand the views, concerns and interests of our stakeholders. A full record of our stakeholder dialogues is posted on our website at www.adidas-Salomon.com. We encourage readers to view both current and past stakeholder reports.

Follow-up to 2003 feedback Feedback from the 2003 stakeholder meetings was incorporated into our plans for 2004 but, as in the previous year we did not achieve all that we aimed for. For example we were not able to complete a global staff survey on the SOE programme, which we now intend to carry out in 2005. We did, however, achieve the following:

- > our enforcement policy and the related guideline were finalised and circulated internally and will be distributed to our suppliers in 2005
- > we drafted an internal corporate policy and procedures regarding HIV-AIDS, supported by a pilot programme in Thailand (see page 35) and extended our funding of projects on sexual and reproductive health for workers in China and Vietnam (see page 40)
- > we arranged a workshop on worker-management communications with selected business partners in Portugal together with a member of the adidas-Salomon European Works Council
- > we maintained steady dialogue with governments in the US and Central America, sometimes as part of FLA engagements. In Asia, our relationships with governments developed through meetings with high-level officials in China and Cambodia. In Germany, adidas-Salomon continued as an active participant in the Round Table on Codes of Conduct, coordinated by the Ministry for Economic Cooperation and Development.
- > we participated in an EU-funded multi-stakeholder project in Bulgaria, as described on page 36
- > we conducted a migrant worker dialogue in south Asia that explored how to consistently enforce compliance with our standard on forced labour.

General feedback from 2004 General feedback from 2004 is summarised below:

- > in the field of social compliance, adidas-Salomon is viewed by several stakeholders as proactive, progressive and engaging. Given this, participants felt that the company should take a greater leadership role in the sports goods industry, be more influential on other brands, and more actively engage with governments on labour rights issues
- > there was support for a reduced emphasis being given to monitoring and greater focus on training and capacity building for suppliers and workers
- > more continuity was sought between reports, such that findings and undertakings reported in one year are carried through and reported in the following years
- > more information is requested. For example, stakeholders asked for actual data to support statements made on the continued improvements in occupational health and safety, or SOE non-compliances
- > provide more facts and figures on human resources
- > more clearly show the business case for compliance
- > further explain our approach in dealing with factories that do not improve over time.

Follow-up to 2004 feedback We have taken into account the feedback received from the multi-stakeholder and worker dialogues held in 2004 and incorporated this into our targets for 2005. Specific areas to be addressed next year include:

- > the development of a self-assessment report for workers to provide feedback on their working lives in China, in collaboration with an international NGO
- > in the Americas, the facilitators who ran the 2004 worker dialogues will spearhead 2005 capacity-building exercises that directly address worker feedback, such as increased code awareness and developing effective worker-management communication channels
- > there will be a minimum of two additional worker dialogues in Central America, facilitated by the same NGOs who managed the 2004 programme. One worker dialogue will be held in Mexico
- > building on our work within the German Round Table, we will participate in the development and execution of pilot projects scheduled in Romania to improve worker-management communication and conflict resolution
- > more worker awareness-raising sessions on the SOE and workers' rights will be held in Europe, Asia and the Americas
- > we will identify NGO partners to support worker rights training in China and will also extend our engagement with the All China Federation of Trade Unions (ACFTU)
- > we will review the enforcement of our policy on forced labour that prohibits suppliers to hold migrant worker passports and will raise workers' awareness of their rights to freedom of movement. This issue will also be raised with those governments in Asia, where the retention of passports by employers is sanctioned by the immigration authorities.

RESPONDING TO ENQUIRIES Each year we have many individual points of contact – from meetings, enquiries, to collaborative project work. We judge ourselves and are judged by others on the basis of our responsiveness to these enquiries. Each enquiry requires a timely, accurate and honest response.

Consumers Consumers frequently contact us, enquiring about product safety and requesting further information on media headlines, or SEA compliance. In each case we respond with relevant information and explanations.

Media During the year we received more than 40 formal enquiries from the media, which included 30 requests for interviews and factory visits. Although we always try to be responsive and meet all requests in a timely manner, we had to postpone three factory visits to 2005. Press conferences on the SEA programme and the Social and Environmental Report 2003 were arranged for the German and European media twice during the year.

Fund managers and analysts Over the course of 2004 we responded to more than 25 written enquiries from socially responsible investors, fund managers and financial analysts. Enquiries from this sector have steadily grown, and are becoming increasingly complex and time-consuming as more and more data is demanded. This has resulted in closer collaboration between departments within the Group, namely Investor Relations, Human Resources, Legal and SEA.

Non-governmental organisations NGOs, worker rights groups, campaigners, student bodies and the academic community were all very active throughout the year, raising questions about current SOE practice and conditions within factories. Examples of enquiries include:

- > concern for the wellbeing of over 1,000 workers, following a decision by a supplier to wind up their business operations in Indonesia
- > repeated allegations by an NGO concerning working conditions in a garment factory in El Salvador
- > engagement with Enlace, a US-based NGO and the former workers of a Mexican bag factory in negotiations with their former employer regarding settlement of worker's severance
- > settlement of an OECD complaint filed against adidas-Salomon by the Clean Clothes Campaign Germany, regarding working conditions in supplier factories in Indonesia
- > the end of the Multi-Fibre Arrangement and the impact on the Group's sourcing strategies.

Where concerns have been raised they have been investigated and a formal response issued. Details of our public responses can be found on our website www.adidas-Salomon.com. See also the Complaint and redress mechanism on page 21.

MATURING RELATIONSHIPS Constructive criticism is welcomed, but can only take place in an open and supportive relationship. In 2003 we reported on the maturing of our relationships with several critical stakeholders, combined with our efforts to reach new levels of understanding and cooperation through closer engagement. These efforts continued throughout 2004:

- > in El Salvador we have collaborated more closely with local NGO GMIES. In recent years, we engaged with GMIES to better understand local working conditions and the roles that civil society, governments and multinationals could play in fostering improvements to working conditions. In 2004, GMIES collaborated more directly with us and our supply chain by facilitating a workers dialogue and monitoring the drinking water quality of an apparel supplier
- > as reported on our website, we continue to collaborate with the Worker Rights Consortium (WRC) on a number of challenging cases. The WRC has independently monitored and publicly reported on working conditions within our supplier factories producing US collegiate and non-collegiate products, as described in the case study on page 18.

PARTICIPATION AND COLLABORATION adidas-Salomon carefully chooses the organisations with whom we work and the events in which we take part. As in previous years, we actively participated in the work of the World Business Council for Sustainable Development (WBCSD), the World Federation of Sporting Goods Industry and the Fair Labor Association – an organisation of which we are Board members until 2006. We also participated in:

- > a two-day forum on CSR and labour rights in China, hosted in Taiwan by the Solidarity Center – a non-profit labour organisation
- > a seminar discussing industry competitiveness and the impact of production efficiency programmes and HR management systems on working conditions, as part of the Central America Annual Textile Summit
- > three round-table meetings organised by the German Ministry for Economic Cooperation and Development
- > advisory committee meetings organised by Stiftung Warentest, a German organisation that has extended test requirements to CSR-related topics across the supply chain, including company codes of conduct and monitoring programmes
- > a meeting facilitated by the ILO to discuss *Play Fair at the Olympics*, a report produced by OXFAM, the Clean Clothes Campaign and international trade unions
- > a World Bank study on public policy roles for host country governments to help implement corporate social responsibility in global supply chains
- > participation in the WBCSD project '*Tomorrow's leaders – defining the role of business in tomorrow's society*'.

COMPLAINT AND REDRESS MECHANISM In 2004, labour rights groups and workers directly approached adidas-Salomon on more than 100 occasions, seeking redress to issues existing in a particular partner factory. The more common complaints and requests for support were regarding industrial relations issues, strikes and disputes, unfair dismissal, restriction to freedom of association, excessive overtime, underpayment of wages, poor workplace conditions and factory closures. In every case, an investigation was conducted, the facts behind the complaint or allegations established and, where proven, action was taken.

Our participation in the Global Accountability Project run by the One World Trust, a UK non-governmental organisation, highlighted ways in which we could improve the transparency of our existing complaint and redress mechanisms. In 2005, we aim to strengthen our approach and will:

- > post our existing complaint and redress mechanism on our web page in plain English
- > highlight the independent third-party complaints channel available through the FLA
- > include worker feedback as a formal element of each SEA consultancy project
- > incorporate complaint and redress mechanisms in the worker rights training planned for 2005.

SHARING KNOWLEDGE WITH OTHER BRANDS Peer collaboration is becoming an increasingly important feature of the work of multinational compliance teams, as they respond to common challenges and share information, ideas and experience. Where such collaboration involves our direct competitors it must be managed within the boundaries of what is legally permissible. We must take care not to share information on intended punitive measures or discuss any action or decision that would influence prices. Examples of peer collaboration during 2004 include:

- > shared FLA audits – in 2004 there were eight FLA audits shared with other brands and one shared verification visit by the FLA at a factory shared with Nike
- > medical training – with Nike and Reebok on the training of doctors on occupational health in Asia (see page 41) and the development of an industry standard for HR management training (see pages 35-37)
- > capacity building – with Levis, Nike, H&M and other stakeholders on a project to help build capacity in the Bulgarian apparel industry.

Chapter summary

- > Workers had an opportunity to tell us what they thought of codes of conduct in general and the issues faced by migrant workers in particular.
- > We expanded our dialogue with SRI analysts.
- > We are deepening our relationship with critical stakeholders.
- > We are increasingly collaborating with our colleagues in other departments, but did not fulfil our goal of surveying staff globally on SOE issues.
- > We have responded to far more enquiries than ever before from customers, the media, NGOs and financial analysts and plan to strengthen our complaints and redress mechanism.



Improving the way we work with suppliers

In this chapter we report on our progress in
delivering sustainability and self-governance
throughout our supply chain.

Improving the way we work with suppliers

Our work with suppliers in 2004 was influenced by ongoing changes in the supply chain and steps taken by Sourcing to strengthen our sourcing model and business relationships. As the end of the Multi-Fibre Arrangement (MFA) approached, our sourcing organisation continued to identify strategic partnerships in six key apparel exporting countries, as well as specialist suppliers in countries such as Cambodia and the Philippines. Even with a focus on supplier consolidation, there is still a large number of factories to monitor, in part due to strategic suppliers building new factories and capacity to fill our product demand.

Currently most of our suppliers improve their Standards of Engagement (SOE) performance based on a reactive compliance model: audits by SEA field staff identify non-compliances, action plans are issued setting out the required remedial steps, and remediation activities aim to close the gaps in compliance performance. This reactive process is both inefficient and ineffective. It lends itself to incremental and at times cosmetic changes in supplier performance, rather than bringing about sustainable compliance. We continue to develop a new model for supplier compliance, one which is built on the foundation of better labour and HSE management systems, supportive training by third-party experts, and more rigorous verification and certification steps.

This year saw the introduction of strategic monitoring practices, which rigorously assess compliance risks and identify the root cause of non-compliance. These practices lead to remediation activities that more effectively evaluate training needs and promote the implementation of HR and HSE management systems.

HOW WE SET AND EXPLAIN OUR STANDARDS Fundamental to our expectations of our business partners is that they continuously improve workplace conditions. This is set out clearly in our Standards of Engagement (SOE), which form the basis of our supply chain programme. The SOE are supplemented by a set of guidelines and guidance notes. Building on the information and materials already provided to suppliers, supplementary guidance notes were developed in 2004 for the following areas:

- > juvenile employees (16 to 18 years) – where the law permits or encourages their employment
- > child labour and the management of child care facilities
- > body searches or ‘pat-downs’ – under what circumstances this is lawful and appropriate
- > maternity leave provisions – where local law does not govern the employer’s obligations
- > managing the process of back-pay
- > safety instructions on manual handling
- > working with contractors – how to manage contractors working on site
- > local exhaust ventilation requirements.

Enforcement guidelines Over the course of the year, the enforcement guidelines were finalised and distributed internally – in 2005 they will be issued to suppliers. The guidelines cover the principles of enforcement of the SOE, and those sanctions or remedies we will apply where the SOE is breached. Such sanctions or remedies include:

- > termination of the manufacturing agreement – in situations of severe or repeat 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 repeat violations of the SOE or local laws have become a matter of public interest
- > warning letters – in cases of ongoing and serious non-compliance
- > review of orders
- > commissioning of special projects – to remedy particular compliance problems.

In addition to the written guidance provided to suppliers, we make considerable effort to ensure that our approach to compliance issues is globally consistent and that the same messages are delivered. For example, in May 2004, a workshop was conducted with SEA team members in China to address Freedom of Association, use of the Comprehensive Working Hours System (under Chinese Labour Law), scheduling of overtime and payments, social security coverage, and deductions from wages.

Warning letter system We strongly believe in a partnership approach, and where suppliers are performing poorly in terms of SOE 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 management to address the issues, we will when appropriate issue a formal warning letter.

Typically, warning letters were issued because of excessive working hours, double book-keeping and the falsification of payroll and time records, lack of management commitment to remedial actions (usually over extended periods of time and following frequent requests and visits), plus other issues such as the presence of banned chemicals, poor health and safety and forced labour.

On any given issue, three warning letters will usually result in an immediate recommendation to terminate.

Number of warning letters issued in Asia in 2004

Country	Warning letter 1	Warning letter 2	Warning letter 3 and recommended terminations	Total warning letters
China	7*	5	0	12
Indonesia	3	2	2	7
Malaysia	1	0	0	1
Philippines	1	1	0	2
Thailand	1	4**	0	5
Vietnam	2	0	0	2

* includes a Group warning to five supplier factories, with potential closure of individual factories if found to be breaching working hour requirements

** earlier warning letters were issued prior to 2004

AUDITING COMPLIANCE WITH OUR STANDARDS This year we continued to evaluate how we monitor our supply chain for compliance. Some of the challenges we face arise because too few suppliers:

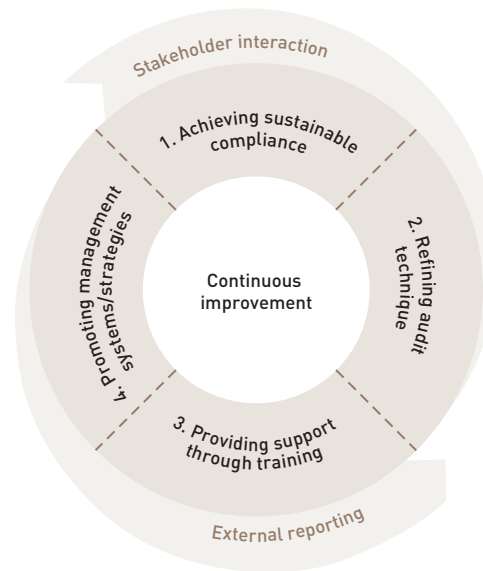
- > appreciate compliance as a competitive advantage
- > understand how effective compliance can minimise operating risks and liabilities
- > include compliance strategies and budgets as part of the annual business planning
- > internalise compliance practices and management systems.

Many of our larger suppliers do not have the management capacity to deliver compliance and have inconsistent or inadequate HR and HSE management systems. Typically, the middle managers in our partner factories lack the appropriate skills or authority to deliver better compliance. We in turn have adopted a broad rather than deep monitoring of suppliers. Our auditing tools lacked sufficient crosschecking and the five-star factory rating system for labour standards was difficult to quantify. Advancing our goal of sustainable compliance meant addressing these issues in a meaningful way.

In 2004, and with the consultation of SEA, two licensees and a Group brand developed comprehensive compliance strategies that were incorporated into their business plans. The adidas-Salomon SOE audit tools were used in self-assessment exercises. The results show strengths in the capacity of suppliers to self-assess HSE compliance, but challenges remain in the self-assessment of labour standards such as wages and freedom of association. Goals for 2005 include defining a process for auditing standards where confidentiality issues apply, for example, wages and benefits and reviewing personnel files, and expanding the project to more suppliers.

Strategic monitoring Critical reflection of our programme in 2002 and 2003 led us to realise that our auditing approach of broadly covering the supply chain was not delivering sustainable compliance. We have therefore introduced a strategic monitoring approach, launched in 2004 with SEA team members and selected suppliers in Thailand, China, Turkey and Central America. The new monitoring system means not merely monitoring compliance performance, but evaluating compliance systems, administrators, and their efficiency. In terms of the current audit practice it means better pre-audit preparation, prioritising the potential non-compliance risks, and then auditing to that risk list. Data is regularly crosschecked at every stage of the audit, and flowcharting tools are used to define the management system and process clearly. Because strategic monitoring is a flexible process, the exercise is adjusted for the findings that emerge. The factory's participation in the compliance action plans, as well as the verification of those plans, is also more clearly defined.

In terms of time and use of resources, this means deeper monitoring coverage of fewer suppliers, and the frequency of a factory's compliance visits and communication will increase two or three-fold. In 2005, more SEA team strategic monitors will be given continuous training and mentoring. They will then apply the new system of monitoring with a larger selection of suppliers.



SEA management cycle

1. Achieving sustainable compliance Our strategy 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 inspectors 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.

2. Refining our audit technique Effective compliance needs committed management that is responsive to feedback and our factory rating system needs to be able to measure this. By refining our auditing approach, we will be more able to close the compliance gap, where suppliers are delivering practices in a superficial, opaque and ineffective way.

3. Providing support through training We are committed to suppliers by facilitating compliance with our SOE. We therefore offer training on all key issues including labour, environment, health and safety – either led by SEA or a qualified external service provider. This training can be customised for a single supplier, or be provided to a number of suppliers in large group sessions. We also provide training with other brands that source from the same factory.

4. Promoting management systems We promote effective human resources, health and 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 supported and empowered by senior management. The Lean manufacturing initiative and SEA's work need to be collaborative at all stages to ensure that the supplier establishes systems that comply both with the SOE and deliver improved efficiency and productivity.

Number of factories audited in 2004				APPAREL				HARDWARE ¹				FOOTWEAR			
Country	Total number of factories	Approx. number of workers per country	Total number of audited factories ²	Main factories		Subcontractors		Main factories		Subcontractors		Main factories		Subcontractors	
				Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited
Australia	14	700	1	13	1			1							
Bangladesh	2	1,900		2											
Cambodia	4	17,000	4	4	4										
China	164	197,000	53	88	33			65	19			11	1		
Hong Kong	10	200	3	5	3			5							
India	16	3,800	11	11	7			4	3			1	1		
Indonesia	34	58,500	27	24	18	1	1	5	5	1		3	3		
Japan	57	3,200	7	29	5	8		18	1	1		1	1		
Korea	61	7,300	6	44	2	1		15	4			1			
Lao P.D.R.	2	3,500		2											
Malaysia	17	3,400	7	15	6			2	1						
New Zealand	9	200		8				1							
Pakistan	5	1,200	3	2				3	3						
Philippines	19	8,400	13	16	12			3	1						
Singapore	7	600		4		3									
Sri Lanka	6	1,500		4				2							
Taiwan	23	800		6		1		15		1					
Thailand	32	27,800	17	25	13	3	3	2	1			2			
Vietnam	17	42,900	13	8	7	2	1	3	2			4	3		
Total Asia	499	379,900	165	310	111	19	5	144	40	3	0	23	9	0	0
Argentina	11	1,000	2	5	2	1		2		3					
Brazil	28	6,500	14	8	8	2		1				8	4	9	2
Canada	22	2,100	10	8	5	6	4	4	1	4					
Chile	2	200		1				1							
Colombia	4	600	1	4	1										
Costa Rica	1	80						1							
El Salvador	5	2,550	4	1	1	4	3								
Guatemala	2	1,000	2			2	2								
Honduras	5	3,600	3	3	2	2	1								
Mexico	11	4,400	9	6	4	4	4	1	1						
Peru	3	250		2				1							
Uruguay	1	50		1											
USA	58	3,600	3	23	3	6		26		3					
Total Americas	153	25,930	48	62	26	27	14	37	2	10	0	8	4	9	2

¹ accessories and gear

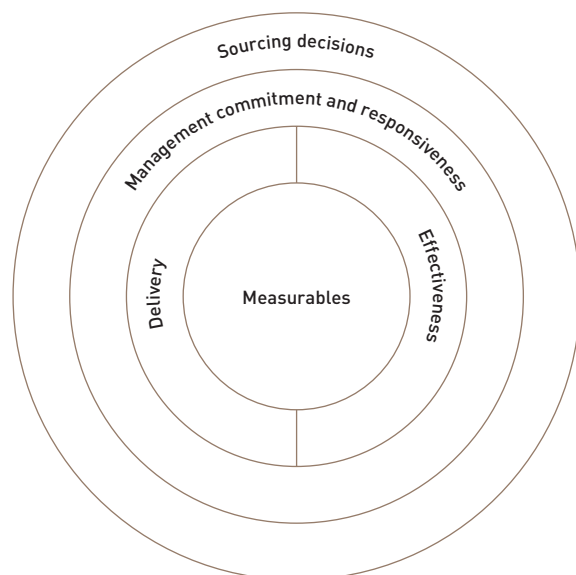
² the number does not include 60 external audits in licensee factories in Asia and two external audits in adidas supplier factories in Asia

Number of factories audited in 2004 continued				APPAREL				HARDWARE ¹				FOOTWEAR			
Country	Total number of factories	Approx. number of workers per country	Total number of audited factories ²	Main factories		Subcontractors		Main factories		Subcontractors		Main factories		Subcontractors	
				Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited	Total	Number audited
Albania	1	360				1									
Austria	2	30		1				1							
Belarus	1	540				1									
Bosnia	1	300												1	
Bulgaria	3	600	3			3	3								
Croatia	1	300												1	
Czech Rep.	2	150	1			1	1			1					
Egypt	2	350	2	2	2										
Estonia	1	30	1			1	1								
Finland	1	30		1											
France	6	900		1				2		3					
Germany	6	400	1	2	1			3				1			
Greece	3	400	3	3	3										
Hungary	1	80								1					
Israel	1	370	1	1	1										
Italy	28	1,100	6	12	2	9	2	4	2	2		1			
Latvia	2	270	2	2	2										
Lithuania	1	300	1	1	1										
Morocco	3	2,050	2	1		2	2								
Poland	2	170	1					1		1	1				
Portugal	29	1,700	17	19	8	10	9								
Romania	11	4,100	6			3	2	7	4	1					
Russia	8	1,400	3	8	3										
Slovenia	1	50	1	1	1										
South Africa	23	4,400	5	19	5			3				1			
Spain	3	50		2				1							
Sweden	1	30		1											
Switzerland	1	30		1											
Syria	2	700	2	1	1	1	1								
Tunisia	13	1,800	7	1	1	12	6								
Turkey	28	7,200	23	16	12	12	11								
UK	1	70		1											
Ukraine	2	230								2					
Total Europe	191	30,490	88	97	43	56	38	22	6	11	1	3	0	2	0
Total Asia	499	379,900	165	310	111	19	5	144	40	3	0	23	9	0	0
Total Americas	153	25,930	48	62	26	27	14	37	2	10	0	8	4	9	2
Total Europe	191	30,490	88	97	43	56	38	22	6	11	1	3	0	2	0
Total Global	843	436,320	301	469	180	102	57	203	48	24	1	34	13	11	2

¹ accessories and gear

² the number does not include 60 external audits in licensee factories in Asia and two external audits in adidas supplier factories in Asia

Our new factory rating system



Updating the factory rating system We audit our suppliers against our SOE and rate them according to their performance. The five-star factory rating system was reviewed in 2004 in order to render a rating system that pragmatically evaluates strategic monitoring findings and accurately defines supplier performance to the satisfaction of internal and external stakeholders. The new five-star factory rating system will be rolled out in 2005 and will grade the supplier management on its ability to deliver fair, healthy and safe workplace conditions in an effective manner. Supplier management will be expected to demonstrate its commitment and responsiveness to the SOE against five measurables:

1. HR and HSE management systems
2. worker-management communications
3. development and delivery of compliance training to employees
4. transparent communications and reporting
5. SOE compliance performance.

The key improvements to the current five-star ratings are:

- > introducing the new measurables in addition to the basic requirement of SOE compliance
- > an evaluation of the effectiveness of actions taken or systems put in place to remedy non-compliance
- > simplifying the rating language.

As the rollout of the new ratings is linked to the rollout of strategic monitoring of supply chain partners, we anticipate a period of 18 months or longer before all of the supply chain can be re-evaluated. Therefore, we will need to report on the supply chain using both the old and the new factory rating systems in 2005.

Licensees In 2004, two significant changes took place in our licensee arrangements:

- > Valley Apparel – a US licensee that specialises in collegiate and professional league apparel and accessories – was acquired by adidas America and from 2005 will be known as 'adidas Team'. It will continue to execute a strategic compliance plan developed in 2001, including a third-party supply chain monitoring programme under the SEA team's oversight
- > Lollytogs Limited – a leading children's apparel company based in the USA – entered into a licensee agreement with adidas America. It has coordinated its strategic compliance plan under the parameters of the SOE and will continue to execute a mature third-party supply chain monitoring programme.

Frequency of factory visits conducted by the SEA team in 2004

Number of visits	Asia	Americas	Europe
0	312	105	103
1	99	22	75
2	44	16	7
3	24	4	6
4	14	4	0
5 or more	6	2	0
Total no. of factories	499	153	191

example: 24 supplier factories in Asia were visited three times in 2004

Independent FLA audits¹

FLA year	Period	No. of audits ²
1st	Aug 2001 – Dec 2002	42
2nd	Jan 2003 – Dec 2003	13
3rd	Jan 2004 – Dec 2004	12

¹ as part of the FLA membership

² From 2003 onwards, a new risk method was applied by the FLA, randomly selecting the factories to be independently audited. Hence the reduced number of factories subject to FLA audits.

Monitoring Tier 2 suppliers Another challenge we faced in 2004 was achieving acceptable levels of monitoring Tier 2 suppliers. A policy was finalised in 2004, extending the coverage of SOE to our nominated material suppliers. The policy will be rolled out in phases, and will comprise:

- > awareness raising – adidas-Salomon’s A01 material testings policy for monitoring and controlling hazardous materials has been extended to include SOE provisions. Material suppliers have received the A01 policy document and will be required to make written acknowledgement and commitment to the SOE
- > training – the focus is on training internal adidas-Salomon material managers and technicians. In 2004, basic health and safety training was provided to this target audience, combined with field work
- > Tier 1 Oversight – the requirement in 2005 is that all Tier 1 suppliers maintain a Suppliers’ Register and track SOE communications and feedback from their Tier 2 suppliers, including subcontractors and service providers
- > pilot audits of Tier 2 – a selective number of third-party audits will be conducted at critical Tier 2 suppliers. Internal audits will also be undertaken where there are vertical manufacturing processes and textile dyeing.

Monitoring and verification In 2004 there were 12 external, independent monitoring visits by FLA-accredited monitors – nine visits were factory audits, three were executed for verification of remediation activities. There were four monitoring visits in the Americas, and eight monitoring visits in Asia (see www.fairlabor.org for more information). In 2005, the FLA will review the SOE programme for accreditation.

There were 954 audits conducted in 301 factories by SEA in 2004, covering labour, health, safety and environmental issues. This included 154 in the Americas, 512 in Asia and 288 in Europe. In total, 36% of our suppliers’ factories were audited. We concentrated on auditing high-risk factories and facilities with a large order volume. Factory audits carried out by subsidiaries on behalf of SEA are not included. Factories with no orders in 2004 were not visited. There was increased attention to pre-production audits of nominated suppliers, with the result that 107 factory sites were accepted, and 35 were rejected. adidas-Salomon licensees continued to expand the scope of SOE monitoring by third-party monitors and in 2004 completed 60 audits of their suppliers.

This year we further promoted self-auditing by our suppliers. In particular, we have developed auditing tools for Asian footwear factories that have established their own in-house compliance teams. These teams are in regular contact with us as they audit their own performance against our SOE.

Trainings in 2004 divided by region and type

Region	Type and number of training				Total trainings
	General SOE training ¹	Specific labour training ²	Specific HSE training ³	Environmental training ⁴	
Americas	15	1	1	0	17
Asia	48	18	33	6	105
Europe	33	4	1	0	38
Total global	96	23	35	6	160*

¹ for example, practical onsite training, presentations for awareness raising

² for example, worker-management communication; sharing best practice; freedom of association; factory overtime system; grievance and appeal systems

³ for example, sharing best practice; chemicals in production

⁴ for example, hazardous waste treatment; environmental best practice

* including 70 group training sessions

Number of audits and trainings

Year	2004	2003	2002	2001
Audits	954 ¹	906 ²	1,148 ²	839
Trainings	160	206	255	267

¹ excluding FLA audits and 62 other external audits conducted by external monitors in adidas-Salomon supplier factories and licensee factories; includes multiple visits in the same factory

² excluding FLA audits (includes multiple visits in the same factory)

PROMOTING MANAGEMENT SYSTEMS Good management systems need to make sense for the scale of the company's business, fit with its culture, structure and management objectives and follow international standards. Effective internalisation of the SOE means developing systems for managing HSE and labour issues. In 2004 we outlined our expectations of our strategic suppliers in Asia as:

- > more responsibility for HR managers to deliver a HR management system that supports good worker-management communications, effective industrial relations and labour rights compliance
- > employment of a dedicated Safety Manager to oversee and implement occupation health and safety systems.

For further information about HSE management systems, see page 39.

TRAINING AND GUIDANCE Training is a key tool in raising compliance awareness, and we evaluate its effectiveness annually. In 2004 a SEA root-cause analysis of audit results revealed that non-compliance is a common finding when training is not adequately supported by factory management. Another finding was that the turnover rate of SOE coordinators in the factories is high, which dilutes their effectiveness in delivering SOE compliance.

This year there was an increased focus on supplier training and education. In Europe and the Americas, the emphasis was on health and safety, Freedom of Association, worker-management communication and general compliance awareness for workers, supervisors and managers. There was continued SEA input and guidance with Lean implementation, especially for components that influence wages, working hours, stress and fatigue. In Asia, we delivered compliance training to our footwear material managers and strategic footwear suppliers. There were three training sessions in Vietnam, China and Indonesia, with an average audience of 40 representatives from suppliers and their adidas-Salomon materials contacts in local sourcing offices.

SEA Lean synergies in El Salvador

Our commitment to identifying synergies and gaps between production efficiency programmes and good working conditions became increasingly important as the number of Lean practitioners in our supply chain grew between 2003 and 2004. Lean benchmarks of increased productivity and efficiency have had a direct influence on wages, benefits, hours of work, stress, fatigue, and injuries. Workers' rights issues, freedom of association, worker-management communications and industrial relations are touched by Lean components of team work. Lean's employee training and Kaizen management events influence employee retention and stability, career advancement, and worker empowerment.

In mid-2004 we piloted a project to measure the effects of Lean implementation on working conditions with two US academics, management and workers from an adidas-Salomon apparel supplier in El Salvador. The study's goals were to collect and collate pre- and post-Lean data from a Lean factory and identify Lean benchmarks that measure working conditions transparently. The next step is to design automated data reporting mechanisms and benchmark the key performance indicators of SOE compliance.

The project was set up in three phases:

- > phase 1 (August to November 2004) – focused on collection of wages, hours, productivity, costing, and delivery data at the factory. A discussion paper by the academics addressing Lean's influence on wages and the cost of production, working hours, and product delivery, will be ready early in 2005
- > phase 2 (scheduled for March to September 2005) – will identify the data collection points for health, safety and stress/fatigue, and collate that data from pre- and post-Lean implementation periods
- > phase 3 (scheduled for mid to end 2005) – will identify collection points for worker's rights data such as worker-management communications and freedom of association, and collate that data from pre- and post-Lean implementation. There will be discussion papers at the end of each phase, and we will report on the findings.

The study's goals are to identify Lean benchmarks that measure working conditions transparently.

Number of business relationship terminations due to SOE problems and rejections after Pre-Approval Audit (PPA) in 2004

Region	Country	Number of terminations per country	Number of rejections after PPA per country	Reasons for termination/rejection
Asia	Cambodia		2	Poor HSE conditions, double book-keeping, falsified working hours records
	China	1		Terminated as a result of ending relationship with parent factory, due to poor management of factory closure in Indonesia
			22	Incorrect payment of wages and benefits, excessive overtime, no Sunday off, double book-keeping, falsified working hours records, child labour, poor HSE conditions
	Indonesia	1		Evidence of misleading and dishonest practices towards adidas-Salomon, falsified working hours records, incorrect payment of wages and benefits, violations of freedom of movement
			2	Incorrect payment of wages and benefits, excessive overtime, inappropriate disciplinary practices, discrimination, insufficient social insurance, poor HSE conditions
Thailand		3	Poor HSE conditions, no maternity leave and sick leave, insufficient social insurance, financial penalties	
Vietnam	1		Excessive working hours, insufficient time recording system, incorrect payment of wages and benefits, improper worker-management communication, poor HSE conditions	
		1	Poor HSE conditions, incorrect payment of wages and benefits	
Americas	Brazil	1		Lack of fire safety, violations of freedom of movement, harassment
	El Salvador		1	Lack of waste water treatment
Europe	Turkey	1		Evidence of misleading and dishonest practices towards adidas-Salomon, insufficient implementation of social insurance
			4	Incorrect payment of wages and benefits, excessive overtime, insufficient implementation of social insurance, insufficient time recording system, poor HSE conditions in spot removing area
Global		5	35	

Review of existing training modules In 2004, we completed a comprehensive review of the training materials for suppliers. We found that our current training modules are not supporting the delivery of effective self-governance sufficiently, including compliance internalisation, self-enforcement, management systems development and process ownership.

The revised training materials will take into account:

- > new modules for implementing HR and HSE management systems and core processes
- > training that is pragmatic and relevant to a supplier's need
- > more rigorous assessment of the supplier's staff competencies and training needs
- > adidas-Salomon key initiatives, such as Lean and Lean/6 Sigma, a more sophisticated methodology aimed at eliminating defects
- > more field and factory-based training programmes for best practices.

In 2004, we continued to evaluate our internal training capacities and identified a need for external trainers to deliver specific materials. However, in Asia and particularly in China, we recognise that a key challenge is the lack of

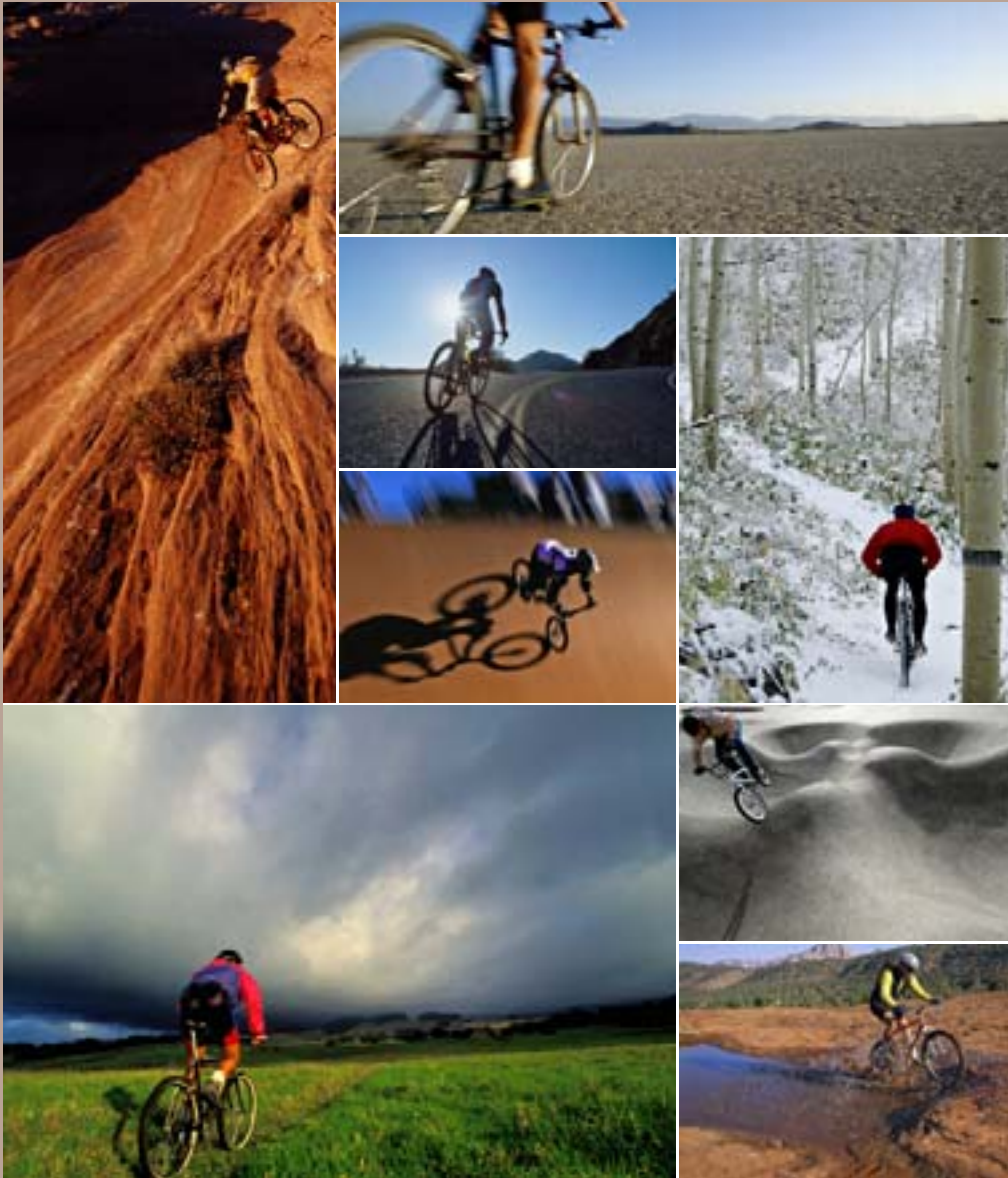
qualified external trainers. A 2005 objective will be to identify qualified third-party trainers, or build the requisite capacity in NGOs to help us improve our delivery of technical and worker-level training.

INTEGRATION WITH OPERATIONS

We continued to integrate compliance activities with Global Operations' key initiatives. To ensure that there was effective use of compliance data in sourcing decisions, we defined a new key performance indicator (KPI) that uses language similar to the KPIs of other corporate supplier initiatives (see the five-star rating on page 38). SEA and Sourcing managers worked closely in the development of sourcing strategies in the Americas and Asia, and with adidas-Salomon Group entities Arc Teryx, Valley Apparel and the licensee Lollytogs. The demand for pre-production audits of proposed suppliers was higher than expected, and while it stretched our internal auditing capacity, these audit findings contributed to the rejection of almost 25% of candidates. In 2005, we will work with sourcing to develop a more rigorous process for nomination and pre-screening of suppliers.

Chapter summary

- > Our SEA team works closely with Global Operations to evaluate nominated supplier partners.
- > We have adopted a new strategic monitoring approach that will cover fewer factories but with deeper investigations that aim to identify and address the root causes of non-compliance.
- > We continue to promote HR and HSE management systems as a means of internalising compliance and driving continuous improvement.
- > We will improve supplier training by providing better materials, delivered by more external trainers.
- > We will continue to investigate the synergies between production efficiency programmes, workers rights and HSE.
- > We have redesigned our five-star factory rating system so it evaluates the delivery and effectiveness of supplier compliance against five core measurables.



Employment, health and safety performance

In response to stakeholder feedback, this chapter not only details our efforts to improve conditions for our suppliers' workers, but also addresses the HR programme for adidas-Salomon employees.

HR performance

Key employee statistics

Index/reporting unit	Total	adidas	Salomon	TMaGolf	HQ-Functions ¹
Total headcount (in %)					
Male	55	52	64	69	48
Female	45	48	36	31	52
Management positions held by (in %)					
Male	79	78	79	88	79
Female	21	22	21	12	21
Average age of employees (in years)	34	32	39	36	36
Employee turnover (in %) ²	9.2	11.8	4.0	7.0	6.7
Annual average length of service (in years)	6.0	4.4	11.4	6.3	5.9
Average number of training hours per employee/year	13.6	14.7	14.9	6.3	11.9

¹ Global Operations, Corporate HQ-Functions

² voluntary attrition

Our people and their talents are critical to our continuing commercial success. With more than 17,000 employees working in 110 countries we need to develop HR strategies that can be implemented globally. The first step is to identify the common challenges we face wherever we operate:

- > talent management – to identify, recruit and retain the most talented people and develop career opportunities for them tailored to the specific needs of our company
- > employee-oriented leadership – to strengthen the alignment of management and employees by improving communication and enhancing employee feedback systems
- > performance management – to instil a result-driven management culture that supports up- and downward performance feedback for continuous learning and improvement
- > motivation – to provide reward and incentive schemes as well as a working environment that promotes employees' commitment, engagement and wellbeing
- > communication – to improve transparency and efficiency in communication at all levels of the Group and wherever we operate.

To rise to these challenges, our programme focuses on five core processes of HR management: attracting, recruiting, developing, rewarding, and retaining staff. Some of our key programme initiatives are described below.

TALENT MANAGEMENT Just like athletes, adidas-Salomon employees need a training plan to build on their strengths, overcome their own challenges and improve their technique to achieve their goals. We call our training plan the 'Fit for Gold' programme. It is based on three pillars:

1. Fit for Today – aims to provide employees with a common platform and standard of skills needed in their current position. Closely tied to the annual Performance Evaluation and Planning process (PEP), Fit for Today provides employees with training on communication, workflow, teamwork, project work, presentation skills and work-life balance.
2. Fit for Tomorrow – focuses on identifying and developing people with high potential at different levels within the organisation. Participants join different development programmes to prepare them for their next step. We are moving away from a pure focus on classical training and seminars and are introducing a much broader range of development activities such as action learning, working on leadership style and cross-functional exchange programmes.
3. Stay Fit – gives employees regular fitness check-ups that help both the organisation and employees cope with current and future challenges. It covers organisational learning and development, including tools such as 360-degree staff appraisals, and also measures the success of the programmes overall, providing input for further refinement.

PERFORMANCE EVALUATION AND PLANNING (PEP) is adidas-Salomon's evaluation tool for comprehensive annual employee reviews. Employee performance levels, as determined by PEP, serve as an indicator for base salary development and variable compensation, supporting our goal of paying for performance. In addition to job performance, competencies and skills, adherence to company values are also evaluated. The PEP evaluation also forms the basis for determining suitable personal and career development activities.

EMPLOYEE REMUNERATION Our Global Salary Management System (GSMS) is linked to the PEP and sets the salaries of our employees in a clear, understandable and measurable way. Managers and the HR department can identify gaps between current and target positions within an employee's salary band and point out how the employee could reach the target position. adidas-Salomon also offers various attractive variable compensation systems:

- > Pay for Performance bonus programme – more than 20% of all employees receive this variable salary component with an average of 20% of their remuneration linked directly to individual and Group performance.
- > Long-Term Incentive Programmes (LTIP) – these include a Management Stock Option Plan (MSOP) that links the compensation of approximately 450 key executives worldwide to the adidas-Salomon share price and adidas-Salomon's position in a peer group index. First allocated in 1999, options could be exercised after a vesting period of two years. The last tranche of the programme issued options in 2003 that can be exercised until 2010. We are currently reworking our LTIP structure and plan to launch further performance enhancing plans in 2005.

Additional long-term incentive programmes are focused on special projects and turn-around initiatives and are in place in various regions and brands.

Other benefits include our 401-K pension plans in the USA and the adidas-Salomon AG pension plan for our employees in Germany. In 2004, 1,102 employees participated in the latter, which represents an increase of 6% compared to the previous year.

GLOBAL MOBILITY Global presence and success in worldwide markets require a workforce willing and able to work around the world. For those employees who are interested in working in different countries, we have a programme of international assignments to worldwide locations within the adidas-Salomon Group. Most of these take place between Germany, USA, China, France, Hong Kong and The Netherlands. adidas-Salomon provides training and cultural preparation to familiarise the relocating professionals and their families with their new living and working environments. In brief:

- > adidas-Salomon Headquarters employs more than 300 international employees from more than 40 countries
- > between 50 and 100 international assignments at various locations begin annually
- > 350 employees are permanently on international assignments.

WORK-LIFE BALANCE Every employee's quality of life should be improved by working for adidas-Salomon, so we have a responsibility to address work-life balance. We aim to harmonise the commercial interests of adidas-Salomon with the private and family needs of our employees, thereby assuring the mutual benefit of both. The programme includes family-oriented services, flexible work time and place, people development and leadership competence related to work-life balance. Hertie Stiftung, the third largest private foundation in Germany, audited our programme to identify and initiate ways to improve family-oriented personnel management. We were re-audited in 2004 and awarded the official certificate as a Family-Friendly Employer.

COMPANY SPORTS We offer our employees a wide range of sports activities at our major sites including team sports such as football and basketball, fitness and relaxation courses such as yoga and Tae Boe and endurance sports such as running. At our headquarters in Germany and Portland our employees have access to a company gym.

EMPLOYEE PARTICIPATION OUTSIDE EUROPE While adidas-Salomon employees in Herzogenaurach, Portland and Annecy have enjoyed access to top management in a variety of forums, creating effective communication channels throughout the regions at Liaison Office (LO) and factory level is a constant challenge.

Our internet-based 'Ask the Management' forum gives employees throughout the regions an opportunity to raise concerns and post questions to top management. More direct communications are being established in the LOs throughout Asia, based on the Guangzhou

model detailed in our Social and Environmental report 2003. The Guangzhou management-employee committee is now in its third year and has incorporated elected representatives from Apparel, Accessories and Gear as well as the original footwear sourcing representatives. In 2004 a number of key issues were discussed and in most cases resolved, including:

- > provision of medical insurance for staff located in different cities
- > housing accumulation fund and social retirement fund coverage
- > the possibility of introducing flexible working hours in the LO
- > the venues and activities for company outings.

adidas-SALOMON HIV-AIDS POLICY At the end of 2003, SEA undertook to develop an HIV-AIDS policy for the Group, drawing on information from the International Labour Organization (ILO). In the first half of 2004, a suite of documents were prepared comprising a draft corporate policy, general guidance on HIV-AIDS, an employee guide, and guidelines for managers on workplace care and support.

These materials are now being field tested by adidas-Salomon's Thailand LO and adidas Thailand Limited, a sales and marketing subsidiary. A joint HIV-AIDS Committee, comprising senior management, administration and HR personnel, has been established to oversee this exercise. The committee members are liaising with a local NGO – the Thai Business Coalition for HIV-AIDS – to organise HIV-AIDS awareness training for the local office and retail staff. The results of the pilot exercise will help inform and refine the company policy and guidelines and define future training requirements.

EMPLOYMENT PRACTICES IN THE SUPPLY CHAIN At the start of 2004 the compliance staff of several brands met to discuss the challenges we face introducing suppliers to the concepts of HR management. Each company faced the same problem – how can the effectiveness of factory HR management be evaluated when many factories do not have the necessary systems in place? Given that there are no standardised off-the-shelf management systems for HR or employment practices, the brands agreed that this was the first step in promoting effective HR management.

The brands' aim is to build a framework for effective HR management in the supply chain that results in sustainable compliance with SOE and supports high performance workplace systems and production processes, for example, Lean manufacturing. Some of our basic assumptions are:

- > compliance auditing and monitoring does not produce sustainable results
- > efficient HR management is fundamental to improved productivity
- > establishing an HR management system empowers workers, promotes positive industrial relations and is fundamental to developing a long-term business plan for growth and success
- > HR management provides systems and methodologies to evaluate, measure and assess key performance indicators and business costs, for example, turnover, re-recruitment and training, days lost to accidents, injuries and absenteeism

Building capacity in the Bulgarian apparel industry

This was a pilot project in different senses. It was the first time in Europe that four major international brands and the European Trade Union Federation of Textiles, Clothing and Leather came together to collaborate on a capacity-building project. Not only were workers and managers of various suppliers involved but also local trade unions, the Bulgarian Ministry of Labour and the Bulgarian General Inspectorate of Labour. Secondly, we wanted to learn from the experience so that we could make any necessary adjustments and see if and how this kind of project could be transferred to other countries.

The goals of the project were to encourage constructive dialogue between management and workers as well as between government, industry and unions, and to build capacity among workers, workers' groups, employers and unions.

Through the initiative, all stakeholders received focused training on corporate responsibility issues, social dialogue, corporate codes, local and international laws and possible local implications. Through 'improvement circles' the workers on the course shared what they had learned with more than 500 other workers in their factories. This has empowered workers and has supported them in gaining a better understanding of their rights. It was obvious at the end of the project that the position of worker committees in factories had strengthened and that labour relations had improved. Both workers and managers became aware how the quality of worker-manager communication affected day-to-day performance in the factory.

Important first steps have been taken, noteworthy progress has been made and different partners have been brought together for the first time. This has led to a greater shared understanding about each stakeholder's position and opened the door for further dialogue and improvement. However, the Bulgarian apparel industry can become more sustainable if factories increase their collaboration and share best practices with each other. Another review of the lessons learned and progress made is planned for 2005.

From March to October 2004, a professional trainer conducted a series of workshops. Approximately 140 people from 10 different factories – with a total workforce of more than 4,000 people – were directly involved in the training. From a total of 140 people, 97 were factory-floor employees.

'We worked out a way of re-organising the production line during an improvement circle session. This has improved productivity in our factory.'

Participant's quote

- > establishing an HR system within supplier factories will facilitate evaluation of supplier performance in a systematic manner
- > many best practices exist in the supply chain and can be used as the foundation of an HR management framework.

While there are a number of initiatives that address the need for improved HR management in factories, this project is unique in that it has involved critical stakeholders from the outset. These include factory owners and their HR managers, HR professionals, compliance and operations staff from participating companies, and HR professionals from other industries. The entire process will be led by HR experts – as opposed to NGOs or commercial monitoring firms – with specific experience in labour-intensive, traditionally low-skill base factory management. This project will be developed and implemented first in the Asia region, where the most critical HR problems exist.

Worker-management communication Our ultimate objective is to raise factory conditions to a standard whereby SEA is no longer needed and factories are able to maintain high labour standards without external monitoring or intervention. To complement the development of HR management systems, as described above, we recognise the importance of open and effective communication between management and workers. Clear and transparent communication is needed so workers can feed back to management and to help workers and management resolve workplace issues and disputes. In 2004 we began to examine ways to improve communication in our supplier factories, moving from passive mechanisms (for example, suggestions boxes and notice boards) to more active means, through joint worker-management committees and dialogues. A guideline on establishing joint worker-management HSE committees was drafted and will be issued in 2005.

Capacity building to improve social dialogue between workers and management, including unions, has strengthened the role of worker committees in our supplier factories in Bulgaria (see further the case study on page 36).

Worker cooperative guidelines In our 2003 report we summarised the findings of our fair wage research and related stakeholder workshop in Indonesia. Among other things, the research identified the value of promoting the development of worker cooperatives in the supply chain. To support this, in 2004 we commissioned two NGOs – the Global Alliance for Workers and Communities (GA) and the World Council of Cooperative Unions (NCOCU) – to prepare a set of guidelines and best practice examples on worker cooperatives. The NGOs undertook field research and visited existing cooperatives in Indonesia and Thailand. In preparing the guidelines, specific attention was given to the key criteria for the establishment of an effective cooperative, as well as the associated pitfalls and challenges. The guidelines are to be published by adidas-Salomon in 2005 and will be distributed to our suppliers, to trade associations, NGOs and international agencies, including the Cooperatives Department of the ILO.

Health and safety performance

AT OUR OWN SITES Everyone has the right to work in a safe environment. This has been recognised the world over and, as a global Group, our operations have to comply with a wide range of different legal and cultural imperatives. Naturally, practices and procedures will vary from one facility to another, but the core requirements remain the same.

These core requirements are fully explained in a set of Corporate Guidelines for Health, Safety and Environment for adidas-Salomon facilities. These guidelines especially help facility management of mainly administrative offices to manage health and safety issues in an effective way. Furthermore, larger adidas-Salomon administration facilities and the few production sites owned by the Group have comprehensive risk, health, safety and environmental management systems coordinated by local facility management.

adidas Footwear Factory, Scheinfeld, Germany After being awarded first prize by the German Trade Association in 2000 for its advanced health, safety and environmental systems, the Scheinfeld factory has maintained a high level of workplace occupational health and safety for its 120 employees. Each workplace in the production area is carefully reviewed for health and safety risks. This year there were three minor accidents which led to 39 lost days.

adidas Apparel Factory, Suzhou, China The industrial accident logbook shows no accidents for 2004.

Salomon Factory, Rumilly, France With 950 employees, this factory manufactures skis and wheels for Salomon and Mavic. An ergonomics programme began in 2003 and was expanded in 2004 to include 30 doctors and medical experts. A special European Safety Week focusing on workplace safety for part-time workers was organised. The factory also ran road-risk training sessions about how accidents can occur on the way to and from work. Overall reported workplace accident numbers have dropped from 45 in 2002 to 25 in 2004, which led to 514 lost days.

TaylorMade Assembly Factory, Carlsbad, USA 731 workers assemble golf clubs in this factory, co-located with the TaylorMade administration offices. In 2004, there were 16 workplace accidents resulting in 171 lost days. One employee accounted for 163 of these lost days.

adidas-Salomon Headquarters, World of Sports, Germany This administration facility with 1,050 employees has effective occupational HSE management, coordinated by a professional health and safety officer and a company doctor. In 2004, various projects were completed including:

- > implementing the occupational health guidelines in the newly created World of Soccer and the factory outlet
- > improving traffic safety with new markings at the exits of the company premises

Factory rating system

For the auditing of our suppliers' compliance with our SOE principles in 2004 we used our old five-star factory rating system. From 2005 on we will be using the new revised system.

The following table summarises the performance of our suppliers against our SOE in 2004, using the factory rating system described below. It reflects the lowest rating of either the HSE or labour performance of each supplier. Once a factory has been rated, an action plan is written.

The five grades of our factory rating system are:

There are numerous severe non-compliance issues. The factory has been given notice that business will be terminated unless there is immediate improvement.

There are some non-compliance issues and the factory is responding to the action plan slowly or with reluctance. The factory is monitored regularly.

There are minor non-compliance issues, and the factory is responding to the action plan positively.

Generally there are no non-compliance issues, and there are some best practices in place, confirmed in documentation.

There are no non-compliance issues and all of the factory's management system and practices are in place, confirmed in documentation.

International and local active supplier factories, including licensee factories

APPAREL

Labour/HSE standards	Asia	Americas	Europe
*	13	0	1
**	80	16	21
***	22	21	54
****	1	5	5
*****	0	0	0
Total active factories rated in 2004	116	42	81
Total active factories in region	329	89	153

HARDWARE¹

Labour/HSE standards	Asia	Americas	Europe
*	7	0	0
**	26	1	1
***	6	1	6
****	1	0	0
*****	0	0	0
Total active factories rated in 2004	40	2	7
Total active factories in region	147	47	33

¹ accessories and gear

FOOTWEAR

Labour/HSE standards	Asia	Americas	Europe
*	0	0	0
**	2	3	0
***	5	1	0
****	2	0	0
*****	0	0	0
Total active factories rated in 2004	9	4	0
Total active factories in region	23	17	5

- > enhancing security in some areas with slip-resistant floor-carpets
- > training on UV skin protection.

Regular activities such as ergonomics training and work-life balance projects have continued. The accident logbook for 2004 showed only three accidents reported on the way to or from work, two minor accidents during work, and one during sports exercises on company grounds.

IN OUR SUPPLY CHAIN We expect our suppliers to provide a safe and hygienic working environment for all their employees. Nothing less is acceptable. To make this a reality, we will in future be making it a requirement for all our business partners to establish a health and safety management system, such as OHSAS 18001. Our footwear suppliers must be certified in OHSAS 18001 by the end of 2006, and are making good progress in this regard. Major apparel and accessories and gear suppliers should be certified by 2007. This year our initiatives have focused on preparing both the SEA team and our business partners for this increased emphasis on management systems.

Training the SEA team To provide the necessary support and evaluate the effectiveness of a health and safety management system, all team members have received introductory training in OHSAS 18001. Selected team members attended an in-depth OHSAS 18001 Lead Auditor course, recognised by the International Register of Certificated Auditors, UK (IRCA). The participants now know how to establish an OHSAS management system from inception through to implementation. At the end of 2004, there were two IRCA-accredited auditors in the SEA team. By the end of the first quarter of 2005, the number of accredited auditors will increase to nine.

In 2004, many internal HSE cross-training activities took place around the world, including:

- > VOC monitoring – two SEA team members were trained to carry out VOC-in-air monitoring
- > fire safety training – in collaboration with the Singapore Aviation Academy (SAA), SEA developed a fire training course for suppliers that was conducted at the SAA facilities in Singapore
- > fire safety audit – our fire safety expert conducted fire safety audits in Indonesia and at the same time trained the Indonesia SEA team
- > HSE cross-training – the SEA team provided training and support to the Group brand Arc'teryx and reviewed the functions of the HSE committee at the Arc'teryx-owned facility in Canada.

One of our SEA team members received chemical burns during a factory inspection in China. This has prompted a review of the emergency response and safety training for all operational staff. As a result, additional health and safety training will be given to SEA, Sourcing and Materials teams in 2005.

Training sourcing personnel We have continued to support the training of footwear sourcing personnel and inform them about the new requirement for management systems. This year we organised two training sessions for adidas-Salomon operations and production management in each footwear sourcing country in Asia. The senior management from each supplier was also invited to facilitate round-table discussions on SOE issues encountered at the factory level in day-to-day operations.

Training suppliers Nominated Tier 2 supplier training sessions were conducted in Indonesia and China, attended by approximately 100 suppliers.

Training was also provided to the top management of TaylorMade suppliers. The purpose of the training was to influence the prevailing management culture (in which compliance has not been prioritised) and encourage the management to view labour and HSE compliance as a benefit that helps make their businesses smarter and more efficient.

Usually, SOE training sessions are initiated and managed by the SEA team in order to enhance the knowledge of suppliers – either to help them work better or obtain their buy-in regarding special initiatives and projects. However, during 2004 one of the footwear suppliers invited the SEA team to conduct occupational health and safety training for its senior management as part of its ongoing internal training programme. This was a first of its kind and confirmed the view that support for the SOE must be demonstrated by top management and driven internally within the supply chain.

Helping small and medium sized enterprises (SME) implement HSE management systems

At the end of 2004 we commissioned an independent consultant to develop a set of industry-specific procedures and guidance to help SMEs establish and implement an occupational health and safety management (OH&S) system. For those very small suppliers with few workers and limited resources, this package will:

- > raise the awareness and importance of occupational health and safety
- > help determine the key OH&S impacts and practices for SMEs
- > demonstrate the basics for developing generic guidance, procedures, and work instructions to support the development of a documented OH&S management system, in general compliance with the requirements of OHSAS 18001.

The end product of this project will be disseminated to all SME suppliers in 2005 and training will be provided on how to establish the necessary management systems.

Reproductive health in the factory and community

In 2003 we reported on our developing partnership with Marie Stopes International (MSI). Based on the research and survey work that was conducted at supplier factories in Vietnam in the first quarter of 2004, a broad-scale project aimed at addressing the fundamental sexual and reproductive health of workers has been developed. During the survey and research phase, it became clear that the two fundamental problems for workers are firstly lack of knowledge and awareness in relation to managing their own health, and secondly lack of access to reproductive medical services. This was evident in the information workers and factory clinic staff provided, which revealed personal practices and emerging trends in the local communities. Research and survey work has also started in Dongguan in south China to assess the needs of workers, factory management and local authorities in respect of reproductive health among the largely migrant workforce.

In 2004 the Chinese authorities fully acknowledged the growing impact of HIV-AIDS. Given the growing support for programmes that address the increasing health risks for China's urban workforce, the MSI China programme will identify the best methods for protecting workers against this disease and poor reproductive health in general. Underpinning the programme is the concept of personal responsibility. At relatively minimal cost to factory management, a significant number of workers can be taught how to protect themselves and improve their overall health and wellbeing.

In January 2005 the implementation phase of the Vietnam programme will begin, starting with the establishment of a permanent reproductive health clinic for workers and the surrounding communities. In addition, a mobile team will travel out from the clinic to the factories to provide a range of services including factory clinic staff training, delivering basic reproductive clinical services from a mobile van, distributing information and educational materials, and training volunteer workers as peer group leaders. Marie Stopes will also help factory clinic staff develop a proper referral network with local clinics, hospitals and pharmacies, as well as promote the MSI clinic and its unique philosophy on health services and standards. Privacy, confidentiality and counselling of the patient or client are still somewhat novel concepts in Vietnam.

'MSI and adidas-Salomon share a common vision that solutions must be long term, sustainable and cost effective, with direct benefit for factory workers as well as factory owners.' Marie Stopes International

Selection of HSE certification bodies Globally, adidas-Salomon suppliers have a wide selection of HSE certification bodies to choose from. However, in developing countries, many certification bodies are not subject to any regulatory constraints and provide little assurance of integrity and accountability. For this reason we have selected five reputable international certification bodies, and suppliers are encouraged to choose from our nominated list of certifiers.

In order to fulfil our requirements, each nominated certification body must:

- > operate according to an OHSAS health and safety management system
- > be recognised by the government authorities where they are located and operate in strict accordance with international standards
- > be subjected to peer assessment by other recognised international accreditation bodies
- > have been accredited by the relevant institutions, such as the United Kingdom Accreditation Service (UKAS)
- > be located in at least three of our major sourcing countries
- > incorporate our SOE and health and safety guidelines.

Promoting occupational health initiatives In 2004 we collaborated with Nike and Reebok to organise occupational health (OH) training at our footwear factories in Asia. International SOS, a medical provider, was invited to develop and implement the training programme, which began in China with a review of the OH conditions in the factory clinics and staff facilities and an assessment of training needs. Based on this review, a series of ten training sessions were held attended by medical doctors, the factory management responsible for health issues, and safety officers. At the end of 2005, a review will be conducted so progress can be assessed and measured.

In November 2004, a parallel OH training programme was launched with SOS International in Vietnam. Occupational health training for Indonesian footwear factories is scheduled to begin in January 2005.

Chapter summary

- > While we have made good progress in formulating a comprehensive HR strategy supported by relevant programmes, we are still to implement these programmes globally, and measure their success.
- > Our focus on achieving sustainable compliance in our supply chain is reflected in a shift away from broad to deep monitoring.
- > We will soon be requiring our business partners to establish HSE management systems and we will continue to support our partners in implementing them.
- > We are collaborating with other brands and have begun to develop an industry standard HR management system for our suppliers.
- > We are strengthening the occupational health capability of the doctors and health and safety professionals employed by our footwear suppliers.



Environmental performance

Environmental impacts occur at all stages of the lifecycle of our products, from product design to disposal.

The largest environmental impact is during manufacture at supplier sites, where more than 95% of our products are made.

Environmental performance

All of us have a responsibility to future generations to look after the natural environment. Our efforts are focused on the environmental impact we can most influence, which is during manufacture at the supplier sites where more than 95% of our products are made. We promote environmental management systems as the best way for suppliers to reduce their environmental impact. Using our own sites as examples of best practice, we provide our business partners with guidelines and training programmes.

The diagram opposite illustrates the impacts at each stage of the product lifecycle and the initiatives taken to address them. The chapter follows the lifecycle of our products beginning with design and innovation, followed by how we manage impacts at our own facilities and then how we help our suppliers to reduce environmental impact at their sites.

SUSTAINABILITY BY INNOVATION AND DESIGN Products must not only be competitive in terms of price and performance. They also need to be safe – during production, use and after disposal – and environmentally sound. So-called end-of-pipe solutions offer only limited environmental benefits. As well as using recycled materials in new products, we are investigating the innovative use of natural fibres. In 2004 we developed a small range of styles containing bamboo fibres that are due to be launched in 2005.

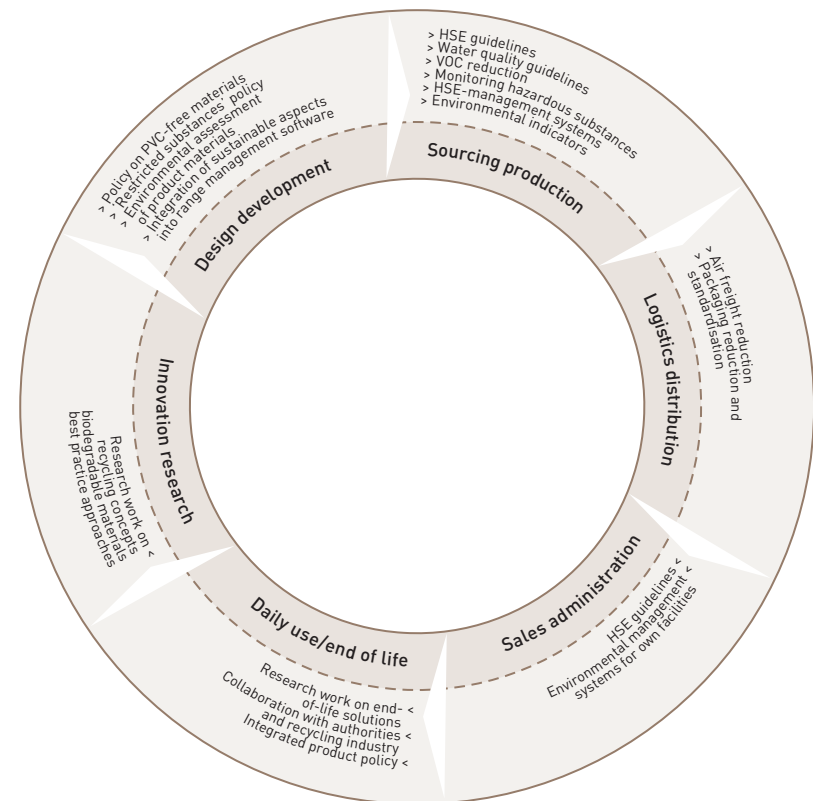
Material selection policy adidas-Salomon does not source raw materials from any endangered or threatened species – those that are on the International Union for Conservation of Nature and Natural Resources (IUCN) red list. Nor do we accept the use of leathers in our products that have involved the inhumane treatment of animals, whether these animals are wild or farmed. We rigorously execute this policy.

We regularly hold internal training sessions, and produce briefings to update product, design and material management teams on what is covered by our material selection policy.

Organic cotton/better cotton strategy We want to secure more sustainable cotton sources, but based on feedback from several stakeholder dialogues we recognise that the use of certified organic cotton is still problematic. Certified organic cotton is both more difficult to source and more expensive. Moreover it does not address the most critical environmental impact of cotton farming – excessive water consumption.

Through ongoing research and discussions with several stakeholders we have been made aware of various new initiatives advocating alternatives to conventional and certified cotton farming. Supported by international companies and NGOs, the approach is to tackle the most serious environmental challenges of cotton farming by providing training and capacity building to farmers in sustainable cotton farming methods without causing big price premiums. This

Product lifecycle



approach is consistent with our overall emphasis on capacity building in our supply chain and we are keen to be involved. We will report back about our engagement in this initiative and on its progress in 2005.

Control and monitoring of restricted substances Restricted substances are those that cause harm or are suspected of harming human health or the environment. Our corporate policy requires our suppliers to avoid the intentional use of such substances and is based on the following principles:

- > always apply the strictest local standard globally
- > approach best practice – benchmark our policy against standards recommended by consumer organisations and environmental groups
- > meet sourcing standards of retailers and customer expectations.

Our policy on the monitoring and controlling of hazardous substances, known as A01 requirements, applies to the entire Group. The policy contains a comprehensive catalogue of restricted substances, corresponding test methods, pre-treatments and threshold limit values (TLVs).

This year we asked an environmental NGO for its view of our policy. Based on their constructive feedback we revised certain provisions and issued the amended policy to our suppliers in October.

In addition, training and a round-robin correlation test took place with over 20 global recommended external testing institutes during the last quarter of the year. This was to check the reliability and quality of material tests, the awareness of testing institutes about the latest changes in legal requirements and standards, and to share experiences about testing procedures for specific material groups. Evaluation of the final results has begun and we will report back on this in 2005.

Regular random material/product checks conducted by our own material labs showed a very high level of consistency with our policy at all production levels and product categories.

We are also engaged in an inter-company working group dealing with restricted substances. The group, which is facilitated by an environmental consulting organisation, consists of representatives from sports and apparel brands, retailers and the furniture industry. Sharing information gives each company the opportunity to learn about policies, approaches and techniques that have worked for others in the group.

Product safety To ensure product quality and consumer-safe products, all materials and product samples are tested in accordance with standardised material and product testing specifications and procedures. Materials, components and products are released only after successfully passing the required testing procedures.

In 2004 we announced a voluntary recall of two adidas basketball shoe styles from the US market. The nature of the problem involved the mid-sole of the heel unit, which in some cases could have separated from the outsole. These models were sold during the year at adidas stores, major athletic shoe stores, independent shoe stores and on the company's website. adidas-Salomon recalled the models in cooperation with the US Consumer Product Safety Commission.

Elimination of PVC Following the principal decision we made in 2000 to eliminate PVC from our products, we have successfully substituted PVC in most products by using Polyurethane (PU), Ethyl Vinyl Acetate (EVA), Silicones or Thermoplastic Rubber.

Only very few apparel styles carrying Plastisole prints (inks based on PVC material) are still in use, because of specific quality requirements for certain design features. We have established a working group with our global ink suppliers with the aim of finding innovative solutions for these applications. Several material tests with PVC-free ink systems were conducted to check whether they meet quality requirements.

While we have continued to reduce PVC materials in Salomon products, a few Salomon footwear styles and other equipment still contain PVC components. The PVC meets the special material and physical properties demanded by the cold temperatures in winter sports.

Some athletic footwear models produced locally still contain PVC materials. While striving for the elimination of PVC from these products we need to acknowledge that appropriate replacement materials are not available in those countries and need to be imported. The considerable import duties significantly increase product costs.

Integrated product policy – creating a sustainable product



Achieving sustainable environmental improvements for our products demands that we look at all stages of the lifecycle, not just the manufacturing stage. Taking on this challenge, we began a pilot project using the principles of integrated product policy (IPP). One football shoe model was selected and all relevant data regarding the environmental impact of this product from inception to disposal was collected.

The project aims were to:

- > develop methods, instruments and systems to record and disseminate key numbers that can be used to assess the environmental impact of products
- > set up information systems to improve communication between the individual elements of the supply and distribution chain
- > develop and sell environmentally sound products that also meet market and performance requirements as well as functionality, quality and price.

We calculated the cumulative environmental impact of the shoe as well as identifying the stages of the lifecycle that cause the largest impact and how we might reduce those impacts. We were also able to quantify changes in the cumulative environmental impact if materials, components or manufacturing processes were changed. The calculation tool can therefore be used as an additional decision-making aid for material selection, design and development.

During the project we realised that the availability of reliable technical data and good interaction between the members of the product panel – all internal and external actors involved in creating and distributing the product – are critical for successfully applying the IPP approach. While we used the IPP process for just one selected sample, the challenge now lies in applying the system and tools to our global production portfolio. We will report back on progress in 2005.

This IPP pilot study for one football shoe model was conducted in conjunction with the environmental consultancy INTECHNICA and funded by the Bavarian Ministry for Environment, Health and Consumer Protection, Germany.

'During the IPP data collection we learned that the energy efficiency of our electromotor is about 60% less than state-of-the-art engines. We will now replace it with a new one that will pay for itself in less than two years.' Framas, component supplier

Measuring impact with environmental indicators

Without measuring the environmental impact of site operations, environmental issues cannot be managed effectively and savings cannot be made. In 2001 we launched a pilot study, asking our major footwear business partners to collect specific environmental data covering the use of raw materials, energy, water, solid waste and waste water. The study aims to create indicators so suppliers can measure the environmental performance of their operations and identify potentials for savings and operational improvements. During 2004, to further enhance the impact of the project, the procedure was changed to providing a monthly data set, and extended to some representative accessories and gear factories in China and Pakistan.

In the initial phase of the project we realised that there were significant weaknesses in the quality and completeness of the data due to factory management's lack of testing equipment or knowledge. However, the project helped significantly to raise our suppliers' awareness that proactive environmental management needs to be based on reliable data systems. Through our ongoing assistance, the accuracy, completeness and reliability of data management matured. Our business partners also learned how to manage records keeping and documentation, which is required for successful ISO 14001 certification.

There were several challenges regarding correct interpretation of data submitted by factories, namely:

- > diversity in product complexity and in the manufacturing set-up
- > clarity in the terminology of parameters
- > varied local conditions and infrastructure.

To overcome these challenges we increased and further customised training in 2004. During these training sessions, specific findings, conclusions and steps for onsite improvements were discussed. Based on these findings, we will be developing clearer guidance materials for our business partners. These will be finalised in 2006.

'The environmental indicator programme gave us a better insight into our raw material, energy and water consumption. We became more efficient, reduced waste and saved money', General Manager, Starite International Ltd.

ENVIRONMENTAL MANAGEMENT AT OUR OWN SITES Most of our sourcing offices, sales subsidiaries and warehouses have little environmental impact compared to the environmental effects of manufacturing facilities. adidas-Salomon operates eight production sites around the world. These factories comply with the respective local laws and regulations, and have established HSE programmes and management systems. Corporate Guidelines for Health, Safety and Environment have been developed and published to help facility managers implement good HSE practices in our own facilities and sites.

In 2004, there were no legal prosecutions reported for environmental liabilities at the Group's own sites.

Scheinfeld, Germany This footwear factory/training and testing centre was certified in accordance with the official EC Environmental Management and Audit Scheme (EMAS) in 1998. Revalidation in accordance with EMAS II was obtained in 2001 and 2004. For more information about our Environmental Statement 2004, see our website www.adidas-salomon.com

Suzhou, China This factory employs 180 workers and produces garments in China. It was certified in accordance with ISO 14001 for the first time in 2002, and was successfully re-audited in October 2004.

The Production Manager, Plant Manager, Office Manager and Administration Supervisor are not only responsible and trained in Standards of Engagement, but are also qualified as internal ISO 14001 auditors. This site serves as a best-practice example for all our business partners in China and we actively encourage them to learn from the Suzhou factory.

Rumilly, France Air quality has been further improved at this site through the modification of the air ventilation system and the replacement of three chemical treatment agents with more environmentally sound alternatives.

Portland Village, USA To further reduce energy consumption at our US headquarters, this year we increased the capacity of the heat exchanger, which has resulted in improved energy efficiency. We are participating in an engineering study with the state of Oregon to determine the energy savings of changing the current boiler system. The study will continue into 2005.

Certifications obtained by footwear supplier sites in Asia

Country	Number of suppliers	ISO 9000/1/2	ISO 14001	OHSAS 18001
Vietnam	4	2	2	1
China	11	6	9	9
Korea	1	1	1	1
Indonesia	3	1	0	0

SUPPLIER ENVIRONMENTAL PERFORMANCE Our business partners must progressively improve their environmental performance. To achieve this, we actively encourage our suppliers to manage their operations with HSE systems. Many of our footwear suppliers have led the way in implementing quality and HSE management systems as illustrated in the table above.

In Asia, 23 apparel and nine accessories and gear factories are certified according to the ISO 9000/1/2, the ISO 14001 and/or the OHSAS scheme. In Europe 19 supplier factories obtained certification to ISO 9000/1/2, three factories to ISO 14001 and one factory to OHSAS 18001.

Through our Guidelines on Best Environmental Practice we have supported our business partners by encouraging them to find sustainable solutions for resources management, energy consumption, pollution and waste management. These guidelines have been promoted through training workshops. In 2004, training on the Guide to Best Environmental Practice was conducted for suppliers in China, Philippines, Malaysia and Korea. The training highlighted the practical steps suppliers can take, such as reducing energy use and waste. A total of 44 suppliers attended this training workshop. More will be carried out in early 2005 for countries that were not covered this year.

Pilot project – rubber shoe sole recycling, Vietnam During the year we initiated a pilot project that aims to recycle waste thermoplastic rubber sole material and to re-use it to create new shoes and soles. The biggest challenge was meeting specific quality standards regarding visual and colour specifications for new products. We tested different mixes of new and recycled material and we have now shipped a limited order for final acceptance by the customer. If these products do not show any quality problems, we will implement this for all our suppliers.

Waste management strategy for footwear factories In 2004 we completed an in-depth study that looked at possible waste prevention and recycling strategies. The study was conducted by an external consultant, and covered our footwear factory partners in China, Indonesia and Vietnam. Based on a detailed evaluation of the different waste amounts and sources, the study showed that it was necessary to:

- > establish a more accurate system for measuring the waste volumes
- > develop more in-house recycling systems
- > consider local conditions and barriers when developing new waste-management approaches.

The study also recommended pooling waste materials from various factories to create greater volumes and the development of organisations that could provide vertically integrated services from collection and sorting to recycling.

Best environmental practice – updates from footwear suppliers In 2003 we detailed our programme of best environmental practice at our Chinese footwear supplier site Evervan. The factory reported the following data for 2004:

- > water usage was reduced by 36%
- > overall energy consumption was reduced again by 2.52%
- > the ratio of re-used waste material was 62.8%.

Although electricity use was reduced by 7%, the amount of diesel fuel used by on-site power generators, which are operated during energy cuts, increased by 8.4%. This is because the municipal power supply could not provide all the energy needed in the area.

Best environmental practice – new Apache II footwear factory The results and findings of the energy-saving project conducted by our footwear supplier Evervan in 2003 were shared with other footwear suppliers, who used the information to make similar improvements at their sites.

For example, the newly opened Chinese footwear factory (Apache II) integrated the findings of the projects into their factory set-up, and compared the results with the operational data of their old factory facility. Several hundred litres of diesel and 30 tons of fresh water per day were saved by establishing a steam recycling facility and a thermal recycling unit that uses the warm air produced by the diesel generators.

Reduction of VOCs in footwear factories in Asia VOCs are found in solvents used to dissolve layering products in the manufacturing process such as paints, cements, cleaner and inks. VOCs cause breathing difficulties and other health complaints. Therefore our policy is to reduce the amount of solvents used in our production lines, while improving productivity and quality.

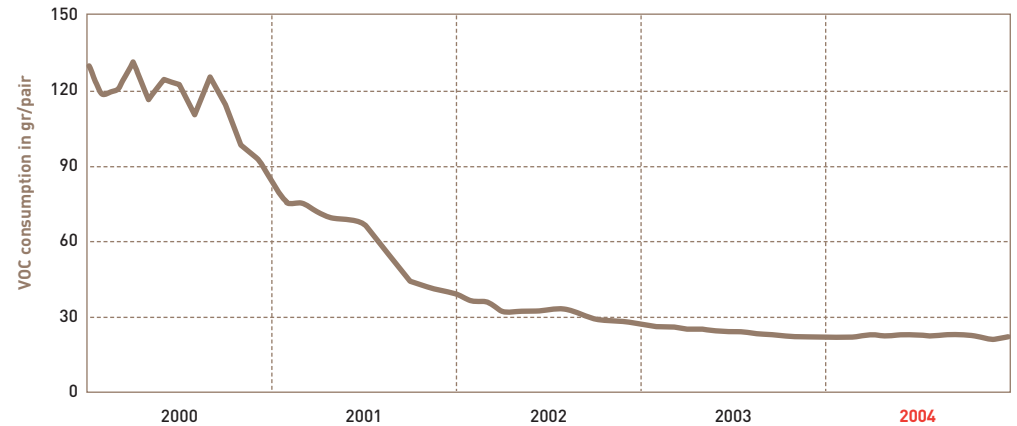
Since 2000, our international footwear suppliers in Asia have reduced the amount of VOCs from an annual average of 140 grams/pair to 22 grams/pair in 2004. This measurement is based on the consumption rate for the solvent used in the production process. The average VOC consumption ranges from 12 grams/pair to 48 grams/pair. The reduction was achieved by greater use of water-based primers and adhesives and extended usage of hot-melt systems. We aim to further reduce VOC content in 2005 to an average of 20 grams/pair.

Salomon products show a VOC emission level of 98 grams/pair, up from 80 grams/pair last year. This increase was mainly due to greater production of styles for which water-based cements cannot be used. As a minimum we want to bring Salomon footwear VOC emissions back to 2003 levels in 2005 by applying better water-based or other less harmful bonding systems.

We measured actual VOC emissions in the workplace by asking workers in one of our supplier factories to carry monitoring sets on their clothing during their workday. The values

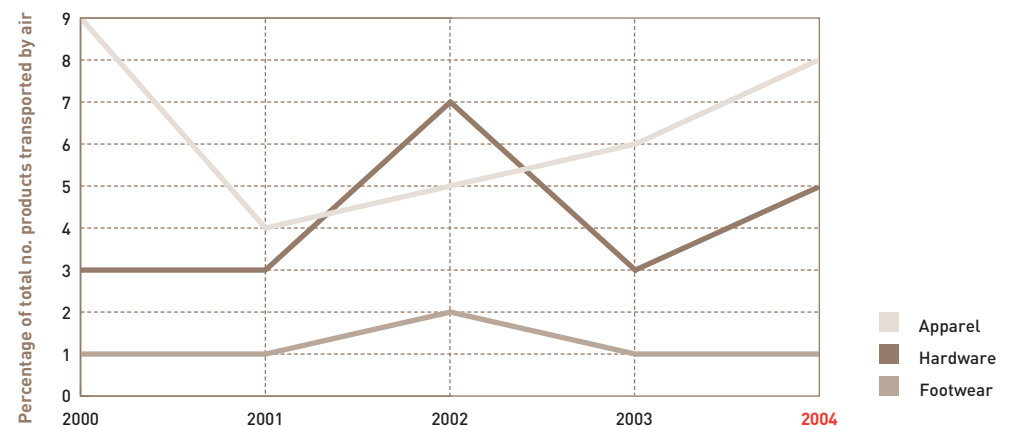
Reducing VOCs in footwear supplier factories

The graph below shows the monthly average obtained from our factories in China, Indonesia and Vietnam over five years.



Percentage of total number of adidas products transported by air

The graph below shows our global use of air freight for all products over five years.



Freight types used to ship adidas products¹

% of products shipped	2004	2003	2002
APPAREL			
Truck	22	27	32
Sea freight	69	66	62
Air freight	8	6	5
Sea and air freight	1	1	1
HARDWARE²			
Truck	4	6	7
Sea freight	91	91	86
Air freight	5	3	7
Sea and air freight	0	0	0
FOOTWEAR			
Truck	5	4	4
Sea freight	94	95	94
Air freight	1	1	2
Sea and air freight	0	0	0

¹ freight types used to ship expressed adidas products as a percentage of the total number of products transported

² accessories and gear

of VOC emissions measured were far below the threshold limit values (TLVs) set in our Guidelines on Health and Safety. Peak values reached 30% of the TLVs, and occasionally 60%. Although these results suggest there is no health risk to workers at current levels, we remain committed to further limiting VOC exposure.

ENVIRONMENTAL IMPACT OF

TRANSPORTATION The fuel used to transport goods from countries of origin to selling markets creates carbon dioxide emissions, which are a major contributor to global warming. Our policy is to minimise the environmental impact in transporting our goods. As air freight results in the greatest emissions of carbon dioxide, the focus of our ongoing efforts is to avoid air freight shipments or at least to reduce them to a minimum, which needs to reflect the fact that air freight may be necessary to accommodate serious production delays and time-sensitive product launches.

As the table on the left shows, most of our

products are transported by sea. However, in 2004 air freight shipments increased for apparel and hardware (accessories and gear items). This was driven mainly by the need to provide products in time for the major sports events that took place during the year, such as the Euro 2004 Football Championships and the Olympics.

- > sea freight contributes 17.5 grams carbon dioxide CO₂/km t
- > road freight contributes 147 grams CO₂/km t
- > air freight contributes 903 grams CO₂/km t.

As a global business, with over 100 offices worldwide, air travel is widely used by adidas-Salomon employees. To quantify the carbon dioxide emissions caused by air travel, the SEA team will record the data of all their specific travel in 2005. This data will be used to calculate the total SEA carbon dioxide emissions. To compensate for these impacts we will identify and fund a certified carbon-offsetting project that meets the quality standards developed by the World Wildlife Fund for Nature (WWF).

Chapter summary

- > We seek to design out environmental problems but we have to balance environmental issues with market demands.
- > The majority of our own sites have HSE management systems.
- > We encourage our suppliers to install environmental management systems as the best way to take ownership of tackling environmental issues in their factories.
- > By providing specific training, for example, on establishing indicators, we support our suppliers' efforts to manage their environmental performance.
- > There are a number of small and medium-sized suppliers in the apparel business that still have to adopt effective management systems.



Community involvement

adidas-Salomon Group's engagement in the places where we operate is characterised by a high diversity of activities, many of which are aimed at supporting youth, education and health.

Towards a corporate strategy

In previous reports we have stated our goal to develop a strategy for corporate giving and community involvement in our supply chain. We have not made the progress we hoped for in 2004 but it was agreed to build on the existing strengths of the social and environmental affairs programme in establishing a clear direction for the way forward. We want our community involvement work to be as innovative as our efforts to improve workplace conditions in our supply chain. To achieve that ambition, we first had to determine internal ownership, since many corporate functions have a stake in this area. A network of employees drawn from around the business will oversee our internal Group activities and the Social and Environmental Affairs team will manage the external supply chain activities.

Reflecting on our work to date, we see our role as facilitating social programmes to meet clearly identified needs. This understanding will inform our strategy, which we are committed to developing and aim to complete in 2005.

GROUP ACTIVITIES adidas-Salomon Group's engagement in the places where we operate is characterised by a high diversity of activities, many of which are aimed at supporting youth, education and health. Our subsidiaries and Group entities manage community and volunteering programmes, as well as charitable donations, at a country level – as they are best placed to judge the different needs and aspects of their own communities and local cultures. Our corporate giving strategy needs to recognise this diversity and respect this local management of community initiatives. It must

Community involvement initiatives

Engagement adidas Colombia In 2004, adidas in Colombia donated to various social service organisations, including a handicapped basketball team, a single mother's organisation, and an organisation for needy children. It also donated funds to construct a football field and sponsored a product exchange programme that benefits needy communities in Cali.

adidas-Salomon and the Franconian International School, Germany The Franconian International School has approximately 150 students from more than 20 different ethnic backgrounds. Since it opened in 1998, many adidas-Salomon employees from our headquarters have enrolled their children here and the company has been involved in all aspects of school life and management.

Charity Programme of TaylorMade-adidas Golf Since 2001, TaylorMade-adidas Golf has been running a programme in the US which contributes products and equipment to a wide range of charities and non-profit organisations.

adidas France and Diambars, West Africa The Diambars initiative has been developed by a group of professional football players in France and establishes sports schools for children from the African continent. The Diambars adidas-Salomon project supports the training of sportspeople in the region, to contribute to the development of sport in Senegal and to promote the value of learning and education. To learn more see www.diambars.com.

Supporting Leukaemia treatment In cooperation with the local Rotary Club in Herzogenaurach and *The Deutsche Knochenmarksspender Datei* (DKMS – German bone marrow donor database) adidas-Salomon organised a charity event to collect donations of blood-forming stem cells for leukaemia sufferers. These are stem cells that mature into blood cells, not embryonic stem cells that can become any cell in the body. As a result of the event, more than 35,000 euros were raised, and 675 people donated blood and committed to join the database.

Donation by adidas-Salomon Group to help tsunami victims The scale and tragedy of the earthquake and tsunami that devastated coastal communities in South East Asia has demanded a global humanitarian response. adidas-Salomon and our employees have joined this international effort by donating food, clothing and money to local charities and disaster relief agencies in Thailand, Indonesia, Sri Lanka, Malaysia and India. At a Group level the company donated 250,000 US\$ to Terre des Hommes, an aid organisation helping children recover from the trauma of the event and rebuilding schools and health centres. We will pledge a further 100,000 US\$ to this charity to match donations made by our employees.

provide an overall direction for our community work. Accordingly, the network we have formed among Group entities is exchanging ideas, experiences, and approaches to corporate giving and is developing guidelines on best practices.

In 2004 we surveyed selected Group entities to better understand the nature and type of community involvement and charitable activities, identify best practices, define the criteria for selecting recipients, and devise better reporting mechanisms. The results showed that more than 50% of our global entities and subsidiaries are actively involved in a form of community involvement. The main emphasis is on corporate donations – with numerous partners from various backgrounds – and the active management of volunteering programmes.

Examples include the financial support for a school for blind people in Greece, contributions to an organisation that benefits children in Australia, spontaneous aid for victims of thunderstorms in Argentina and the sponsoring of a charity tennis tournament in Thailand. Other examples are on the previous page.

Managing requests At our global headquarters in Herzogenaurach we receive numerous enquiries every year from individuals, schools, teams and various organisations. In 2004 we received 4,200 requests and enquiries regarding corporate giving and donations. These are currently dealt with on an ad hoc basis. To more efficiently and transparently manage grant applications, we have drafted a policy which will be published on our website in 2005. The policy will give external applicants guidance regarding the Group's criteria for the selection of beneficiaries and how to apply. In the medium term we aim to create an accurate annual record of our Group-wide community involvement and other charitable activities. This will be established by 2006.

SUPPLY CHAIN ACTIVITIES In 2003 we reported that we would continue to research ways to support our suppliers' community involvement efforts. The survey results provided us again with an overview of the broad spectrum of community involvement in our supply chain. Most suppliers, including their workforce, are engaged in various ways

in their communities. The factories' engagement is very important to their communities. However, the survey results and engagements with third parties have shown that our approach to social programmes should be broader. We learnt that adidas-Salomon can act as a catalyst for change that otherwise would not occur by partnering with a capable third party and our suppliers on a specific community and worker-oriented social programme.

The collaboration with Marie Stopes International Australia (MSIA) is an example of this. Given the majority of workers in our supply chain are women – many of whom are migrants with relatively low educational levels – women's sexual and reproductive health is a critical issue. Building on early work with the NGO CARE in Cambodia, adidas-Salomon has chosen to partner with MSIA to address women health issues in our supplier factories. Marie Stopes International is an NGO and a leader in reproductive health education and the treatment of HIV-AIDS and other sexually transmitted diseases. In 2004, MSIA conducted research and surveys to assess the reproductive health knowledge

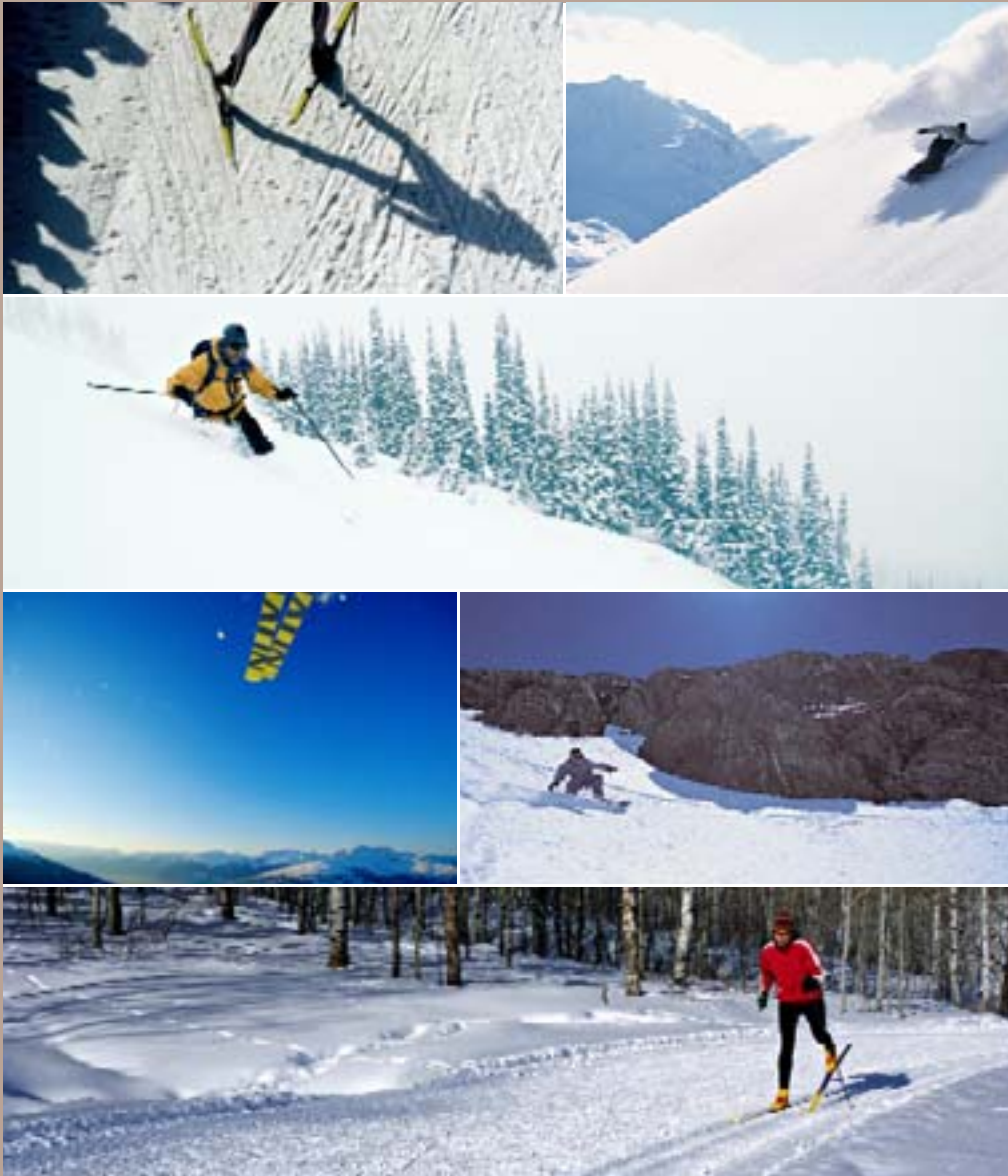
and needs of workers in our supplier factories near Ho Chi Min City in Vietnam as well as in Dongguan in southern China. For further information about our work with MSIA see the case study on page 40.

It is envisaged that the partnership with MSI will grow and that we will work together in other countries where adidas-Salomon operates. For example, we are in discussions with MSI about a reproductive health project in Honduras in 2005.

NEXT STEPS We are committed to showing leadership through collaborative projects and during 2005 we will explore how we can develop our work on social programmes. We will evaluate how to transfer the experiences from existing social programmes to other countries, establish criteria for selecting social issues and define the role of NGO partners. We will also create guidelines that highlight ways to develop partnerships and follow best practices on community involvement for our suppliers.

Chapter summary

- > Our community involvement approach is decentralised and includes the different aspects of local cultures and practices.
- > There is a huge diversity in community involvement activities in our Group entities and in our supply chain.
- > We are in the process of developing guidelines to help our Group entities manage their community involvement programmes.
- > We are partnering with Marie Stopes International in developing reproductive health programmes in China and Vietnam, and intend to work together in other countries.
- > We are exploring how to formalise our approach to social programmes and provide guidance to our suppliers.



Progress and next steps

In this chapter we summarise our progress in 2004 against our targets and state our targets for 2005.

You can also review the document against the Global Reporting Initiative guidelines for social and environmental reports.

Progress against targets

The summary of our progress against targets in 2004 now includes the signposts on each road to sustainability and self-governance. Stakeholders can therefore see how this year's achievements relate to our overall goals.

Targets 2004	Actual performance	0	10	20	30	40	50	60	70	80	90	100%
ENVIRONMENT												
<ul style="list-style-type: none"> > Negative screening of environmentally unfriendly materials and processes > Positive selection of environmentally friendly options > Lifecycle assessment of product materials and processes 												
To reduce VOC levels to near 20 grams/pair of shoes; to include Salomon products in the VOC reporting framework	Overall solvent consumption reduced to an average of 22 grams/pair for adidas footwear. Measurement of VOC levels at selected workplaces well below threshold limit values. Solvent consumption of Salomon footwear increased compared to 2003.											100%
To work with material suppliers to replace PVC plastisole prints and to use technically feasible material options for upcoming product styles	Interdisciplinary working group established to research technical solutions. Comprehensive print trials with innovative ink suppliers were conducted to test quality and functional performance of PVC-free inks.											100%
To renew EMAS certification for the adidas-Salomon production site in Scheinfeld, Germany	Scheinfeld passed an EMAS II revalidation audit in September 2004 and our Environmental Statement 2004 was published.											100%
To report on findings, progress and results of the Integrated Product Policy Study	Calculation of the overall environmental impact of the sample product lifecycle was finalised. The calculation method is now being used in the development of new products to field test in-line application. The prototype development is in progress. The final report will be published in 2005.											100%
To establish a monthly reporting system to measure the environmental impact of footwear suppliers' factories; to report on results; to extend the systems to main accessories and gear factories	Footwear factories are regularly reporting environmental data and have implemented steps to improve the evaluation of data. There is still potential to improve data collection and the setting of quantitative environmental targets.											100%
To report on a waste management study conducted with selected business partners	Report completed. Results contribute to the development of specific targets and programmes that help footwear factories improve their waste management practices.											100%
To provide a progress report about the Group's efforts regarding the use of sustainable product materials	Marketability and economical obstacles restrict the use of organic materials and products. Innovative material solutions are under development.											100%
MANAGEMENT												
<ul style="list-style-type: none"> > Define standards, guidelines, programmes > Establish review systems > Increase transparency through reporting, interaction and verification > Integrate social, environmental and economic aspects 												
To rework and launch the corporate code of ethics for adidas-Salomon employees globally	The corporate code of conduct for adidas-Salomon employees developed in 2002 was revised and extended. The actual draft code as well as an effective Group-wide compliance programme for employees is under review by several Group entities and the legal department.											100%
To conduct formal stakeholder dialogues with selected target groups in Europe, the Americas and Asia	Six formal stakeholder dialogues were undertaken. Two worker dialogues were planned for Asia, but only one took place. This was offset by a multi-stakeholder dialogue held in Hong Kong. Worker dialogues also took place in El Salvador, Honduras and Turkey.											100%
To participate in an EC-funded multi-stakeholder initiative to build capacity in the Bulgarian apparel industry	Ten local factories attended intensive training sessions from March to November 2004. The final evaluation workshop took place in November in Sofia, Bulgaria.											100%
To communicate the SOE policy for Tier 2 suppliers	The SOE policy has been communicated to Tier 2 suppliers through awareness-raising programmes, training, formal reporting requirements and monitoring work conducted by SEA or third-parties.											100%

Targets 2004

Actual performance

0 10 20 30 40 50 60 70 80 90 100%

MANAGEMENT continued

To re-survey selected group entities and suppliers to better understand the diversity of community involvement and report on progress in next year's report

A global survey was conducted of Group entities, and details obtained on their specific activities and current management practices. Some selected suppliers have been re-surveyed.



To outline a corporate policy on HIV/AIDS prevention and treatment of affected employees

Our draft policy is being reviewed by Global HR. Field testing of policy, procedures and awareness training is ongoing in Thailand. Results will be summarised in a case study.



To launch programmes in selected factories that support activities by integrated SEA and Lean factory teams that improve workplace conditions and efficiencies, and worker participation

The following programmes were launched:
 > Ten joint SEA/Lean audits in China, El Salvador, Mexico, Turkey and the Philippines
 > Nine exercises to cross-train factory Lean/SEA teams in Honduras, El Salvador, Mexico, Turkey and China
 > One third-party project to analyse the impact of Lean on working conditions in El Salvador.



SUPPLIERS

- > Raise SOE-awareness
- > Develop monitoring strategies
- > Supplier self-assessment
- > Self-governance

To rollout the revised strategy of sustainable compliance: suppliers to establish effective HR and HSE management systems; OHSAS 18001 and ISO 14001 mandatory for strategic business partners by end of 2005

Draft guidance was prepared, circulated for internal comment and consensus and is close to being finalised. Because of a convergence of end-of-year commitments, the guidelines will now be formally issued in March 2005.



To support suppliers in achieving sustainable compliance by conducting 100 specific training sessions on HR management, OHSAS 18001 and environmental best practice

Out of 160 training sessions, 57 specific training sessions were held for suppliers, of which 20 were training sessions on employment standards and HR systems, 32 were sessions on HSE and five on environmental best practice. Of these 57 specific training workshops, 40 were attended by more than one supplier so that a high coverage of supplier factories was reached.



Field testing of revised audit technique and development of meaningful key performance indicators as basis for sourcing decisions

> Ten strategic monitoring exercises and field tests of new tools in El Salvador, Honduras, Turkey, China and Thailand
 > One training session on revised technique and strategic monitoring tools given to the global SEA team
 > New KPIs and units of measure were developed and are being field-tested.



To roll out projects related to workers' health, in particular HIV/AIDS education and prevention

Launch of Marie Stopes reproductive health programme with Vietnam suppliers delayed until 2005. Needs assessment for Marie Stopes programme in China completed for selected suppliers.



Targets consistent with our obligations as a participating company in the FLA: to complete the required Independent Monitoring activity for year three; participate in the launch of FLA value-added exercises; and finalise all other activities in anticipation of the 2005 programme certification

> Nine required Independent External Monitoring (IEM) audits completed, plus three verification audits
 > All required FLA reporting was completed including regular updates. All IEM tracking worksheets were published on the FLA's website, and in the 2003 FLA annual public report
 > Participation in various FLA projects including Sustainable Monitoring, China Working Hours, Central America Project on Employment Practices, and the Multi-Stakeholder Initiative.



Targets 2004	Actual performance	0	10	20	30	40	50	60	70	80	90	100%
FINANCE												
<ul style="list-style-type: none"> > Reacting to business risks > Positively managing business risks > Increased value 												
Drive currency-neutral sales growth of 3-5%	Currency-neutral sales grew by 7%.	☑										
Deliver currency-neutral top-line growth at all brands	Currency-neutral revenues increased at all brands and in all regions.	☑										
Expand gross margin for the fifth consecutive year	Group gross margin reached record level of 47.2%.	☑										
Visibly increase operating margin	Operating margin grew 1.1 percentage points to 9.0%.	☑										
Drive earnings growth of at least 10%	Group earnings grew 21%. The earnings growth is more than twice as high as the initial guidance at the beginning of the fiscal year.	☑										
Further increase shareholder value	The adidas-Salomon share price grew 32%. The Executive Board has announced it will propose an increased dividend to the AGM 2005.	☑										

Targets for 2005

0 10 20 30 40 50 60 70 80 90 100%

ENVIRONMENT

- > To report on progress of applying the IPP system and tools for selected football shoe developments (page 45).
- > To implement the use of recycled rubber as policy for all our suppliers if test products using recycled waste of rubber do not show any quality problems (page 47).
- > To provide training sessions to 15 footwear suppliers on the Guide to Best Environmental Practice with focus on energy saving and waste management (page 47).
- > To report back about our involvement in the Better Cotton Practices initiative (pages 43-44).
- > To reduce the reported VOC levels of Salomon shoes by 20% per pair of shoes (page 48).



MANAGEMENT

- > To conduct a global staff survey, identifying the internal perceptions of the SOE programme and performance (page 19).
- > To use the results of the HIV/AIDS pilot project (adidas Thailand) in the development of a globally applicable policy (page 35).
- > To incorporate the new five-star factory rating into the adidas-Salomon factory performance reporting system (page 28).
- > To achieve a consistent role out of key programmes (Fit for Gold, Global Salary Management System) globally for the adidas-Salomon Group (pages 34-35).
- > To involve at least four out of our seven key HQ locations worldwide in our work-life balance initiatives and further promote active diversity management (page 35).
- > To increase the percentage of the global workforce covered by our HR Information System and add intelligent functionality.
- > To implement a corporate protocol for company giving (page 51).



SUPPLIERS

- > To distribute and communicate sustainable compliance guidelines to suppliers (page 23).
- > To participate in the development and execution of at least four pilot projects to improve worker-management communication and conflict resolution (page 37).
- > To distribute worker-management communication guidelines and associated training to suppliers (page 37).
- > To continue the SEA-Lean Project by identifying Lean benchmarks that can measure working conditions and to increase SOE transparency through joint SEA-Lean monitoring (page 31).
- > To meet the targets set out in our obligations as a participating company in the FLA and to participate in the FLA strategic monitoring project in China (page 19).
- > To develop HSE management system guidelines for small and medium-sized suppliers and to finalise and introduce to strategic business partners HR management systems and training modules (page 39).
- > To provide training based on the work ergonomics guide developed in 2004.
- > To report on the progress of occupational health doctors' training (page 41).
- > To conduct at least six worker dialogues, and other engagements for social programmes (page 52).
- > To transfer the experiences from the MSIA project in Vietnam to other regions (page 40).



FINANCE

- > To deliver mid- to high-single digit currency-neutral sales growth.
- > To grow currency-neutral revenues at all brands and in all regions.
- > To exceed medium-term gross margin range of 45-46%.
- > To achieve our highest operating margin ever.
- > To drive earnings growth of 10-15%.
- > To further increase shareholder value.



About this report and the GRI

The guidelines of the Global Reporting Initiative (GRI) provide an internationally consistent format for social and environmental reports. While the GRI guidelines are a useful benchmark for report readers, they do not fully take into account the nature of the sporting goods industry, where the impacts of supply chain management outweigh the direct social and environmental impacts of the companies themselves.

For this reason, while we have followed the GRI format as much as is practical and helpful, this report goes outside the requirements of the guidelines in order to provide the range of information that is relevant to our business.

We acknowledge that there are still gaps in our reporting, and the GRI guidelines have proved helpful in identifying these. To make the gaps clear to readers, we have highlighted them in the index opposite. Some of this information is covered in our annual report, or on our website at www.adidas-Salomon.com.

For more about the GRI and its reporting guidelines, visit www.globalreporting.org

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2.3 Operational structure	10-12
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2.5 Location of adidas-Salomon operations	6
2.6 Nature of ownership	Annual report
2.7 Nature of markets served	6
2.8 Scale of reporting organisation	6
2.9 List of adidas-Salomon stakeholders	16
2.10 Contact person(s) for the report	60
2.11 Reporting period	2
2.12 Date of previous report	3
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2.14 Significant changes in size, structure, ownership or products	Nothing to report
2.15 Basis for reporting on joint ventures	Not reported
2.16 Explanation of any restatements of information in previous reports	Nothing to report
2.17 Decisions not to apply GRI principles	3, 58
2.18 Criteria/definitions used	Not reported
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EC5 Total payroll and benefits	Not reported
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EN3 & EN4 Direct and indirect energy use	42-49*
EN5 Total water use	42-49*
EN6 Biodiversity	44
EN7 Impacts on biodiversity	44
EN8 Greenhouse gas emissions	Not reported
EN9 Ozone-depleting substances	44
EN10 NO _x , SO _x and other air emissions	Not reported
EN11 Total amount of waste	42-49*
EN12 Significant discharges to water	42-49*
EN13 Significant spills	Nothing to report
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* We have referred to programmes in place to address these issues with our supply chain in the pages indicated. Information on our own performance has not been reported or has been reported partially.

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PR3 Policy relating to consumer privacy	Not reported

Glossary

Capacity building Helping our business partners and others understand how to manage and improve workplace conditions, for example, through training, producing guidance manuals, and sharing best practice.

Corporate social responsibility (CSR)

Managing a company's business processes in a way that creates economic value while also respecting people and communities and minimising environmental impact.

Eco-Management and Audit Scheme (EMAS)

System designed to improve a company's environmental performance by ensuring that all environmental effects and impacts of a facility are recorded and documented.

Fair Labor Association (FLA) Non-profit organisation working cooperatively with companies, NGOs and universities to promote a workplace code of conduct based on International Labour Organisation standards.

Global Operations Board function responsible for the global development and sourcing of adidas-Salomon products such as footwear, apparel, accessories and gear.

Global Reporting Initiative (GRI) Independent global institution developing a generally accepted framework for sustainability reporting.

Hot melt Environmentally safe bonding technology using heat-activated adhesives.

ISO 14000/1 Environmental management standard.

Lean Manufacturing efficiency programme promoted by adidas-Salomon to improve overall factory performance in terms of delivery, quality and cost.

Lean/6 Sigma A more sophisticated methodology aimed at eliminating defects.

Multi-Fibre Arrangement (MFA) Introduced in 1974, establishing the rules for international trade in textiles and garments. Through the MFA, quotas were set limiting the amount of imports of textiles and clothing to the developed world. The MFA expired at the end of 2004.

Non-governmental organisations (NGOs)

Special interest groups, often not-for-profit, raising awareness of sustainable development issues in business.

Occupational Health and Safety Assessment

Series 18001 (OHSAS) Occupational health and safety standard.

Polyvinyl chloride (PVC) Synthetic material used in the manufacture of sports apparel and hardware that we are striving to phase out because of its adverse health and environmental impacts.

Social and Environmental Affairs (SEA)

adidas-Salomon department responsible for producing and developing sustainability policies and initiatives, and promoting social and environmental awareness throughout the company and its supply chain.

Socially Responsible Investment (SRI)

Investment that is made on the basis of both the financial and social performance of a company.

Stakeholder Person, community or organisation that affects, or is affected by, the operations of a company.

Standards of Engagement (SOE)

The Group's code of conduct – a set of labour, health and safety, and environmental principles designed as tools to help adidas-Salomon choose supply chain partners, monitor their performance and identify problems.

Sustainability The ability to create economic, social and environmental value in the long term.

Volatile Organic Compounds (VOCs)

Solvents that can cause breathing and health problems. VOCs are by-products of the shoe manufacturing process.

Feedback

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To give us feedback, or for further information, please contact:

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