

# Philips highlights the conciseness of the Forum's metrics and calls on the EU to simplify sustainability reporting



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## Introduction

Philips is a global health technology company headquartered in the Netherlands, which aims to deliver integrated solutions in the areas of healthy living and prevention, diagnosis, minimally invasive treatments and advanced home care. It employs 73,000 people, with sales and services in more than 100 countries.

The company's stated purpose is "to improve people's health and well-being through meaningful innovation", while its goal is "to improve the lives of 2.5 billion people a year by 2030" – including 400 million people in under-served communities. Philips is a leader on the analysis, reporting and execution of sustainability-related measures and was among the first 60 companies to adopt the Forum's SCMs.

For this case study, we interviewed Simon Braaksma, Senior Director, Group Sustainability, Royal Philips.

“ If you measure your impact on sustainability properly, you can drive innovation.

Simon Braaksma, Senior Director, Group Sustainability, Royal Philips

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## Key takeaways

- Philips' goal is to improve the lives of 2.5 billion people a year by 2030 – including 400 million people in under-served communities. Hitting this target will be possible only through rigorous tracking and reporting of sustainability metrics.
- The company aims to improve lives by focusing on three of the UN's SDGs: Goal 3, Ensure healthy lives and promote well-being; Goal 12, Ensure sustainable consumption and production; Goal 13, Take urgent action to combat climate change.
- On ensuring healthy lives, Philips developed its own framework, "Lives Improved", in conjunction with investors, who now use it for their own disclosures. Philips links performance on this set of metrics to "long-term incentives", which form part of executives' remuneration.
- On climate change, Philips became 100% carbon neutral in 2020, while in 2021 it committed to align its entire value chain emissions on a 1.5°C global warming pathway. The company goes beyond simply measuring emissions by monetizing its impacts on the environment through a unique "Environmental Profit & Loss" approach to reporting.
- Philips doubled its circularity by revenue from 7% in 2015 to 15% in 2020 and set a new target of 25% by 2025. A transition towards a circular economy could reduce global emissions by 40% in 2050, according to the Ellen MacArthur Foundation. Driving circularity requires retraining the sales force to discuss new business models with customers.

- For Philips, accurate reporting on the environmental and social impacts of its operations points customers towards the most impactful products on the market and, importantly, drives the company's innovation agenda to design more sustainable solutions.
- Perhaps surprisingly, Philips' personal health products (e.g. hairdryers and curlers) generate more value-chain emissions than its large magnetic resonance (MR) and computerized tomography (CT) scanners.
- Philips estimates that to disclose against all 137 of the EU's proposed sustainability requirements by 2024 would add 100 pages to its management reports – "that's almost mission impossible". The company calls on standard-setters to align and focus on what is most impactful.
- For Philips, the great strength of the Forum's metrics is that they are concise, well defined and well written – a combination of the Forum's and GRI's core metrics would go a long way towards setting global sustainability standards.

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## **Rationale for reporting: recognize the only way to deliver on ambitious targets is through rigorous, quarterly tracking and disclosure**

Philips frames its contributions to society and the planet in terms of three of the UN's SDGs:

- Goal 3: Ensure healthy lives and promote well-being for all at all ages
- Goal 12: Ensure sustainable consumption and production patterns
- Goal 13: Take urgent action to combat climate change and its impacts

The company has framed ambitious targets around each of these goals, targets that would be impossible to hit without accurate measurement and reporting, which in turn requires detailed methodologies and metrics.

To contribute to Goal 3, Philips has set a short-term goal to improve the lives of 2 billion people (including 300 million in under-served communities) by 2025, rising to 2.5 billion and 400 million respectively by 2030. In 2021, the company improved the lives of 1.67 billion people worldwide and 167 million lives in under-served communities.

At the core of Goal 12 is a call to reduce consumption – a challenge that Philips is tackling through a focus on circularity. It is shifting its entire business from the linear model of "Take > Make > Dispose" to the circular model of "Make > Use > Return". Philips' outgoing CEO Frans van Houten, who is also Co-Chair of the Platform for Accelerating the Circular Economy (PACE), has called on companies to embrace PACE's goal of doubling their own circularity by 2032. For its part, Philips doubled its circularity by revenue from 7% in 2015 to 15% in 2020 and the company has set a new target of 25% by 2025.

In terms of Goal 13, Philips sees climate change as a serious threat to human health, well-being and life on Earth. At the end of 2020, the company became 100% carbon neutral in its operations and sourced all its electricity from renewable sources. Last year, it committed to reducing its entire value-chain carbon emissions in line with a 1.5°C global warming scenario, through a range of initiatives including prioritizing the circular economy. If successful, this major push to decarbonize the company's supply chain would have an impact seven times greater than the reduction of CO<sub>2</sub> emissions from Philips' own operations.

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## **Solutions: Philips' focus on measuring both outputs and impacts helps drive innovation and improve lives**

### **Goal 3: Ensure healthy lives and promote well-being for all at all ages**

As a health technology company, Philips has put improving people's health and well-being at the core of its mission for decades. But when the company turned this mission into a purpose with measurable targets eight years ago, it was challenging. No such disclosures for improving lives existed. The UN, for example, lacked metrics that

companies could use to capture their contributions to Goal 3. So Philips developed its own “Lives Improved” framework. The methodology adopts a three-step approach:

1. Determine the installed base of Philips’ health and well-being devices and solutions (e.g. ultrasound, MR and CT scanners)
2. Determine the number of times each product is used per year – and divide that by the standard number of treatments needed per patient to arrive at the number of patients per year benefiting
3. Eliminate any double counting between health- and well-being-related products and solutions

According to Simon Braaksma: “Measuring health impacts is something that’s quite complex and none of our peers did anything in that respect. Our stakeholders, especially investors and NGOs, really wanted us to try and quantify this impact. So we worked together with our investors to create and validate this framework. And now investors are using this set of metrics for their own impact reports – it’s the best example of measuring health impacts that they can find.”

Philips’ Lives Improved set of metrics is now assured to the same level as the company’s financial information and the framework has even been adopted by the company’s competitors. Philips updates data on the framework monthly via custom-made data management software and includes it in the company’s quarterly reviews of the business. To drive continuous improvement on this set of metrics, Philips links performance against it to “long-term incentives”, which form a substantial part of the total remuneration paid to senior management and other company executives.

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Simon Braaksma

## Goal 12: Ensure sustainable consumption and production patterns

A key strategy in Philips’ goal of reducing both consumption and emissions is the company’s focus on circularity. This requires investment in innovative design and business models to ensure that fewer raw materials and less energy are consumed in the production and use of its healthcare and well-being devices. A transition towards a circular economy could reduce global emissions by 40% in 2050, according to research by the Ellen MacArthur Foundation.

“Two years ago we decided to step up our reporting on circularity,” says Braaksma, who adds: “As with Lives Improved, we wanted to report on specific topics to drive change, but no metrics were available.” So Philips developed a key performance indicator (KPI) that expresses circularity by revenue. This is in line with the Forum’s expanded metric on resource circularity under the Planet pillar, which encourages companies to select the most appropriate circularity metric for their business.

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Simon Braaksma

In a circular economy, according to Philips, products, parts and materials are kept at their highest utility and value at all times, circulating between customers. These productive loops maintain value while minimizing waste and the extraction of finite resource reserves. Philips’ circular model of “Make > Use > Return” features five returning loops, which in descending order of value are:

1. Dematerialize/optimize usage
2. Service/upgrade/extend lifetime
3. Refurbish
4. Recover parts
5. Recycle

The company has set itself the ambitious target of generating 25% of its revenue from circular products, services and solutions by 2025 – up from just 7% in its baseline year of 2015. “We need to make a very significant effort in the company to deliver on our 25% circularity target. It comes down to innovation. If you don’t design for circularity from the start – and with energy, materials and waste reduction in mind – it’s very difficult to increase the percentage of your revenue that’s circular,” says Braaksma. Circularity also requires a new business model and training of the sales force to promote not just new devices but also refurbished systems and alternative means of purchasing, such as pay-per-use.

### Goal 13: Take urgent action to combat climate change and its impacts

Philips takes a similarly in-depth approach to reporting on its climate impact. As well as disclosing the company’s Scope 3 emissions in terms of tonnes of greenhouse gas emissions, for the past four years it has reported on its “Environmental Profit & Loss” (EPL), which aims to monetize the company’s impacts on the environment. This is very much in line with the Forum’s expanded metrics in the Planet pillar, which include disclosing the “valued impact of greenhouse gas emissions” and the “societal cost of carbon used”.

The company captures its environmental impacts under 10 separate headings, including climate change, ozone depletion, water pollution, particulate matter and land use. It is transparent about its pricing methodology (created by environmental consultancy CE Delft), which is based on the price citizens are willing to pay for not having to be exposed to additional environmental pollutants, expressed in euros per 1kg of emissions. For example, the climate change impact is priced at €0.06/kg CO<sub>2</sub>-equivalent, which equates to €60 per tonne.

To arrive at the EPL data for the year, Philips combines this monetized metric with the estimated lifetime of each product. The company also factors in the sustainability of power grids in its key markets – because consuming a kilowatt of power in Norway will have less impact on the climate than consuming a kilowatt in, say, China.

“ If Mother Earth were to send an invoice to Philips for the resources we consume, this is basically our environmental profit and loss. What’s great about all of this is that it points you directly to the most impactful products that you put on the market and this in turn drives your innovation agenda.

Simon Braaksma

Philips monetized its environmental impact in 2021 at €2.16 billion, of which the customer-use phase accounted for the vast majority (80%). However, this figure does not include the company’s domestic appliances division, which contributed €2.59 billion of environmental impact in 2020. What is revealing about disaggregating this data is that, while many people may assume that Philips’ medical solutions such as MR and CT scanners consume the most electricity, it is actually haircare products such as dryers and curlers that generate the most emissions. This is because they are sold in large quantities, they have to generate heat (which is very energy-intensive), they are used daily and the biggest buyers are markets with a lower proportion of renewables in the grid (e.g. China).

The net result of this analysis then feeds through to Philips’ innovation function. Put simply, if the company wants to hit its science-based targets to keep its supply chain on track for a 1.5°C warming pathway, it will need to design more energy-efficient personal health products.

“ What surprises many people is that our haircare products, such as dryers and curlers, have a greater environmental impact than our big MR and CT scanners. If we want our supply chain to stick to our science-based target for a 1.5°C pathway, we need to design more efficient hairdryers.

Simon Braaksma

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## Impact, learning and advice

### Advice for standard-setters

Braaksma has recently provided candid feedback to the EU on its standard-setting process. For example, he felt the Technical Expert Group drafting the standards for the European Financial Reporting Advisory Group (EFRAG) went into too much detail, instead of focusing on the topics that really matter. “EFRAG has produced 137 disclosure requirements, each with multiple data points. We’ve estimated at Philips that to include all this,

our management reports would increase by about 100 pages,” says Braaksma, who adds: “If the EU decides on 137 disclosure requirements by 2024, that’s almost mission impossible, even for multinationals with a long experience of ESG reporting.”

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He argues that industry-specific standards are necessary for disclosing Scope 3 emissions. Healthcare, for example, needs standards that define generic use-case scenarios for, say, MR scanners, while the automotive sector – whose products contain thousands of parts from third-party suppliers – require a different solution.

Braaksma’s two key pieces of advice for standard-setters are:

1. **Align as much as possible.** The EU should start by adopting the IFRS Foundation’s work as a basis and only build on that where it is needed. “Cut the detailed disclosures,” he says.
2. **Focus on what is impactful.** Spell out what is material to specific industries and include industry-specific metrics where required.

#### Advice for peer practitioners

Braaksma has two pieces of advice for fellow practitioners:

1. **It all starts with leadership.** “If your leadership is not committed and engaged, it will be a painful process,” he says.
2. **Get ahead of the regulation.** Now that the European Commission has approved the new Corporate Sustainability Reporting Directive (CSRD), it will become law in 2024. A public listed company that is required to report against CSRD and which fails to do so is committing an economic crime. “No company wants to start a dialogue with the regulator about why they didn’t comply with the rules,” he says.

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## Added value of the Forum’s Stakeholder Capitalism Metrics

The great strength of the SCMs lies in their conciseness and clarity, according to Braaksma: “The Forum did very well to limit the number of topics and indicators; they are very well defined and well written,” he says, adding: “The European Commission could learn a lot from that.” While the Forum’s core 21 metrics are a “bare minimum”, and will not, of course, be enough for the EU, if they are blended with GRI’s core metrics, “you will go a long way towards setting minimum global sustainability standards,” says Braaksma. The Forum’s expanded metrics also offer companies encouragement to report more on impacts and important but complex areas such as the living wage and circularity.

Another key factor in favour of the SCMs is that they have been adopted by so many companies already – more than 180 at the latest count. “The fact that you’ve got a limited set of standards that is being reported on by so many of the largest companies in the world makes a lot of sense,” says Braaksma.

“ If you blend the Forum’s core 21 metrics with GRI’s core metrics, you will go a long way towards setting minimum global sustainability standards.

Simon Braaksma