

## Innovations create value

---

Our commercial success depends to a large extent on our innovative capability and the long-term focus of our corporate policy. In 2006, we rigorously pursued the optimization and strategic development of our portfolio. The year was dominated by the acquisition and integration of Schering.

Including the figures from Schering, Berlin, Germany, we spent €2.3 billion on research and development in 2006, putting us at the head of the German chemical and pharmaceutical industry. Alongside constant optimization of our product portfolio and production processes, special attention is paid to developing product innovations that strengthen our core business. On average, we submit three new patent applications every working day. That testifies to the achievements of our employees and especially of the more than 10,000 people who work in research and development.

All employees worldwide are expected to come up with innovative business ideas. The “Triple-i” initiative introduced throughout the Bayer Group in spring 2006 stands for inspiration, ideas and innovation. It has been extremely well received by our employees and around a year after its launch more than 2,200 suggestions for new products had been submitted. These are currently being evaluated. One proposal, for example, focuses on utilizing progress in cell therapy to develop new therapeutic agents. In future, encapsulated cells whose metabolic profile has therapeutic properties could be implanted without being rejected by the human immune system. Many of the ideas submitted relate to specific suggestions for new products in the subgroups and are currently being pursued further in the business units.

Other challenges which we are looking to meet with innovative business ideas are big issues

such as climate change, demographic trends and the related scarcity of natural resources such as water. Our aim is to contribute to sustainable development by introducing new medicines, innovative materials and products that secure yields and improve crop quality, and thereby to position Bayer on the markets of the future.

### **Innovations: Market success**

Further new products launched in 2006 are already proving very successful. One example is our new cancer drug Nexavar®, which generated sales of around €130 million in its first year on the market.

Active substances introduced by CropScience in its core markets since 2000 achieved their sales target of €1 billion in 2006. Constant innovations are being made in crop protection as a result of research and development in response to feedback from the markets and the registration authorities. Innovative products include, for example, seed dressings which allow very targeted use of crop protection products. At the same time, we often discontinue the sale of less suitable products by replacing them with others with improved biological efficiency and better environmental and health profiles. This includes the gradual replacement of WHO Class I formulations, an undertaking to which Bayer CropScience committed itself in 1995. All these measures optimize Bayer CropScience’s product range and are an important requirement for sustainable development in agriculture.

More detailed information on these and other successful products can be found in our Annual Report.

#### **Counterfeits: Action taken**

Counterfeit drugs have become a serious problem worldwide in recent years. They can pose a threat to the health of patients or even put lives at risk. For the manufacturers of the original products they result in a considerable loss of revenues and may cause damage to their reputation. The extent of counterfeiting activity and the products affected vary widely around the world. In the western world, for example, the most common targets are expensive prescription-only drugs and so-called "lifestyle" drugs.

Bayer has an extensive concept for countering counterfeit drugs. For example, it uses modern security technology for the packaging of Nexavar<sup>®</sup>, its new cancer drug, and Kogenate<sup>®</sup> for the treatment of hemophilia. Information on the possible risks of counterfeit drugs and how to recognize original products also plays a central role in Bayer Health-Care's security concept. A special website has been established to provide information for patients.

A strategy for combating counterfeit products is provided by Bayer Technology Services in the form of Protexxion<sup>®</sup>. This innovative identification technology for the forgery-proof authentication of objects and packaging was presented with the Hermes Award in April 2007. This is Europe's leading innovation prize.

#### **Opportunities for innovation: Biotechnology and nanotechnology**

Biotechnology and nanotechnology offer enormous opportunities for innovation. Already, every fourth pharmaceutical product introduced by Bayer is a biopharmaceutical based on active ingredients produced in bioreactors. Many new medicines, including products used to treat cancer, are monoclonal antibodies. These proteins and vaccines can also be generated in plants, an area where Bayer leads the world.

Rising production of biofuels from canola, sugar cane, soya, wheat and corn is opening up new

niche markets. Bayer sustainably supports the efficient production of these crops, for instance through seeds and crop protection. In addition, we have special expertise in the planning and construction of biofuel production facilities at our Chemical Parks. An investor is currently planning to build a facility for the production of biofuel in Leverkusen in Germany. Bayer experts are working on all stages of this construction project, from initial planning to start-up.

We are also convinced that nanotechnology offers attractive scope for innovation. Examples include dirt-repellent surfaces and self-regenerating coatings. In spring 2007, Bayer started production of carbon nanotubes which are marketed as Baytubes<sup>®</sup>. These minute tubes are prime examples of nanotechnology: Although their mass is only one-quarter of the mass of steel, they can withstand mechanic strain five times better. Applications include lighter, longer and thus more resistant rotors for wind turbines. When applying nanotechnology we also pay attention to the safety aspects of this new technology (see page 42).

[www](#)

- 11 Bayer's Annual Report
- 12 Information on WHO class chemicals
- 13 Counterfeit drugs

## Competitive conduct

A major focus of our lobbying activities in 2006 was the new European chemicals legislation, REACH (Registration, Evaluation and Authorization of Chemicals). REACH came into effect on June 1, 2007 and stipulates that producers and importers of chemicals must systematically test their impact on health and the environment. This Regulation relates to chemicals manufactured or imported in quantities of more than one metric ton annually. Across the EU it affects some 30,000 substances. Bayer companies have to compile information on around 700 chemicals and notify this to the European Chemicals Agency in Helsinki, Finland. The cost to Bayer in the next 11 years is expected to be in the upper double-digit million range.

Following seven years of preparation and tough debate, the REACH legislation is certainly a very comprehensive law. Compared with the original drafts, the final Regulation has achieved a reasonable balance between environmental considerations, the protection of health and economic requirements.

Major improvements were achieved with respect to registration in particular. The data level required for substances used purely as industrial intermediates has been adjusted. More data are required for substances produced or imported in quantities of 100 metric tons or more and for substances used in consumer products.

The main cause of concern is the new authorization process for substances with particularly hazardous properties. The new statutory substitution requirements will result in the replacement or banning of hazardous substances per se, even if they could be used safely.

### Political donations: Clear guidelines

The Bayer Group has issued a clear directive which states that no donations may be made to politicians, political parties or related institutions. In the United States, individual employees make private donations to the Bayer Corporate Political Action Committee (BAYPAC) which supports individual candidates for election to parliament. In 2005/2006

a total of US\$ 226,000 was donated to 240 candidates in various election campaigns. These donations are independent of party lines.

Providing financial support for specific patients' organizations on the basis of clear and transparent guidelines that prevent influence being brought to bear is an integral part of corporate policy at Bayer HealthCare. Bayer HealthCare also supports the European Federation of Pharmaceutical Industries and Associations (EFPIA) in its endeavors to draw up a corresponding self-commitment on the part of the industry.

As in the past, German employees who are elected to the European Parliament, German parliament, a regional parliament or local council are covered by our "Officeholders Directive" (see Sustainable Development Report 2005, page 31).

Bayer CropScience openly shares its views on current multinational policy issues and topics of importance to the company on the Internet under "Corporate Positions" as "To the point" discussions focusing on issues such as water, biodiversity and human rights.

### Group-wide compliance management: Systematic action to counter violations

Corporate compliance has become a central factor in the creation of value. Bayer AG, its subgroups (Bayer HealthCare, Bayer CropScience and Bayer MaterialScience) and its service companies each have a Compliance Officer and Compliance Committees. A working group at Group level ensures a constant exchange of information.

Their daily work comprises raising awareness of Bayer's code of conduct and training employees in specific aspects. They are also responsible for adopting effective controls and, if necessary, sanctions. If employees at the company's sites in Germany have reasonable grounds to suspect that the code of conduct is being infringed in their sphere of activity, they can call an external law firm – anonymously if they wish – via a special telephone hotline. Employees called the law firm in ten instances

in 2006, compared with nine cases in the previous year. The reports are passed on to the Compliance Officer at Bayer AG on an anonymized basis. Similar reporting facilities are being set up in other countries. In the United States, for example, there is a telephone hotline (“Integrity Line”) to an ombudsman which operates analogously to the German hotline.

Special attention is paid to infringements of anti-trust and anticorruption law because these can cause substantial financial damage to the company as well as damaging its reputation. Bayer has openly communicated violations and serious financial consequences, including the fact that two employees in the United States had been given prison sentences.

We have stepped up training in antitrust law and introduced more stringent internal regulations. Moreover, antitrust legislation was one of the issues addressed during “Compliance Awareness Week” in October 2006, when Bayer employees in the United States were given extensive information on legal conduct.

The state prosecutor in Cologne, Germany, is currently investigating allegations of overpayment and invoicing for services not rendered in the technical divisions of the company. These relate to employees of Bayer and external companies.

To reinforce its policy, Bayer has declared 2007 the year of anticorruption.

In Mexico, Bayer has a particularly good reputation for legal and responsible conduct. Evidence was provided by a report published by “Tranparencia Mexicana,” the national section of Transparency International, in January 2007. Bayer came out top in the chemical/pharmaceutical industry category in Mexico and was ranked fifth overall.

**Political lobbying: Reorganized**

To step up our activities to represent the Bayer Group’s interests at political level, we have reorganized this area internally and have set up a Politics

Community Council (cc Politics) to structure and coordinate our activities in this field. It draws on information, for example, from our liaison offices and Senior Bayer Representatives, who help place our views in the political debate.

The current political issues have been identified, evaluated and assigned to the responsible experts (caretakers). The subgroups assume responsibility for issues closely related to their business. Overarching political issues of relevance to the entire Group are assigned to the relevant Corporate Center departments.

**www**

- 14 Bayer CropScience’s view on (multi-)national public policy issues
- 15 Corporate Governance Code

**Reorganization of Bayer’s political activities**



## Contribution to regional economic development

Bayer helps small to mid-sized suppliers get in shape for global competition through a range of projects designed to put its social and ecological requirements into practice. Without such partnership, globalization could easily result in further restriction of development opportunities in less advanced regions. One of these projects was completed in 2006 and a new one was started.

### Suppliers: Prepared for certification

Under the acronym BIGAS (Bayer CropScience Integrated Environmental Gains Along the Supply Chain for Sustainable Agriculture), Bayer CropScience and the Asia-Pacific Roundtable for Sustainable Consumption and Production (APRSCP) have established an initiative to help suppliers in the Philippines introduce social and environmental management systems. This initiative receives financial support from the German development financing agency DEG. 24 small to mid-sized agricultural suppliers on the islands of Luzon and Panay (Visayas) attended a range of seminars organized by a public-private partnership to help them prepare for certification under the Filipino version of British Standard 8555 (PNS BS 8555). 20 of them successfully passed the audit and have been awarded the certificate. The guidelines for the introduction of integrated management systems in agricultural organizations developed during the project were a completely new concept in the Philippines.

### Small-scale farmers: "Green World" launched

A similar public-private partnership project named "Green World" is run by Bayer CropScience and the German technical development agency GTZ in Kenya. It aims to train around 150 technical advisors and small distributors in good agricultural practices, including the responsible use of crop protection products. Once trained they will act as multipliers and by the end of 2007 about 4,000 small-scale farmers will have been reached through this process. The project started in 2006 and is initially planned to run for five years. Through the Green World project, Bayer CropScience also strives to support farmers and help them be able to produce more high-quality crops.

The high quality of the yields will increase sales opportunities and will therefore also improve their incomes and their livelihood as they will gain a long-term foothold in the important Kenyan export business. They will also have a competitive edge in local markets.

In addition, Bayer signed a Memorandum of Understanding with Tongji University in Shanghai in 2006 to found a Chair for Sustainable Development and establish a special training program. Focusing on developing and newly industrializing countries, students from China and other countries are to be given management know-how that is essential for maintaining sustainable development processes.

## Sustainability indices and sustainability funds

Bayer is included in a number of indices and investment funds which only list companies that apply the principles of sustainable development. This is an acknowledgement of our corporate strategy. In addition to purely economic criteria such as return on investment, a long-term responsible approach to resources and corporate governance criteria are important factors for investors looking to invest in sustainability funds.

In 2006, Bayer stock was again listed on the Dow Jones Sustainability Index (DJSI) World and the European DJSI STOXX. The company has been included in both indices as “best in class” since their inception. In last year’s review of the companies included in the DJSI, which is performed by the SAM Group in Zurich, Switzerland, Bayer obtained top scores for environmental protection and compliance with anti-trust law. It also ranks among the world leaders in product safety, employment relationships and sustainability reporting among other areas.

We have also been listed continuously on the FTSE4Good index series since 2001. FTSE, an independent company established in 1995 by the Financial Times and London Stock Exchange, is one of the world’s leading providers of bond and equity indices. Bayer’s place in the benchmark FTSE4Good Europe and FTSE4Good Global indices was confirmed by the half-year review in March 2007. These indices list companies with a particularly good performance in environmental protection, human rights and social standards.

In addition, in May 2007 Bayer was included in the new FTSE4Good Environmental Leaders Europe 40 Index. This lists the 40 largest companies in terms of market capitalization who fulfil the FTSE4Good’s environmental protection criteria.

As in previous years, in the latest sustainability reviews by Storebrand (Norway), Bayer is among the leaders in its sector.

In 2005, Bayer was included in the Climate Leadership Index, the first global index of its type, which is published by the Carbon Disclosure Project. In 2006, we were even rated the best company in our sector. In the year under review, more than 200 financial service-providers with assets under management of more than US\$31 trillion were involved in the Carbon Disclosure Project. They use the index as a basis for investment decisions. The index contains the top ten percent of the world’s 500 largest listed companies.

[www](#)

17 Bayer stock

18 Stock market indices which include Bayer

### Sustainability indices



Dow Jones Sustainability Indexes  
FUNDING 2006-12



FTSE4Good



FTSE4Good  
Environmental Leader



BEST IN CLASS  
environmental and social performance  
STOREBRAND



ASPI  
Advanced Sustainable Performance Indices

Bayer is included in a variety of indices and investment funds that single out companies with a sustainable and responsible corporate policy. These include the Dow Jones Sustainability Indices, the FTSE4Good index family, the Storebrand Principle Funds and the Advanced Sustainable Performance Indices (ASPI) Eurozone.

Focus on Bayer and Schering:

## Integrating strong corporate cultures

The acquisition of Schering AG, Berlin, Germany, for approximately €17 billion significantly changed the face of the Bayer Group in the past fiscal year. The new company, Bayer Schering Pharma AG<sup>1</sup>, Berlin, Germany, is one of the world's leading companies in the field of pharmaceutical specialties, and as such will strengthen the HealthCare business and thus the Bayer Group as whole. The key to economic success here is a smooth fusion process and the ongoing integration of the two corporate cultures.



*“The main priority in mergers is to ensure that the new company has the ability to make decisions and take action as well as to avoid creating a sense of insecurity among the employees.”*

Dr. Johannes Rüeegg-Stürm, Professor of Business Administration at the University of St. Gallen, Switzerland

Bayer quickly and vigorously embarked on the integration of Schering right from the first announcement concerning the acquisition on March 23, 2006. Bayer integration manager Lambert Courth, who had previously successfully handled the assimilation of Roche's self-medication business, underlined the importance of deadline pressure. He and his team, composed of members of both companies, were able to transfer all key functions into the new organizational and management structure as of February 1, 2007. “We've been working as one company ever since,” says Courth.

### **The goal is joint success**

Professor Johannes Rüeegg-Stürm, who teaches business administration at the University of St. Gallen in Switzerland, confirms the necessity for rapid integration: “It would naturally be preferable to first learn about all resources in detail in order to make optimal use of them. But the main priority in mergers is to ensure that the new company has the ability to make decisions and take action as well as to avoid creating a sense of insecurity among the employees.” Courth is convinced that Bayer has accomplished just that: “We were able to integrate Schering into the Bayer Group quickly.

Now we are well on the way to developing a cooperative, performance-oriented and clearly structured style of working.”

In order to succeed, it is crucial that everyone affected be convinced of the new company's chances on the market and actively contribute to the integration process. Professor Rüeegg-Stürm, who specializes in organizational behavior, regards the key task as convincing the involved employees of the strategic reasoning for the merger. “This reasoning is based on market demands and customer needs.” The main reasons for a takeover are usually new challenges in a changing environment, he adds.

### **Making the integration fair**

Bayer estimates that the merger will generate approximately €700 million in synergy effects per year. In addition, the company expects to reap sustained benefits from the expanded product portfolio and well-filled research and development pipeline. Right from the start, however, Group management has pointed out that the merger will yield not only opportunities but also the need to eliminate 6,100 jobs worldwide by 2009. Since fusion processes are associated with hardships

for individual employees, Professor Rüegg-Stürm always calls for the difficulties and the opportunities of corporate mergers to be spread across the entire workforce as fairly as possible. "This enables the company to lastingly secure its social capital, i.e. the voluntary loyalty and motivation of its employees." Courth can only confirm that statement. Company management remains aware of this challenge at all times, says the Bayer expert. And the management will stand by its promise to make sure that personnel adjustments are socially compatible and as balanced as possible.

1,500 of the jobs to be eliminated are in Germany. In March 2007, the Board of Management of the new Bayer Schering Pharma AG signed a company agreement with the Works Council. The agreement is initially valid until late 2009 and outlines the key points in the socially compatible elimination of jobs at the Berlin headquarters. It envisages part-time work plans for older employees and early retirements, severance agreements with compensation payments as well as part-time offers and an internal job center. Added to this are offers to transfer to new positions within the Bayer Group. The Group has assured the employees at Berlin headquarters that there will be no dismissals for operational reasons before mid-2008. Nor is there a "winning" or a "losing" side in the selection of managers for the new Bayer Schering Pharma AG, according to the integration specialist. "53 percent come from Schering, 47 percent from Bayer," says Courth. "I think that is a very balanced proportion."

#### Corporate culture as a success factor

The creation of a sustainable, joint corporate culture will play a decisive role in the success of Bayer Schering Pharma. Professor Rüegg-Stürm also regards a strong and sustainable corporate culture, conveyed through mutual respect and joint strategic challenges and attractive future areas of activity, as an important requirement for economic success. A strong corporate culture, according to Rüegg-Stürm, is the "life form of an organization" as expressed in "self-evident factors" such as "day-to-day approaches of cooperation and management applied in dealing with customer requests, suggestions for improvement and criticism."

The fact that both companies have developed similar "self-evident factors" is significantly simplifying the integration process, says Courth. These self-evident factors include basic management and behavioral principles such as those outlined in the Bayer Group's Mission Statement and Sustainability Policy as well as management systems for environmental protection and work safety. Courth is therefore convinced that a new "Bayer Schering Pharma culture" will develop, "uniting the strengths of both companies. It will be future oriented, committed to business success and inspire motivation to reach ambitious goals."

#### Uniting past tradition and future perspectives

Another goal of the Schering integration is to take people on both sides "into the new future." It is important to honor tradition while at the same time "taking leave of some things," underscores Rüegg-Stürm. The St. Gallen Professor adds: "Economic success depends just as much on employees' identification with the company as it does on their ability to accept new developments." During an integration process, it is therefore of great importance to shift focus onto the resources and strengths of both partners and to emphasize new possibilities and perspectives. Courth underscores this point as well: "Discovering common ground is just as important as a goal-oriented alignment. This is why we quickly initiated internal projects, e.g. on Bayer Schering Pharma corporate culture, in which employees from both companies are working together, applying their respective methods in an effort to reach the targets set."



*"We were able to integrate Schering into the Bayer Group quickly."*

Lambert Courth, in charge of integrating Schering into the Bayer Group

- 1) The names "Bayer Schering Pharma" or "Schering" as used in this publication always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively. The reference to Bayer Schering Pharma AG or Schering AG also includes business conducted by affiliated entities in countries outside Germany. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, United States, are unaffiliated companies that have been totally independent of each other for many years.



NEW YORK  
DOWNTOWN  
HOSPITAL

EMERGENCY  
8899  
EMERGENZA



# Freedom.

The scholarship gives me a great deal of freedom. It also provides me with the extra investment that I need for the different stages of my clinical studies. My personal highlights certainly include my time in the Department of Surgery at New York Downtown Hospital. In my eight weeks here I have been able to broaden my specialist knowledge and gain an insight into the U.S. health care system. The positive experience with the country and its people has reinforced my decision to go abroad for a period after my exams.

## ARASCH WAFSAIDE

Medical student,  
scholarship from the Bayer Foundations for  
an internship at the Department of Surgery at  
New York Downtown Hospital, United States

