

Economic Responsibility

Sustainable business practices

Today, Bayer is one of the world's largest chemical and health care groups. That is reflected by our stock, which was one of the top-performers on Germany's DAX index in 2005. And Bayer stock should remain a good investment in the future, both on economic grounds and from a social and ecological viewpoint.

To safeguard the future success of our business, it is vital to link innovation, value and sustainability. Bayer's long-term strategy therefore concentrates on maximizing the utilization of resources. That reduces environmental impact and cuts costs. It also creates value – for our stockholders and for society.

Innovation: Enabling lasting corporate success

Bayer is a research-based company, and spent more than €3.8 billion on research and development in 2004/2005. Bayer's own innovation projects are backed up by access to an international network of universities, public-sector research centers and other institutes. Moreover, our subsidiary Bayer Innovation GmbH is dedicated to exploring new business ideas based on innovative technologies.

In spring 2006 we launched the "Triple-i" initiative. "Triple-i" stands for inspiration, ideas and innovation. All Bayer employees are invited to consider whether there are key requirements relating to their work, at home or elsewhere for which satisfactory solutions do not yet exist. The Bayer Group has earmarked €50 million for the development and commercialization of these innovative business ideas, in addition to its research and development budget.

Risk and reputation management established

Compliance with external standards plays a central role in risk and reputation management at Bayer. Alongside in-house quality and safety directives, Bayer therefore applies external directives, codes of conduct and self-control mechanisms in all areas of business (see page 54 et seq.).

Stock ownership structure: A broad base

Our last stock ownership survey in 2001 was based on responses representing 95.6 percent of the company's capital stock. Individuals hold 24 percent of the capital stock recorded by the survey and 67 percent is held by institutional investors – comprising 55 percent banks and insurance companies and 12 percent investment funds. The remaining nine percent is divided between trade and industry (three) and others (six). A share of 5.04 percent of capital stock was recorded for The Capital Group Companies Inc., United States (on April 19, 2006), and of 5.03 percent for the Capital Research and Management Company, United States (on May 10, 2006).

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11 Bayer Innovation GmbH takes up new business ideas based on innovative technologies.

Bayer stock: A sustainable investment

Institutional and private investors have included sustainability criteria in their investment policies for many years. Bayer is well-positioned to benefit from such considerations through its commitment to society and the environment. Our stock is included in all major share indices that highlight especially sustainable enterprises.

We are also pioneering new approaches to financial management. In summer 2005 Bayer became the first non-governmental organization to issue a high-volume hybrid bond. The main feature of such instruments – which are a cross between a stock and a genuine bond – is their long maturity. For example, Bayer's hybrid bond matures in 100 years. It was oversubscribed within a short period, indicating investors' confidence in our long-term business performance. The issue raised €1.3 billion, €300 million more than originally planned.

Sustainability indices:

Inclusion in the Climate Leadership Index

We are particularly proud to have been given a place in the Climate Leadership Index in fall 2005. This index contains the top 12 percent of the world's 500 largest listed corporations, measured by their climate protection performance (see page 8).

We have been included in the Dow Jones Sustainability Index World (DJSI World) continuously since it was established in 1999. Since 2001 we have also been listed in its European counterpart, the Dow Jones Sustainability Index STOXX (DJSI STOXX). Inclusion in this index is based on an assessment by the Zurich-based rating agency SAM Research. In the 2005 rating process Bayer's company score was 75 percent of the maximum, placing it above the average for the chemical industry, which was 60 percent. Furthermore, we have been included in the benchmark sustainability indices in the FTSE4Good series since it was launched by the Financial Times and the London Stock Exchange in 2001. In 2005 analysts at the Storebrand Principle Global Funds again included Bayer in

the top ten percent of chemical companies on the basis of its sustainability performance.

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12 Further information on selected sustainability indices in which Bayer is included.



Significance of corporate sustainability activities

Prof. Rüdiger von Rosen, Managing Director of Deutsches Aktieninstitut e.V.

Information on corporate sustainability activities is becoming more important in equity analysis and attracting more attention from analysts. Besides, including non-financial risks greatly improves the quality of both corporate risk management and equity analysis. It therefore has a positive impact on the relationship between companies and their owners, the stockholders.

Various analyses have examined whether such qualitative improvements have a direct financial impact. Focusing on sustainability criteria does not automatically improve a company's financial performance. However, it does generate an impressive improvement in its reputation, without adversely affecting its financial performance. That is a decisive factor from the investor's viewpoint.

By addressing the wide-ranging, long-term aspects of sustainability and incorporating them into their strategy, companies like Bayer strengthen corporate risk management. Competent corporate governance is a key factor in investors' decisions. Increased transparency also reinforces the relationship between the company and its investors. Companies that take a constructive approach to such challenges therefore deserve to be congratulated.

Products and customers

The Bayer Group's focus on innovation and growth has generated products with strong sales in recent years. Our portfolio offers prospects for good economic growth in the future as well.

Profitable products:

New developments in the research pipeline

We launched our new cancer drug Nexavar® in the United States at the end of 2005 for the therapy of advanced renal cell carcinoma. It has since received regulatory approval in Mexico and Switzerland too. The Committee for Human Medicinal Products at the European regulatory agency EMEA has recommended Nexavar® for approval in the E.U. We expect this approval to be granted in the second half of 2006. Further Phase III studies are currently under way in patients with advanced liver cancer, metastasized melanoma and non-small cell bronchial carcinoma. We have received orphan drug status from both the European and the U.S. regulatory agencies for the indication liver cancer; this status confers, among other things, exclusive marketing rights. If Nexavar® is approved in this indications, it could have a sales potential in excess of €1 billion.

We expect our oral thrombosis drug, a Factor Xa inhibitor, to have a similar sales potential. The product is currently in Phase III clinical trials for the prevention of venous thrombosis and in Phase II studies for the treatment of venous thrombosis and the prevention of stroke in patients with atrial fibrillation. We expect our hemophilia drug Kogenate® to have a sales potential of €1 billion.

Our CropScience business has brought as many as 16 new active ingredients to market since 2000. We anticipate a total sales potential from our CropScience pipeline – including these and a further ten active ingredients scheduled for launch by 2011 – of up to €2 billion. Seed dressings and our Environmental Science and BioScience businesses also promise opportunities for above-average growth.

Bayer MaterialScience is a world leader with leading-edge technologies, ranking top in polyurethanes and coating raw materials and second in polycarbonates.

Safe products:

Early identification and avoidance of risks

We have established comprehensive systems to identify risks associated with our developments at an early stage and to avoid them; these include product evaluations and various forms of product monitoring and field studies carried out by the subgroups (see page 54 et seq.). Evaluations are undertaken as part of a wide variety of programs designed to research the properties of our products and to ensure that they are handled safely. The data obtained in this way are documented in registration dossiers, databases, safety data sheets and instructions for safe use. Our specialists are involved in a large number of expert groups and external bodies to ensure that comprehensive information and in-depth analyses of substances are generated and perpetuated systematically on a regional, national and global level. Before significant investment decisions are made, we carry out systematic analyses of the health and environmental impact of our products and processes. These analyses focus on local production methods and the entire product life cycle from manufacture to disposal. In spite of all our efforts, however, various points of criticism arose in the reporting period 2004/2005.

In connection with the litigation regarding Lipobay/Baycol, some 5,000 lawsuits were still pending worldwide on March 31, 2006, approximately 4,900 of them in the United States (including several class actions). By the same date, Bayer had settled about 3,100 cases worldwide without acknowledging any legal liability, resulting in payments of approximately US\$ 1.15 billion. On a voluntary basis and without acknowledging any legal liability, Bayer will continue its policy of trying to agree on fair compensation for people who experienced serious

side effects from Lipobay/Baycol. In the United States five cases have been tried to final judgment to date, all of which resulted in verdicts in our favor.

Our quarterly reports contain information on other products which have been the target of criticism, such as PPA and Cipro®.

Sustainable products: Potential for the future

We factor sustainability aspects into the equation when developing all the products in our portfolio. We also set our sights on attaining a specific sustainability advantage in particular areas. In this respect, we concentrate on meeting two major challenges: climate change and global water demand.

Example of renewable energies

The new Bayer plastics for solar energy applications provide this future technology with substantial optimization potential. The polyurethane Bayflex® not only represents a cost- and energy-saving alternative to the existing aluminum frame used in solar modules, it also enables easier and quicker assembly. What's more, the Bayer material Desmopan® is outstandingly well-suited to the manufacture of solar modules. Desmopan® fulfils the dual function of embedding the silicon cells and bonding with the polycarbonate or glass panels. The material's properties increase the effectiveness of the solar module manufacturing process.

Example of reduction in water consumption

When we develop new crop protection products we make every effort to see that natural water resources and living organisms in aquatic ecosystems come to as little harm as possible. A very strict evaluation process means that only a fraction of all the potential new products meet the stringent

approval criteria. But our concern for the world's water resources goes far beyond the product development stage; we also pursue an active and comprehensive range of activities to promote good agricultural practice with our products.

Much of the water consumed in Asia is used to grow rice. In the Philippines, rice is either pregerminated and sown directly or, in the traditional method, young rice plants are transplanted to the growing field. Direct sowing is becoming increasingly popular because it involves less work. Bayer CropScience brought the new herbicide RiceStar® Xtra onto the market in 2002. This product is used in both cultivation systems to combat Leptochloa, a type of grass that is difficult to control and has spread widely in recent years. Following the introduction of the new product, the direct-sowing method became established more rapidly as farmers learned to trust its efficacy. Since the direct-sowing method uses about 20 percent less water than the traditional method, our product is also making an indirect contribution to reducing water consumption.

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- 13** Information on the legal risks to which the Group is exposed in the Quarterly Report for the first quarter of 2006

Rules on competitive conduct

In 2004 we tightened up our “Program for Legal Compliance and Corporate Responsibility.” This code of conduct explicitly states: “The company is unreservedly committed to the principle of free competition and to ensuring that contracts with its business partners are entered into on fair terms. We expect others to show a similar commitment. Anti-competitive practices that are illegal per se include: joint price-fixing with competitors, agreements on market shares, agreements on production capacities, market divisions, customer divisions and agreements to dictate or control a customer’s resale price. Any kind of concerted actions, informal talks or gentlemen’s agreements that are intended to restrict competition, or may have the effect of doing so, are prohibited. Employees must not even give the appearance of being party to any such conspiracy.”

Cases in the past that violated this code seriously damaged our reputation and resulted in hefty fines. Expenses for antitrust proceedings alone came to €336 million in 2005. We sincerely regret these infringements of the law. Employees who knowingly violate our regulations and harm the Bayer Group through their actions can expect harsh sanctions, including dismissal.

The Program for Legal Compliance and Corporate Responsibility also contains clear statements on blackmail and corruption: “No personal favors of any kind shall be offered or rendered to any domestic or foreign public official or to an employee of another company.” The only exceptions to this rule are the usual gifts and giveaways of low value. Moreover, it is company policy not to make donations to politicians, political parties or institutions connected with them.

In the United States there are independent organizations that collect funds to finance election campaigns. One of these is the “Bayer Corporation Political Action Committee (BAYPAC).” BAYPAC is not supported by either Bayer AG or by Bayer Corpo-

ration. Employees at Bayer Corporation made private donations of around US\$ 122,000 in 2005.

Bayer’s political activities: Showing our position

Bayer regards itself as a member of society. From that it derives a duty and a right to play a competent role in shaping political opinion. At the same time, Bayer is one of the companies that is regularly impacted by new regulations. We therefore have an interest in ensuring that statutory and other regulations are based on the actual situation.

Bayer has liaison offices in Berlin (Germany), Brussels (Belgium and the E.U.) and Washington (United States) to engage in dialog with politicians. A Policy Coordination Circle spanning all subgroups meets once a month to discuss relevant political issues and agree on Bayer’s position on planned legislation. The Community Council on Political Activities, which comprises representatives of the subgroups, service companies and relevant Corporate Center departments, is responsible for general coordination of all activities in this field.

In 2004/2005 our political activities centered on proposed legislation on energy policy (trading in emissions allowances), the review of European Chemicals legislation (REACH) and genetic engineering (biopatents). Our efforts to protect our interests were not always successful. However, the draft REACH Regulation shows that our endeavors to achieve a more practical structure have been helpful.

We also take a stance through membership of a number of industry associations, professional initiatives and organizations that work towards sustainable development and corporate responsibility, including the United Nations Global Compact Network, the Global Reporting Initiative, the World Business Council for Sustainable Development (WBCSD) and the German sustainability forum “econsense.”

Clear rules for employees who hold public offices

We maintain a database with the names of all employees who are actively involved in industry and professional associations and similar bodies. The database also includes German employees who are elected members of parliaments and local councils. We specifically welcome their willingness to accept such offices. To prevent conflicts of interest, in July 2005 we issued an "Officeholders Directive." This states: "Bayer unreservedly respects the independence of its employees in the performance of such duties." It also contains clear rules on the compensation of employees who continue to work for the company while holding full-time offices of this type: "The compensation to be paid must be commensurate with the scope of the work agreed upon and actually performed. No compensation will be paid unless such work is performed."

Responsibility for regional development: Bayer's role in the local economy

As well as being a strong global player, Bayer plays a key role in the economy in the regions around its sites. We actively promote these regions and invest in our sites because we are convinced that they offer attractive conditions and high innovative potential. Above all, our presence in such regions helps us keep in touch with our markets.

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- 14 Global Compact Initiative
- 15 World Business Council for Sustainable Development
- 16 "econsense" sustainability forum

Sustainability indices

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





Seeking alternative energies

Yazmin Cobos Colombia

In Colombia, the production of alcohol generates heavily polluted effluent containing large quantities of organic material and salts. It has a very low pH. Yazmin Cobos has been working for some time on the treatment of this effluent by anaerobic fermentation (biological treatment) to decontaminate the water and utilize the resultant biogas as an alternative energy source. The composition of this wastewater after treatment is such that it can be used as a fertilizer. "The aim of my work is to conserve water resources and find new alternatives in energy production."

Photo: Yazmin Cobos in front of the wastewater treatment plant in Leverkusen-Bürriq