

# Extending the LANGUAGE OF BUSINESS

Long-term business success depends on how companies understand and manage their impact on society. Novartis started on a journey to identify, measure, and value its social and environmental impact. Our goal is to prepare the grounds for systematic holistic decision making considering all aspects and trade-offs. This becomes much easier when social and environmental impacts are monetized and thus made comparable.

By Denise Weger

Over the last century our economic system has created tremendous financial wealth. This led to significant improvements also for the poorest people of the world. The latest report from the United Nations about the Sustainable Development Goals shows rapid decreases of extreme poverty, malnutrition and child mortality. Unfortunately, at the same time, inequalities have increased and climate change challenges societies. For businesses, technical disruption as brought along by digitalization and artificial intelligence can turn out as risk and opportunity. Inequality and social tensions, however, are expected to further increase due to these technological advancements.

The narrow view of a company's impact as defined by our accounting principles and concepts (codified in the 1970s), now poses a challenge for the stability of our social, environmental, and economic systems. In that view, a company focuses solely on optimizing the financial output of its own operations – defined by immediate ownership and control rather than considering the value generation of its business activities along the entire value chain. Novartis realizes that long-term business success not only depends on innovation, operational excellence, and financial success but also on how environmentally sustainable and socially responsible it operates. Delivering on our purpose to reimagine medicine to improve and extend people's lives, is therefore much about understanding our comprehensive impacts and how we manage them.

## We need to address currently unseen aspects

But which frameworks and concepts can we use for these broader impacts? Financial accounting is still the universal language of business, and it has definite advantages. Financial statements express in monetary metrics complex matters that are comparable and can be evaluated in relation to one another. Therefore, they are making information accessible to support decision-making. Acknowledging that a company is not a stand-alone body but embedded in an ecosystem, decision-making should be based upon information across all impact dimensions, both positive and negative. We need to overcome the shortcomings of the persisting business language broadening it to address currently unseen aspects. But this is more challenging than it sounds. Social and environmental impacts are not easy to grasp. They need to be identified, defined, and prioritized before we can even think about measuring them. By now, we may have learned how to measure CO<sub>2</sub> emissions, but what about the impacts on the social end, e.g., employee well-being?

At Novartis, about a decade ago, we started leveraging Materiality Assessments to better understand important issues within the social and environmental dimensions. A variety of top internal and key external stakeholders helped us to understand and prioritize these crucial nonfinancial and mostly intangible issues. In discussions with them, we learned how these issues are perceived to evolve in importance and what actions are expected from us.



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“What gets measured gets done” is a famous saying in business. Its practical relevance applies also to these additional elements. Understanding the nature of important social and environmental issues can only be a start. We need to be able to measure them to start managing them.

In its essence, this is also the underlying idea of existing ESG standards and sustainability rankings. They try to make environmental, social and governance aspects more tangible and start quantifying them. At a recent Oxford Union Debate, it was even discussed to what extent the disclosure of these issues should become a part of financial accounting and reporting, and hence mandatory.

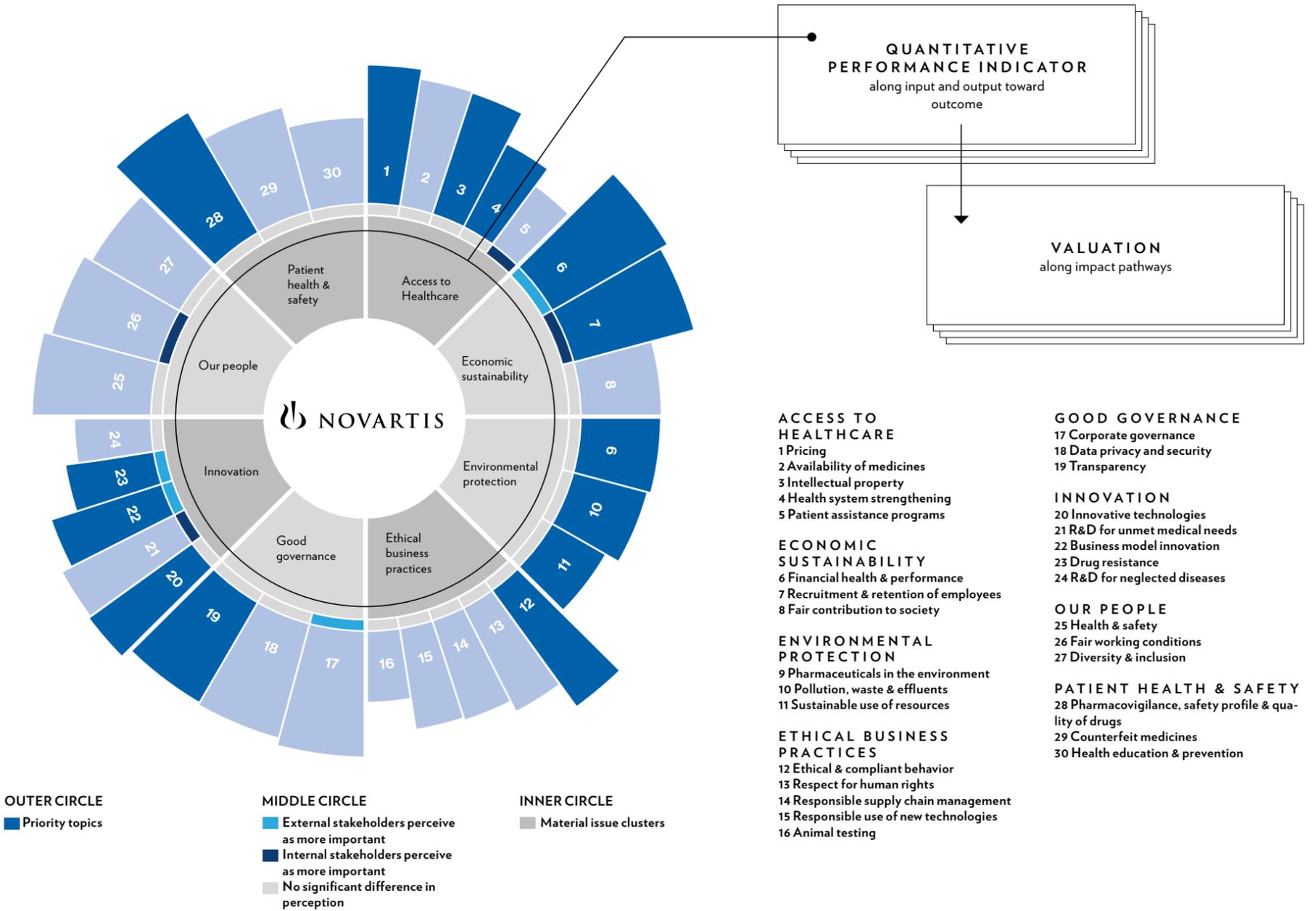
## Impact metrics measure what really counts

Novartis welcomes these initiatives as a step in the right direction, but we believe that the current focus on output metrics as a proxy for impact should be questioned. Output metrics focus on the action/intervention itself (e.g., the number of pills donated). Impact metrics on the other hand measure what really counts, the positive/negative consequences of the action (e.g., the value created due to the treatment with donated pills). While the focus on output might be the most practical approach, the actual outcomes and impacts of companies' actions are often insufficiently captured and little understood. In order for environmental and social aspects to receive the attention they deserve, we need to translate them into the current language of business. By monetizing quantitative aspects of social and environmental issues, the advantages known from financial accounting can be realized, and decision making becomes more holistic.

That's why, three years ago, Novartis started considering the valuation of impacts. The objective of our impact valuation of social and environmental issues is to quantify the impacts of our business activities. By looking at impact pathways, we translate positive and negative; direct, indirect, and induced; intended and unintended impacts into financial terms. With this, we not only consider the impacts of our direct operations but also impacts caused by our supply chain.

Due to the complexity of many issues, our approach to impact valuation is still evolving as we are not yet able to capture and calculate impacts for all dimensions of our issue areas identified by the Materiality Assessment. However, the current indicators already give us a lot of information on a global as well as a country level and help inform our business strategy. They also serve us when discussing our priorities and impacts with external stakeholders. Novartis plans to continue to add additional areas to the analysis to get closer to a full understanding of our impacts on society, both positive as well as negative.

2017 NOVARTIS MATERIALITY ASSESSMENT RESULTS



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