Management of non-financial information:

Corporate value creation insights from advanced case studies

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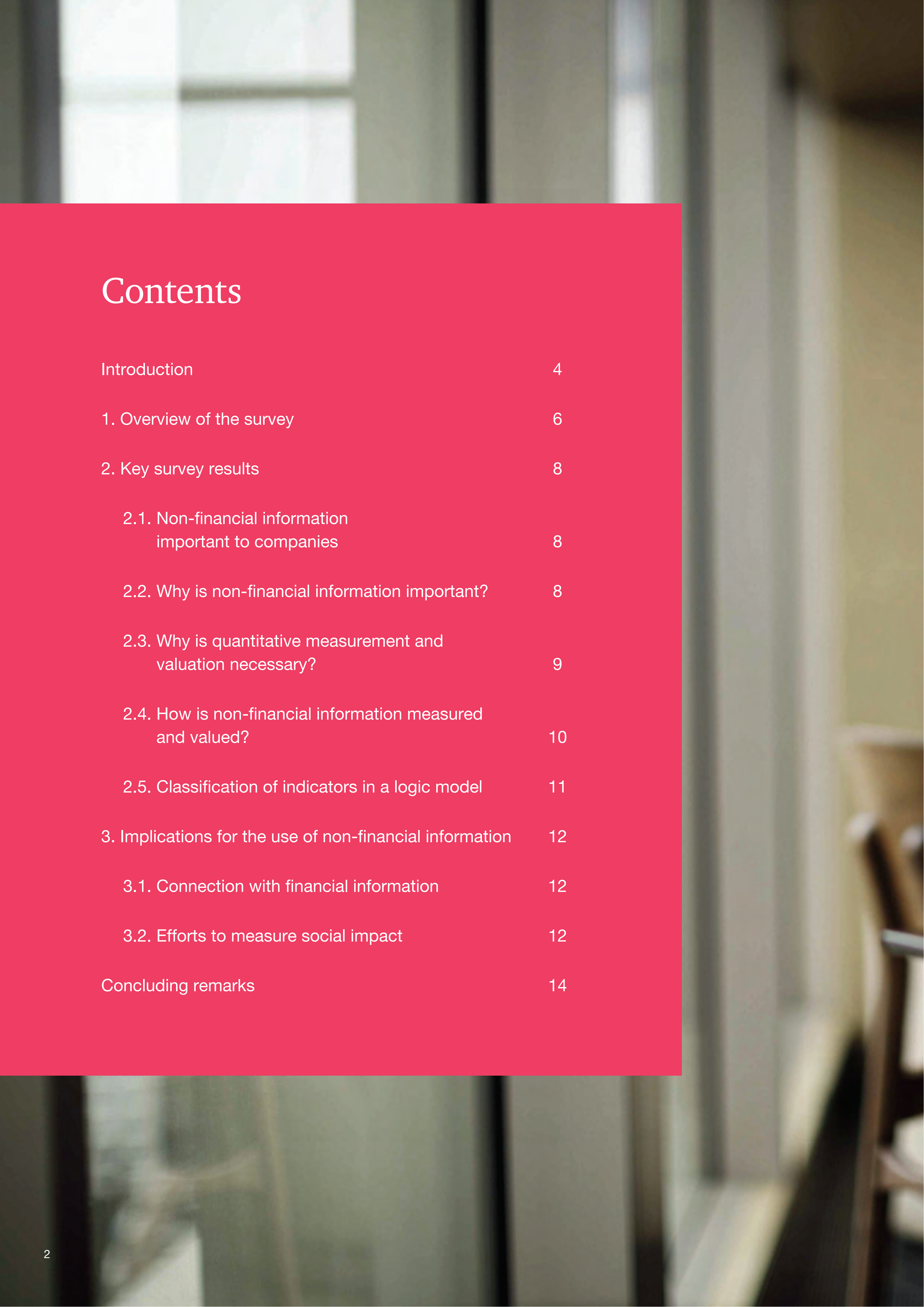

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Introduction

There has been a growing interest in corporate non-financial information and intangible assets in recent years. This partly reflects increased expectations and demands from society for companies to tackle environmental and social issues amid global efforts to build a sustainable society, such as the United Nations Sustainable Development Goals (SDGs) and the Paris Agreement. A company cannot grow over the long term without the trust of society and its stakeholders. To be sustainable, a company needs to create shared value with society from both financial and non-financial perspectives and meet society's expectations and demands.

Another factor is that investors place more emphasis on non-financial information from the perspective of corporate value, as evidenced by the expansion of ESG (environmental, social and governance) investment. For investors, it is important to see whether the investee company is responding to the expectations and demands of society, and whether it can sustainably grow in response to changes in the natural and social environment. As this cannot be judged by financial and accounting information alone, non-financial information is also used to determine the company's ability to create value over the medium to long term.

With the increased emphasis on non-financial information, various standards and frameworks for non-financial information disclosure have been established (Table 1), including the Integrated Reporting Framework published by the International Integrated Reporting Council (IIRC), the Standards established by the US Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) guidelines. The recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which are supported by an increasing number of Japanese companies, are also considered a framework for the disclosure of non-financial information.

As so many standards and frameworks are established, the management and disclosure of non-financial information is often perceived as a new 'obligation' by companies. What should be emphasized, however, is that non-financial information is indispensable for companies to gain the trust of society by responding to its expectations and demands and to communicate with investors and other stakeholders about medium- to long-term value creation. It is an element to be incorporated into and effectively utilized in decision-making mechanisms.

Table 1: Overview of major standards and frameworks for non-financial information

The IIRC's International <IR> Framework	A framework for the integrated disclosure of corporate value creation processes using six financial and non-financial capitals (financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital and natural capital)
SASB Standards	Standards for the disclosure of non-financial components that are expected to have a material future financial impact (mainly focusing on investor needs)
GRI Standards	Framework for reporting non-financial information that has a significant impact on the economy, the environment and society
TCFD recommendations	A framework for financial and non-financial disclosures related to climate change

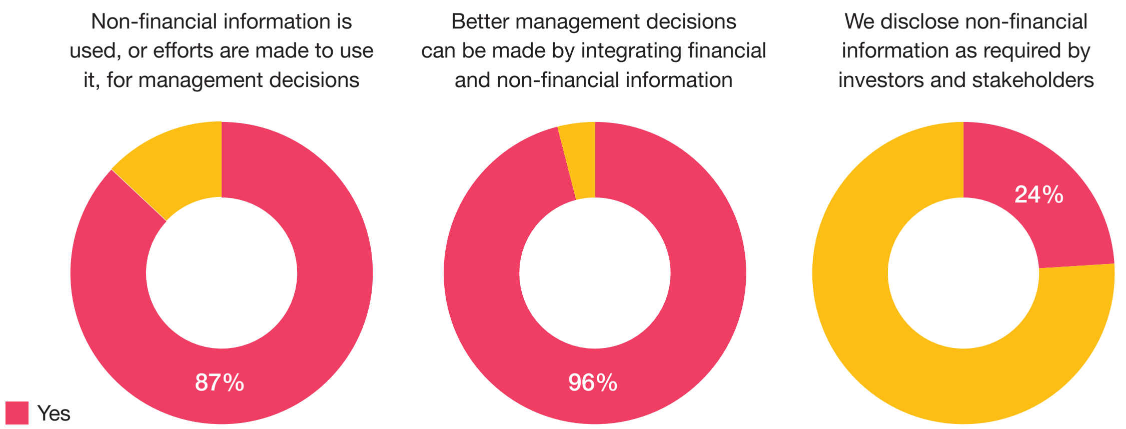
According to a survey of senior executives from more than 50 countries worldwide (see Box 1), 96% of executives think that ‘integrating financial and non-financial information improves insights into the process of creating long-term business value and leads to better management decisions.’ While the executives recognize the importance of non-financial information, only 24% said that they are disclosing non-financial information as required by investors and stakeholders. In fact, many companies have problems with the measurement and quality of non-financial factors.

Under these circumstances, PwC Japan conducted a comprehensive survey and analysis of how non-financial components are measured, valued and used in business management by leading companies outside of Japan. We hope that the results of this survey and the insights obtained will help you identify the challenges and steps to be taken for the use of non-financial information in the future.

Box 1: Executives’ awareness of non-financial information

In a survey of executives from over 50 countries[1], 87% say they either utilize, or actively try to utilize, non-financial information in management decisions, and 96% say that integrating financial and non-financial information improves insights into the process of creating long-term value and leads to better management decisions.

While the respondents emphasised the performance measurement of non-financial factors, only 24% of the respondents said that they were able to provide the non-financial information required by investors and other stakeholders, and many companies faced challenges in the measurement of non-financial factors and the quality of non-financial data.



1 Association of International Certified Professional Accountants, Black Sun and the IIRC, 2018, “Purpose Beyond Profit”, Accessed March 1, 2021. https://integratedreporting.org/resource/purpose-beyond-profit/

1 Overview of the survey

From November 2018 to March 2019, PwC Japan conducted a survey of leading companies in the measurement and valuation of non-financial information and the utilization of such information for business management. The survey used a combination of questionnaires, telephone interviews and desktop research on corporate disclosures, and focused on the three perspectives 'Why?', 'What?' and 'How?', as described below. Based on the information obtained, PwC analyzed the best practices of leading companies, and examined and explored how non-financial information helps enhance corporate value.

Survey overview

Purpose	Analyze leading companies' best practices regarding the management of non-financial information (mainly on natural capital, social capital and human capital) to examine and get insights into how non-financial information affects the enhancement of corporate value.	
Survey method	1. Selection of target companies	We collaborated with the World Business Council for Sustainable Development (WBCSD)[2] to select leading companies in the measurement, valuation and use of non-financial information and sent questionnaires to WBCSD member companies as well as companies with whom PwC has connections.
	2. Research	We collected detailed information from 22 companies that participated in the survey through questionnaires, telephone interviews, or desktop research based on corporate disclosures (or a combination of these methods).
	3. Analysis and categorisation	We analysed and categorised trends based on the information we collected.

2 WBCSD released the Natural Capital Protocol in 2016 and the Social and Human Capital Protocol in 2019, providing basic concepts and standard procedures for managing these types of non-financial capital.

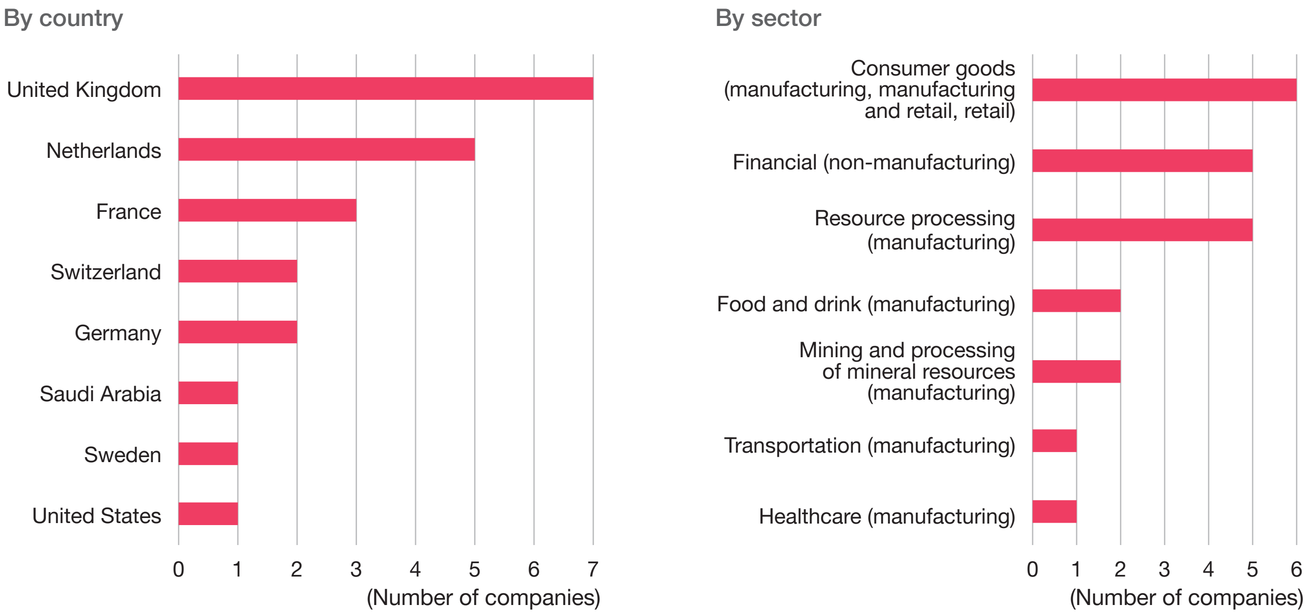
Key survey questions

Why?	Why is it important to measure and value non-financial information?
What?	What non-financial information is considered important to your company?
How?	How is material non-financial information measured, valued, and used (e.g., measurement and valution methods, usage, usage frequency and disclosure or non-disclosure of non-financial information)?

Box 2: Definitions of terms in this survey (based on WBCSD definitions)

Natural capital	The stock of renewable and non-renewable natural resources (e.g. plants, animals, air, soils, minerals) that combine to yield a flow of benefits, i,e., services, to people.
Social and human capital	Relationships and resources provided by people and society, comprising human capital such as people's skills, knowledge and well being, and social capital such as societies relationships, shared values and organizations) *PwC's note: The above corresonds to IIRC's definitions of 'human capital' and 'social and relationship capital'.
Measurement	The process of determining the amount, extent and condition of social and natural capital through the collection of qualitative and/or quantitative data.
Valuation	The process of estimating the relative significance, worth, or usefulness of social capital or natural capital to people or to a business in a particular context. Valuation may involve qualitative, quantitative, or monetary approaches, or a combination of these.

Figure 1: Breakdown of 22 participating companies



Specialist perspective

Matthew Watkins

Manager, Redefining Value project, WBCSD

The World Business Council for Sustainable Development's (WBCSD) Redefining Value program helps companies measure and manage risk, gain competitive advantage and seize new opportunities by understanding environmental, social and governance (ESG) information.

We do this by building collaborations and developing tools, guidance, case studies, engagement and education opportunities to help companies incorporate ESG performance into mainstream business and finance systems.

Our goal is to improve decision-making and external disclosure, eventually transforming the financial system to reward the most sustainable companies.

We believe that assessing natural, social and human capital alongside financial capital provides more meaningful information to build better decisions, driving value creation for business, society, the environment and—ultimately—capital providers.

This PwC report provides insights on the business case for measuring and valuing business impacts and dependencies on people and nature, yielding interesting conclusions on how these values are integrated into risks and opportunities relating to business costs and revenues.

2 Key survey results

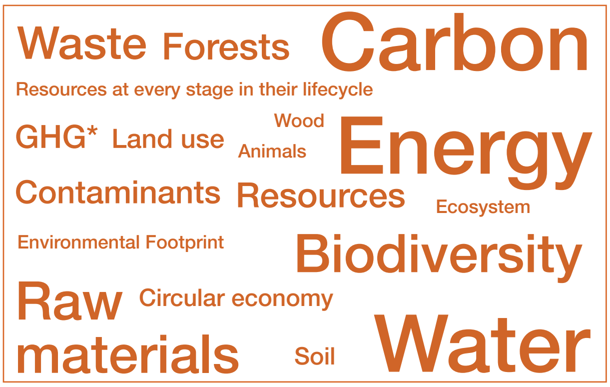
2-1. Non-financial information important to companies

When the companies surveyed were asked about the natural, social and human capital that is important to their companies, the most common responses for natural capital were ‘carbon’, ‘water or water resources’, ‘energy’, ‘climate and climate change’ and ‘raw materials’. There were also industry-specific responses. For example, companies using forest resources as raw materials for products responded that forests and wood were important non-financial information while companies handling agricultural resources considered land use, soil and biodiversity as important natural capital.

Regarding social and human capital, ‘community’, ‘employees’ and ‘human rights’ were the most frequent responses.

Figure 2: Non-financial capital important to companies

Important natural capital



Important social and human capital

2-2. Why is non-financial information important?

Why is the aforementioned non-financial capital considered important to companies?

Non-financial information management is often seen as an essential part of risk management and disclosure. In contrast, the companies who participated in this survey view that non-financial information is strategically important because it can also provide a means to improve operations, create strategic business opportunities and promote innovation.

Figure 3 on the following page shows the relationship between non-financial information and the reasons why it is considered important (as classified into three categories: risk management, operational improvement, and opportunity and innovation). While these reasons differ depending on the type of non-financial information, it is clear that each reason is related to the creation or impairment of future corporate value and that non-financial information is regarded as an accelerator or an obstacle in the story of mid- to long-term value creation.

* GHG: Greenhouse gas

Figure 3: Classification of reasons for strategic emphasis on non-financial factors

Drivers	Risk management	Operational improvement	Opportunity and innovation
Natural capital	Carbon/ GHGs: Climate change is one of the most important issues for all companies, as responding to climate change (carbon and GHG emissions) and contributing to a low carbon society can affect a company's **reputation.**	Raw materials/ resources; Energy: If a company's business depends on resources (water, timber etc.) that are at risk of exhaustion, it needs to **secure a long-term supply chain.** It may also face **increased raw material procurement costs.**	Carbon/ GHGs; Energy: Climate change can be considered as a **strategic opportunity** rather than just a risk aspect, because it leads to the creation of new products and services (such as low-carbon or energy-efficient products and services).
	Environmental pollutants: If company's business has a direct negative impact on the natural environment (GHG emissions, toxic substances or waste water) it affects **operational permissions** and **reputation.**	Waste: Reduction of energy, water use and waste **contributes to cost reduction** as well as reduction of environmental burden.	Waste: By treating waste as a new resource, circular business becomes an opportunity for **innovation and new business development.**
Social and human capital	Employees/ suppliers; Communities: Securing relationships with employees, supplies and communities, as well as the occupational health and safety of employees and clients, is the basis of business activities for all companies. It also affects a company's **reputation**, and is therefore essential for sustainable business growth in society.	Employees/ suppliers: Employees are one of **the most important types of capital for a company's operation.** It is important to focus on improving employee satisfaction and diversity and inclusion for reasons such as human resource development and retention, talent development, and a boost to the well-being and productivity of employees.	Employees/ suppliers; Communities/ clients: Well-being of employees and suppliers leads to a community's prosperity, which ultimately contributes to customers' prosperity and provides the **company with opportunity for business growth.**
	Human rights: Respect for human rights from the perspective of supply chain management is an important **response to reputational risk.**	Human rights: Respect for human rights is important not only for reputational risk management, but also in terms of **engagement with business partners (suppliers).**	

2-3. Why is quantitative measurement and valuation necessary?

When asked about the objective of measuring and valuing non-financial information quantitatively, many companies said that they use non-financial information to identify organizational risks and opportunities and to make decisions. The responses indicate that leading companies are not only identifying, measuring and evaluating significant non-financial information, but also incorporating it into decision-making.

Table 2: Purposes of quantitative measurement and valuation

Identifying risks and opportunities and making decisions	✓ To understand an organization's risks and opportunities ✓ To improve decision-making about future business opportunities ✓ To identify risks and opportunities, using monetary valuation as a common language that management can understand ✓ To use quantitative data for decision making that needs to take into account priority and materiality. ✓ To Identify high-risk areas that have large negative impacts on the environment and areas where innovation is possible for a long-term strategy of developing products and solutions and reducing environmental negative impacts ✓ To continuously improve communication and reach a common understanding with management
Monitoring	✓ To monitor efficiency and cost-improvement targets and to secure transparency ✓ To monitor indicators to measure progress and adjust corporate activities accordingly for optimization ✓ To measure the entire value chain by visualizing the stages at which environmental impact is significant and determining measures to reduce the environmental impact ✓ To confirm and ensure that group-wide commitments are properly fulfilled ✓ To check the progress of set targets
Communication with stakeholders	✓ As a tool for communication with stakeholders ✓ To disclose information transparently to external stakeholders, including customers who want to purchase sustainable products

2-4. How is non-financial information measured and valued?

The question of how material non-financial information is measured and valued revealed the indicators commonly measured by many companies (Figure 4).

All surveyed companies carry out quantitative measurement and set indicators and targets for natural capital. In particular, carbon and GHG emissions are measured by all companies because addressing climate change has become an integral part of any business. Raw materials and waste-related quantitative indicators are also defined and measured, espeicially in the manufacturing industry. With regard to the range of target data, several companies conduct environmental footprint measurement across the entire product life cycle. For GHGs in particular, efforts to measure the environmental footprint of the entire product lifecycle in line with the GHG Protocol (i.e., Scope 2 and Scope 3 emissions) are increasing while some companies go even further and measure non-financial indicators beyond GHG emissions across the entire value chain and product lifecycle.

Social and human capital is also measured and valued by most companies, but compared with natural capital, quantitative indicators and measurement are used only in a limited manner. Social and human capital indicators are usually set for each stakeholder. Many companies define and measure indicators for employees, in particular, while some companies also set indicators for local communities and human rights.

Figure 4: Common indicators measured by many companies

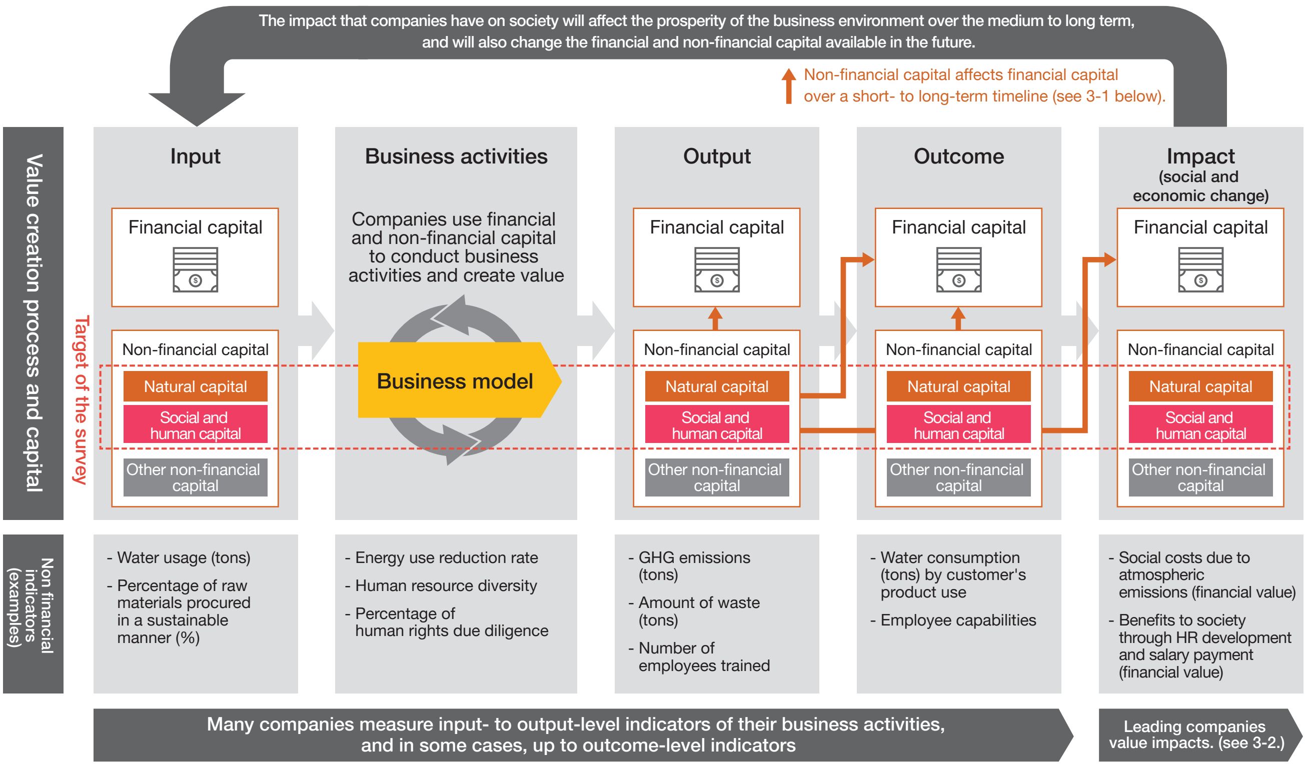
Key quantitative indicators for natural capital	Key quantitative indicators for social and human capital
Climate change indicators - Carbon and GHG emissions (measured by all surveyed companies) - Carbon footprint (product lifecycle) - Reduction in energy consumption rate - Renewable energy conversion rate	**Employee indicators** - Employee satisfaction - Diversity and inclusion - Accident rate, injury rate (occupational health and safety)
Raw materials / resource indicators - Water use - Efficiency of water use - Percentage of raw materials that are sustainably produced (timber, palm oil, cotton etc.)	**Community indicators** - Participation and investment in community programs, such as the number of programs and amount of investments
Waste indicators - Amount of waste	**Human rights indicators** - Percentage of projects for which human rights due diligence and ethical procurement are in place

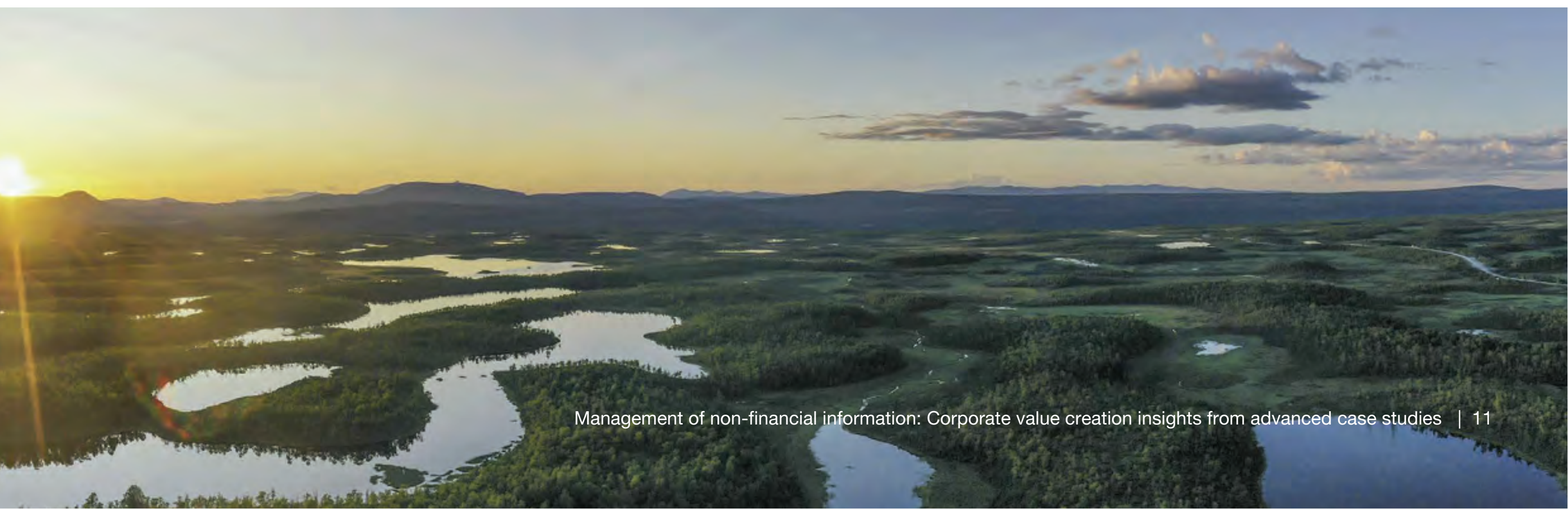
2-5. Classification of indicators in a logic model

When non-financial indicators and valuation methods are applied to a basic logic model, or an impact chain, many companies measure and value non-financial performance up to the output or outcome level.

Some leading companies go further to evaluate non-financial information at the impact level, based on the recognition that the impact on the environment and society will affect changes in the business environment over the medium to long term, and will change the capital available to the company in the future. By quantitatively evaluating social costs (negative impacts) and benefits (positive impacts), it is possible to visualize the shared value with society, which can be used for decision-making and communication (details are explained in Section 3-2).

Figure 5: Examples of non-financial indicators in a logic model





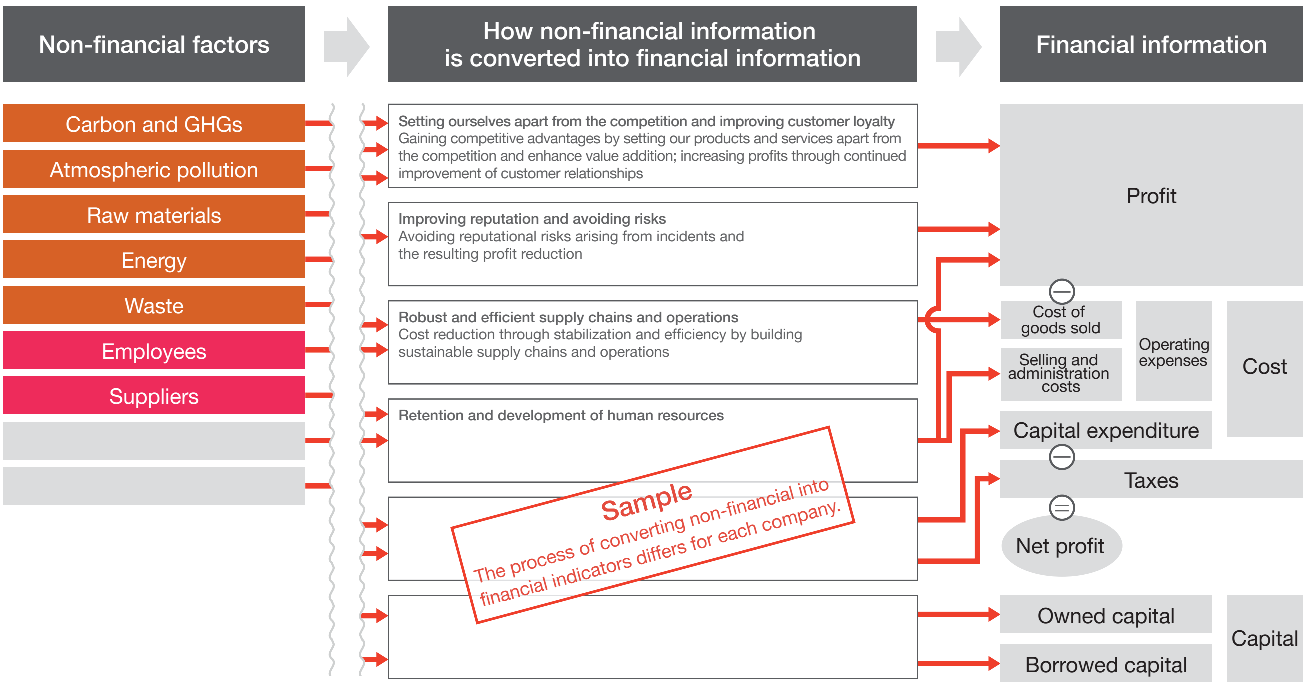
3 Implications for the use of non-financial information

3-1. Connection with financial information

As described in 2-2, the analysis of the responses to why non-financial information is strategically important found that non-financial information is considered as a factor that creates or impairs corporate value in the medium- to long-term story of value creation. Based on this finding, we have examined the connection or linkage between non-financial factors and future financial factors.

While the specific relationship between non-financial and financial factors varies by industry and type of business, our examination further clarified the core mechanism behind this relationship. Understanding the mechanism would, for example, help develop a system to determine indicators for measuring non-financial information, monitor progress and predict and understand the impact of non-financial factors on financial factors.

Figure 6: Connection between non-financial factors and financial factors (example)



3-2. Efforts to measure social impact

As described in 2-5, some leading companies have begun to assess environmental and social impacts of long-term value creation so as to visualize the value they share with society. By minimizing negative impacts while maximizing positive impacts, these companies aim to coexist with society, gain the trust of society and stakeholders, and grow sustainably. By valuing the impact (by converting it to monetary value), companies integrate it with financial information and use it to make management decisions.

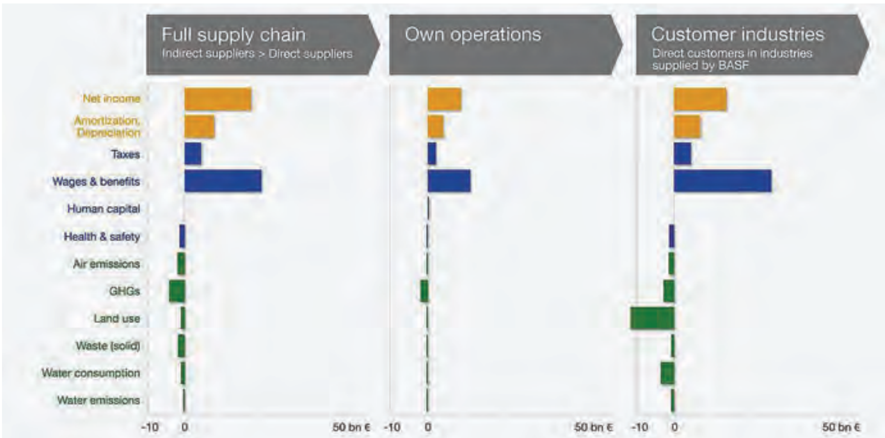
As for impact assessment, there are initiatives by several companies to standardize their models by forming alliances, and we expect their efforts to expand in the future.[3]

3 Under the Value Balancing Alliance launched in August 2019, BASF, Deutsche Bank, Novartis and SAP are taking the lead in developing multidimensional models for calculating the value that companies bring to society and the environment.

Box 3: Examples of impact valuation

1. Value-to-Society, BASF

BASF has developed the Value-to-Society framework to assess the impact of its entire supply chain on the economy, environment and society with the objective of 'creating chemistry for a sustainable future' (a balanced growth of economic success, environmental conservation and social responsibility). The results are used to make strategic decisions, plan portfolios, make decisions on large projects (such as site development), conduct R&D and manage rewards. (Source: BASF website)[4]



The following impacts have been valued and converted into monetary values:

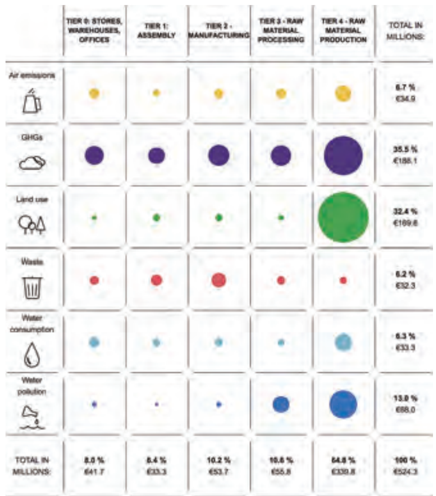
<u>Environmental impacts</u>
Air emissions
GHGs
Land use
Waste (solid)
Water consumption
Water emissions

<u>Social impact</u>
Taxes
Wages and benefits
Human capital
Health and safety

(Souce: BASF[4])

2. EP&L (Environmental Profit and Loss Statement), Kering

Kering, a global luxury group, has positioned sustainability at the heart of its business strategy. As its fashion and jewelry products rely heavily on natural capital for raw materials, they have considerable impacts on the environment. This also makes their business vulnerable to climate change. EP&L is used to show the monetary value of the environmental impact of the company's operations and its entire supply chain (by water use, waste, raw material, product etc.) and to understand where the environmental impact is highest in the value chain. The results are taken into account in making decisions on material and product development and efficient raw material procurement. EP&L functions as a common language that connects business with society because it is expressed in monetary terms. (Source: Kering website)[5]



Environmental impact is converted into euros for each tier in the supply chain. (Souce: Kering[5])

3. FES (Financial, Environmental and Social) impact valuation, Novartis

The basic idea of FES impact valuation is to quantify and monetize the impacts of the triple bottom line (economy, society and environment). As for the economic impact, FES impact valuation shows contributions to GDP and employment. For the environment, it calculates the monetary value created by reduced environmental impacts related to climate change, energy, water, waste and so on. As for society, it calculates the social value of medicines while converting the social value of human resources development, work environment health, living wages, and so on into monetary value. Using this know-how, the SROI (Social Return on Investment) of individual projects is also calculated. (Source: Novartis Synthesis Report) [6]

4 https://www.basf.com/jp/ja/who-we-are/sustainability/management-and-instruments/quantifying-sustainability/we-create-value/impact-categories.html
5 https://kering-group.opendatasoft.com/pages/report/
6 https://www.novartis.com/investors/novartis-annual-reporting-suite/annual-report-and-20-f-archive

Concluding remarks

In light of growing interest in non-financial information among companies, this report presented the results of a survey and analysis of leading companies in the management of non-financial information. The results provide a variety of insights into the importance of non-financial information for long-term value creation, its effective utilization and future trends.

With the increasing demand for disclosure of non-financial information, companies are concerned that collecting data and identifying appropriate metrics are becoming a burden. However, we believe it will become more and more important to strategically consider the management and utilization of non-financial information from the perspectives of why non-financial information is important and how it can affect the creation or impairment of future corporate value.

We hope that the results and insights of this survey will help companies seeking to engage in long-term value creation and non-financial information management.

We would like to express our gratitude to all those involved in this survey for their cooperation.

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The Sustainability Center of Excellence is a comprehensive team at PwC Japan that helps clients to transform their businesses into sustainable businesses.With the rapidly growing interest in sustainable management and investment as a top business agenda, we offer a wide range of services aiming to make environmental, social and economic values mutually compatible rather than traded off for each other.

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