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## McKinsey Quarterly

# McKinsey conversations with global leaders: Dan Vasella of Novartis

The CEO and chairman of Novartis AG shares his personal approach to management and leadership and discusses health care reform, the economic downturn, and executive compensation.



**Dan Vasella, CEO and chairman of Novartis AG**, leads off our video interview series *McKinsey conversations with global leaders*. This ongoing project explores vital management issues, industry insights, and topical analysis with CEOs of today's leading global companies.

In this transcript of our video interview, Vasella shares his personal approach to management and leadership. He also examines subjects including health care reform, the economic downturn, and executive compensation. Rik Kirkland, McKinsey's director of publishing, conducted the interview in New York in May 2009.

### **The downturn: Looking ahead**

**The Quarterly:** *We know looking in the rearview mirror that this has been the worst economy for the world since the Great Depression, at least that's what they say. What is your outlook in the near term and, more important, for the medium term? And how's that affecting Novartis—your strategy and your priorities?*

**Dan Vasella:** Of course, we both know nobody knows really how the future will look. But, personally, I am not overly optimistic from a point of view of growth, respectively contraction. So if we have a contraction of 4 percent plus/minus something now in the US, in Europe, and much lower growth rate in Asia, in Latin America than previously, I anticipate that it will take two to three years until we come out of this.

Now for us as a company, I would say there are specific questions related to the specific industry we're in. In health care, first of all, the good news is that the demand will not be really massively influenced by the economy. People get sick. They need treatments. They may change what kind of treatments they get, but, you know, they need something—and you give up a lot of things before you give up your health. Having said that, I would also anticipate that with less tax income because of a declining economy industrial—now the real economy declining—governments will have to be very cost conscientious.

And, with that, they will cut also health care expenditures; and that, in a second cycle, will touch the health care industry. And so I believe that these downturns in fact are opportunities also for companies. And the opportunity is to re-question what are the core elements which create value for society and then, secondarily, value for the company, its employees, and the communities in which we operate, and what is really a cost item where we can become more efficient, more productive, more effective. And that's really what we're looking at. So we are looking at capital expenditures. We are looking at questions: "What is really, really necessary? And what is maybe not so necessary?" And we have flattened the organization to be hopefully less bureaucratic, which is always a problem in a big enterprise.

So we are undertaking a number of things which you could say, “You can do this any time.” It’s true. But it’s much easier when the environment encourages you to do it.

**The Quarterly:** *What are a couple of the big trends that you, from where you sit, think will really affect the overall business environment?*

**Dan Vasella:** I would say some of the megatrends, of course, affect in some ways almost everyone. And I would say one (which also for us is very important) is aging—aging of societies. On the other side, we have declining birth rates in the developed world. So that in itself is a shift in demographics that has importance in consumption, what the goods are which people need and want. And for us, of course, then with aging you have much more health care needs.

So that is one of the key drivers, really. And with that you have a question about pension funds—you know, affordability. How long do we have to work? Shouldn’t it be longer and, you know, what we’re used to in the ‘60s when these rules were set up? All of these questions have, I think, deep implications. And then the shift of power, economic power as I mentioned, from the West to the East more than from the North to the South. And, you know, you have to create real goods and real value. You cannot just live from virtual value and virtual money.

### **Management lessons: The balancing act**

**The Quarterly:** *What do you think are the most significant lessons you’ve learned about managing, and particularly managing change and adapting? And what do you think are some of the advances, if there have been any, in the art and science of management that really register for you?*

**Dan Vasella:** I would say: number one, you never can do it alone. So you’re also dependent on many others. But at the same time, you should not be shy about standing for what you believe. And in the long term, one of the conclusions I have drawn is you may not please all the time. But the fact that people say, “What he says he really believes,” I think is very important. And I believe you have to be first of all very respectful of people and, I would say, the broader environment too. The respect means one needs to be also very direct and tough when appropriate, because it’s an expression of respect. And it’s often not done because people are afraid. They are afraid. It’s not that they want to be particularly nice or care so much about the feelings of the other. It’s much more that they are afraid to confront with the other realities and then the response of it.

So you have to be able to be very tough and very supportive, if supportive is needed. And you have to give others room. But that doesn’t mean you abdicate authority, because you

have been entrusted with authority if you lead something and then you have to exert it. You can not do as if you would not be in charge.

And some people will tell you, “Don’t get involved in this,” or, “This is too detailed,” and I think that’s wrong. You should understand what you are managing and what you’re leading. You should know the key facts. And you should know the people and then know when you let them totally do [it] and you can go to bed, close both eyes, and sleep deeply and well, and you know things are being really done extremely well—and maybe better than you could do it. And when do you have to say, “No. This is not sounding right. It’s not smelling right. And here, I want to understand. And I go deep in detail.”

And I think these give a certain tension also in the organization because they don’t exactly know when is he going to go deep or not. And some people will say, “Well, that’s unpredictability.” And that’s very negative. You should be predictable. And if unpredictability is predicable, it’s also a kind of a pattern which people will know.

If you’re fair and fact based when you intervene, it’s not a problem, because it’s all something which you will elaborate then maybe debate—because, very often, there’s not one right answer but two or three, and you have to choose. And I enjoy choosing together, after having had a kind of a discussion.

**The Quarterly:** *Are there tools that you have found that have made this easier than it was 10 or 15 years ago? Or is pretty much the same tough thing?*

**Dan Vasella:** No. My evolution and learnings have been that, in the beginning, I have tried to read, listen, assimilate massively, and then really to practice, and over time to internalize certain things. And others you forget. And so with the approach we have taken, continuous learning is crucial. We have also, with Harvard Business School, regular seminars where the top team goes—I go too. I sit in on the bench and go through the course.

And the question is, when do you become idiosyncratic? How do you get new ideas? How to rejuvenate? And at the same time, it’s a fact of life that you get older. And you have young people. And they are again with more energy, more skills, different skills. Then you need to give them room, and you need to enjoy seeing others grow.

So I think what you do [at age] 40 is different than what you do with [at age] 50 or 60. And so the styles also evolve. You asked about new management techniques, and I would say I have rather the opposite reaction. I go back and I read more in Peter Drucker’s books than on the newest kind of monolithic theme, because what we have watched and observed—and I know you know this in and out—we regularly have one theme which is blown up to a

book, a new paradigm. But, frankly, it is just one element which has been specifically well investigated and then, you know, exposed and sold, but it always has been present. So if you go back to the roots, I think you see that most has been said and written.

### **The big picture: Health care reform**

**The Quarterly:** *Let me get you to a subject you know a lot about, which is health care and the challenges in terms of how innovation can address both the quality of care and the cost of care. Where do you see the opportunities? What are the barriers?*

**Dan Vasella:** I would say access, quality, and sustainability—financial sustainability and affordability—are all three very important criteria. Now if we look at the overall health care costs we have, depending on the countries, between 7 to maybe 20 percent of the bill are medicines, pharmaceuticals. Then you have 25 to maybe 35 percent physicians. The biggest part is the hospital systems. That's the most expensive in the developed world. In the developing world, drugs make up about 20 percent and hospitals much less, because the hospitals don't exist. So the number one conclusion is that, with all this talk about pharmaceuticals being expensive and, you know, ruining the system, you could take away all the profits of the pharmaceutical industry—it wouldn't fix the problem.

So I believe to recognize that not a single player will be able to fix it and not a single activity will be able to create the fantastic system is an important conclusion. If we look at the effectiveness of the system, I think we see a lot of areas for improvement from a point of view of coordination, from a point of view of understanding really what action has what kind of result.

Prevention is a whole other field. So if we would look at the spending today of one dollar, five cents [of it] are being spent on prevention. Now if you look at obesity and diabetes in this country and the link between them and cardiovascular disease and then add, you know, joint degeneration if you become older, these are humongous costs which obesity creates— I mean, humongous. It's projected by 2025 to go over a trillion [dollars], diabetes also over a trillion, cardiovascular disease over a trillion. So you start to add these things. Then you have Alzheimer's disease or dementia and cancer, which [includes] age-related cancer. Then you see that aging and poor balance of calories and metabolism create enormous costs in the future. And the most rational thing to do is really to enhance prevention as a first step so that you don't get sick.

In the UK, for example, the doctors measure the body mass index starting at age 16. When they take care of diabetes patients, they are paid for preventing measures, preventing complications. Here it would be very different. You're being paid for treating the complications. And so the whole incentive system needs to be reviewed. And we can of

course only take rational action if we also know which intervention produces what kind of outcome. It will take a lot of hard work. It isn't easy to do that. But we need to move forward.

In the US, if you look at Medicare and you look at the Medicare costs and the quality outcome, you see almost an inverse proportional system. In the South, Medicare is much more expensive, and the outcomes are poorer than in some of the northern states. There, very little is being done. If you look at the tort system, the tort system in the US is hundreds of billions [of dollars], around \$125 billion spent, and growing exponentially year after year. This is multiple [times more than] the NIH<sup>1</sup> budget.

If I was the king of health care reform, I would attack first the waste and the quality and then look at efficiency and productivity. I think we have a lot of opportunities. But one of the central issues of reform is that if you have several parties interested in nonchange, it becomes extremely difficult. So if a hospital earns a lot of money on diagnostic interventions, which are being made in order to practice defensive medicine, and you have the tort system, which makes a lot of money through the whole litigation, then it's very difficult to break this.

You know, with all the negative which I mentioned before, I'm deeply optimistic because I think society is smart enough that they will keep up incentives if you really bring advances. So I'm saying, let's focus on one thing: we need to advance medicine, help to advance medicine. That's our purpose in society. And we want to bring better therapies. The rest will be taken care of. I'm pretty confident if we do good stuff we will also be paid for it, and that already takes away a lot of distraction. And, from a point of view of the diseases—if you think of dementia or cancer—unless we have better interventions, the cost will be even higher because we have seen that, with every dollar spent in the systems, for example for effective drugs, you save overall costs from the system by shortening mostly the hospital stays and getting the patient back into productive life earlier. Frankly, that makes such a big difference.

So that's how I look at it. And I don't think we should overly complicate it. I also am a strong believer not only in intellectual-property rights and protecting them, I'm also a strong believer in generics. So I'm saying, once the monopoly of this know-how and knowledge and invention is over, well then, somebody can copy it and sell it very cheaply, which in turn saves a lot of money.

### **In the industry: Pharmaceuticals**

**The Quarterly:** *How do you see the industry? What are the major factors that will influence the industry?*

<sup>1</sup>National Institutes of Health

**Dan Vasella:** We came out of a diversified business. Some would call it conglomerate—chemicals, agribusiness, nutrition, and health care. And what we did is we divested piece after piece and just kept the health care and expanded in that area more. So we became stronger in that field. Why did we do it? One is because the know-how and the nature of the business is different, and we didn't see a lot of synergies.

In the beginning we launched a life science kind of concept which allowed us to divest chemicals with a good public rationale and to keep the seeds [of the] business, which had all the genetics and so forth together with the health care business. But frankly it was more an intellectual concept than it was something where we saw really big synergies among the businesses. And so we went to the next step and then divested the ag-business. And that was a period where everyone was talking about focus, and we were basically labeled as an unfocused company.

I would say, between the portfolio and the reality, there's a big difference. I would argue we are and were a highly focused company, because our divisions were very focused on their business, measured on their business not the overall. And so the people who were running the different businesses were and are really focused on their business.

We see a different evolution now, which I find rather amusing. Now, you know, with the risk and risk awareness being bigger, with companies which were once the top of the industry having fallen deep down—not just from a point of view of growth but also market cap-wise—now people say, “Well, maybe that's not the recipe. One should diversify.” And so we are seeing now competitors who said, “What? In generics? You cannot be in generics. It's incompatible, and you can't run these two businesses together.” Now suddenly we see more and more and more pharmaceutical players entering generics. Now, if you would ask me if I would enter generics if I wasn't at all in it, I'm not sure I would. We have been in that business since, you know, decades. And what we have done: we have grown it. But it was something we knew already pretty well.

### **On leadership: Leading through crisis**

**The Quarterly:** *What is leadership to you? And how would you define your leadership style?*

**Dan Vasella:** Peter Drucker said that the purpose of organizations is to make common men do uncommon things. And I would say and add, leadership is to make it happen. We are all plus-minus common men and women. And we have, as leaders, to make common people become very uncommon people: extraordinary people who can do extraordinary things, go beyond what we think is possible.

And it's not every day, but occasionally, that we achieve really extraordinary stuff. And we do. If we look at what we are achieving—and when we have a new medicine which is a breakthrough which changes the practice of medicine—it's extraordinary. It's fantastic. And there's so much knowledge. And not a single one person could have all of that.

And then translating this knowledge into a drug. And from the drug really producing it and then selling it and talking about it. These are all skills which need to play together. And in organizations, we have always people who shine and are able to move others. That's leadership. Moving others where they thought they could not and would not move.

**The Quarterly:** *I'd like to talk about an issue you've been outspoken on in the past, which is the role of the business leader in society. I wonder if you think that the crisis itself and how we come out of it is raising any new thinking or new model about what the relationship between business and society should be?*

**Dan Vasella:** Well, we would hope so. Even if I don't know what it will be. But, number one, I would say yes, it has been a crisis of leadership. If you had to stop and you would ask yourself, "Do I really understand what kind of risks we are running?"—not mathematical models on I don't know what kind of assumptions with thick books—but to really understand, I think many people would have had to say, "No, I don't. And I'm running just like everybody else."

But that to me is not really responsible behavior. And then the greed. People say, "It's the greed of managers, greed of investment bankers." My view is: maybe. But by which and whose greed was it driven? And then I'm saying, by everybody's greed. It was the little man. It was the pension fund. It was the investment fund, the portfolio manager. Everybody was running after quick and fast returns.

**The Quarterly:** *The implication of your earliest comments is that we were focused on quick gains and transactions and not building things of lasting value. So do you see a shift coming? And how would you like to see that discussion framed?*

**Dan Vasella:** I will be politically incorrect. In the sense that what I'm observing also, regarding the corporate-governance model, is that we believe that splitting power and responsibility and accountability into atomic kind of pieces will fix the issue—by installing new and more controls and more boxes to check, we will have less risks. And I adamantly believe that is not true.

The fact is that when you have a sheet of control with 21 signatures, nobody will feel responsible. And if you have boards who have advisers, independent advisers, and you have I don't know whom giving input, no single board member alone will feel fully responsible—and no CEO will feel fully responsible.

So I think, give the responsibility back where it belongs. And also then, point toward this point person who cannot deflect it and make them really accountable. So the clarification of accountabilities, responsibility, and with that also decision power, I think is more important than splitting it.

I'm also doubting that a ton of new controls will improve it, because my observation would be, certainly in investment, in banking, the innovation is always, "How do I circumvent certain rules to make more and better returns?" And so this will not stop. It will just be somewhat different. But when one sees huge shadow economies develop and doesn't do anything about it, you don't have to be surprised if one day you have a big explosion.

### **Business in society: Executive compensation**

**The Quarterly:** *How can business leaders like yourself address, or at least partially close, this trust gap?*

**Dan Vasella:** First of all, I think it of course has to do with integrity and transparency—and with respect. If you're respectful of the environment, respectful of the society, respectful of your employees, your family, you do certain things and you don't do certain things. And so that is one element. Of course, it means [one must] have certain value systems, and these value systems are not constant over time. They are being modified as society evolves. And new factors come into play.

One point I would make is certainly the inequality and the lack of perceived fairness and compensation is one important factor. And the problem is, how do you get out of the cycle we were in? It's extremely difficult to say to somebody, "Well, you earned \$10 million. And now, frankly, we think \$800,000 is more than enough."

And when can you make these retractions, these going back to what people would feel is still a lot of money but is fairer than what it is today? And I don't have the answer, but I think it's in transitions where you can do it, it's the easiest, less painful. And then to exert restraint as you go forward and reason—the problem is the entities which have emerged are so much bigger, so much more potent, so much more profitable.

And then, you know, boards look at it and say, "Well, this is not important—if we pay \$800,000 or \$10 million. What's really important is that we get the best person, because, even if it's a 10 percent increment as to what we would get otherwise, the incremental value creation is such that it justifies this 100 times." And that's all rational, it's all true, but you cannot communicate that. You cannot. How do you explain that to anybody? It's not feasible. If you are in a farm and you barely make your month, or if you're in a city and you're a working family with kids and both are working and both are bringing home, I don't know, \$18,000 or \$20,000.

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**The Quarterly:** *So it’s not just the issues of pay for performance, which is always a difficult thing and some places do it well and so places do it badly, but you do think that there will be a debate about the sheer levels?*

**Dan Vasella:** Oh, absolutely. I mean, pay for performance is for me a nonissue. Anything which isn’t pay for performance is not defensible. Anyway. So you have to link the compensation, which is variable, to the results. And these results may be a combination between money and behavior. So I’m not saying it has to be just monetary terms. It’s broader than that.

But for us, for example, innovation, what kind of talent do you develop, how do you act toward the environment—an array of things, balanced score card in other words, I think is more reasonable. But then is the absolute level. And then you start really getting to an issue, because would I say voluntarily I’m foregoing this money? No. Why should I? And then the question becomes even more complex. For whom? For the shareholder? To make the rich richer? No.

And, is it a question of how much I earn or how I use it? I have come to the conclusion, I think it’s much more important to ask, “How do you use what you have?” It’s like with the talents you have, do you really use them for the best of society? Do you give something? How do you use the money you have? Is it just to have more zeroes on the bank account at the end of the year? Or do you do something right with it? And these are the true ethical and moral questions we have to ask ourselves. And nobody else, other than ourselves, will be able to give the answer. ○