thinkPARALLAX

GETTING THE MOST OUT OF YOUR ESG

Materiality Assessment

CONTENTS

Leading companies understand that environmental, social, and governance (ESG) issues affect their bottom lines: extreme weather events connected to the climate crisis disrupt supply chains, a lack of diversity, equity, and inclusion (DE&I) programs pose reputational risk, data privacy failures reduce consumer trust and ultimately can impact valuations. But with a whole universe of potential issues to focus on and limited resources to address them, companies must prioritize those issues that most impact their business, society, and stakeholders. In response, a growing number of corporate sustainability teams are turning to materiality assessments to engage stakeholders who *affect* and are *affected by* the company in order to assess risk, identify opportunities, and gather insights. The results ultimately define what is "material" to a business, and therefore where to most efficiently direct scarce resources.

However, many companies continue to view materiality assessments as merely a required reporting exercise conducted every two to three years, in which stakeholders are surveyed, issues are ranked by importance, and the results guide reporting.

But done right, materiality can be much more than just a box-checking exercise. An effective materiality is an opportunity to engage stakeholders who your business impacts and who impact your business. It is an opportunity to understand both what is important to your stakeholders and *why*, to understand not only where to focus your efforts, but *how*. If approached strategically, materiality assessments are a key driver of business success.

The materiality landscape

Whether you're just starting down your ESG journey or are further along, it's important to be clear about what exactly materiality means, the differences between ESG and financial materiality, and how the materiality conversation is evolving.

Defining "materiality" depends on context. While the historical, SEC-driven definition of materiality is heavily focused on direct financial impact, ESG materiality includes issues that have direct financial importance, as well as those that affect a company's stakeholders, the planet, and society—which may have financial impacts in the long run. Here are just a few definitions:

United States Securities and Exchange Commission (SEC): "[a] matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important…The omission or misstatement of an item…is material if, in the light of the surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."

Sustainable Accounting Standards Board (SASB): "Financially material issues…are the issues that are reasonably likely to impact the financial condition or operating performance of a company and therefore are most important to investors."

Global Reporting Initiative (GRI): "Material topics are topics that reflect the organization's most significant impacts on the economy, environment, and people, including impacts on human rights."

The materiality process

STAKEHOLDER & TOPIC IDENTIFICATION

- Stakeholder and topic mapping
- Review relevant reporting frameworks, global trends, business strategy
- Conduct peer benchmarking
- Identify and define universe of business-relevant ESG issues

STAKEHOLDER INPUT

Interviews and surveys rate the following:

- Topic importance to the business and to each stakeholder group
- Perceptions of performance per topic
- Expectations of performance by stakeholder group

ANALYSIS & RECOMMENDATIONS

- Identify material issues and the anticipated timing of their impact
- Create materiality matrix and disclosure
- Provide insights to refine ESG strategy, track emerging issues, and develop a winning communication and disclosure strategy

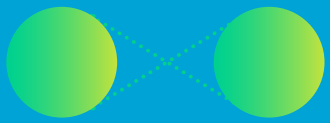
Adding to these are two emerging concepts: **double materiality** and **dynamic materiality**. While the nomenclature is new, the concepts are not. The new terminology and thinking attempt to fill the void of the varying understandings of materiality.

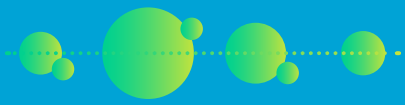
Double materiality describes how a company should both report on sustainability issues/risks that affect its business and operations, as well as the company's impact on the environment and society. The introduction of this term to remind individuals to take both vantage points reflects how materiality is interpreted in different ways. Some companies take an outward-in view, while others think inward-out. It is key to clearly define materiality to your audience — and to use the same definition when referring to a "material" topic.

Dynamic materiality is the idea that what is material to a company is continuously evolving, and that companies need to remain on the pulse of how trends and global events are affecting what stakeholders deem important. A three-year old materiality assessment, for example, would not have captured the impact that something like COVID-19 or the racial justice movement would have on the business.

Looking ahead, companies should simply make a point of weaving the concepts of double and dynamic materiality into a broader understanding of materiality versus thinking of them as distinct approaches.

Dynamic & Double, Defined





DOUBLE MATERIALITY

The EU Commission, as part of its proposal for a Corporate Sustainability Reporting Directive (CSRD, June 2021), an amendment to the Non-Financial Reporting Directive (NFRD), introduced the concept of double materiality. This is the idea that a company should report on both the issues that impact its business and the impact the company has on the environment and society. This departs from a more traditional view of focusing solely on ESG issues that directly influence or pose a risk/opportunity to also encompass externalities and external impacts. Starting in 2023, companies in the European Union will need to incorporate double materiality into their sustainability reporting.

DYNAMIC MATERIALITY

The World Economic Forum recently introduced the concept of dynamic materiality, which argues that some issues may not currently be financially material now but can become so in the near to long-term based on seen or unforeseen events. Leading sustainability reporting standards and frameworks like GRI, SASB, and CDP have shifted their definitions to label materiality as dynamic. Dynamic materiality also reiterates the need and value of conducting materiality assessments periodically, making it more fluid, to ensure the issues and importance of them are accurate.

The heart of materiality

An effective ESG materiality assessment must accomplish two things:

1 **Meet the requirements necessary for various reporting standards** by identifying which reporting frameworks they are reporting to, understanding the requirements of those frameworks, establishing a list of key issues (based on those frameworks, peer benchmarking, and internal risk assessment), then asking stakeholders about those issues in surveys and interviews.

2 **Help the company better understand risks and opportunities,** and provide insights to guide business, sustainability, and communications strategies. This is where companies can make the most impact by digging deeper into the insightful "whys."

How to make materiality work

Creating a materiality assessment that provides real insight means asking the right questions to the right people, and digging deep — all while keeping the engagement as concise as possible. Here are some tips for designing a more insightful materiality assessment:

TIP #1: BE THOUGHTFUL ABOUT WHAT YOU ASK, AND TO WHOM.

While asking a single set of questions to all stakeholders allows for comparability of results across groups, try to dig deeper. It is table stakes to ask questions that allow you to infer issue importance and prioritization. Follow-up questions that uncover what drives their perspective ensure the validity of outcomes and helps drive improved disclosure, strategy, or engagement. Secondly, target additional questions by group. Consider asking customers about the effectiveness of sustainability communication or asking investors which rating agencies they use to inform their decision matrices. The result of more nuanced questions is more specific guidance on areas to focus on and improve.

TIP #2: FOCUS QUESTIONS ON *WHY*.

Sometimes materiality assessments simply tell you what you already know. But there is significant value in doing the legwork to back up your intuitions. And it's an opportunity to dig deeper and better understand *why* stakeholders believe what they do: Is it because that issue poses a risk? Is it because they see it as an opportunity to lead or differentiate? Is it because of some future trend they have a pulse on? And beyond that, how well do stakeholders believe the company is managing those issues? How well do they expect the company to be performing? And will management of this issue affect their relationship with the company? These sorts of questions go beyond just prioritizing issues, but being able to find real insights and inform strategy and your communications.

TIP #3: ENSURE THE ABILITY TO TRULY RANK TOPICS.

Most materiality assessments are, at least partially, based on the result of stakeholder surveying, many of which use a Likert scale to rate each topic. The problem though is that companies often end up with a long list of issues that are equally "important." This doesn't allow them to truly prioritize issues, and it doesn't provide insight into which issues are most pressing today versus something they can set longer-term goals around. By compelling stakeholders to rank issues, companies can gain greater insights.

TIP #4: REVIEW THE ISSUES AT THE BOTTOM OF THE LIST OR THAT NO ONE IS MENTIONING.

Rather than take data at face value, dig into why those issues are ranked so low. Was anything misinterpreted? Are there insights to be gleaned? How do the lowest ranked issues compare across groups? An analysis of the data might reveal, for example, that while overall the issue of community engagement ranks lowest, employees believe it is among the most important issues — an insight which drives employee communication strategy.

TIP #5: CROSS-COLLABORATE WITH OTHER DEPARTMENTS.

Many materiality assessments are initiated and conducted by the sustainability department and used only by that department. But collaboration can lead to better survey design, better stakeholder engagement, and better results. For example, the enterprise risk management team can provide insight and direction in initial topic selection. By collaborating with sales, human resources, and investor relations, you can gain access to more potential stakeholders. It's also a great way to achieve buy-in to reach out to their stakeholders—or even better, initiating the stakeholder engagement themselves, which in turn increases the response rate.

4 common materiality mistakes

NOT ENOUGH STAKEHOLDERS ENGAGED

The more of the right stakeholders engaged, the more reliable the results.

ASKING THE WRONG QUESTIONS

The more targeted and specific the questions, the more insightful.

LACK OF CROSS-TEAM COLLABORATION

The more departments involved in engagement, the more impactful.

NOT LEVERAGING FINDINGS BEYOND REPORTING

The more effective circulation of insights, the better return on investment.

The benefits of well-done materiality

In our rapidly changing world, it's more important than ever to have consistent, meaningful dialogue with stakeholders. It shouldn't be every few years. And it shouldn't be a hastily created, basic survey that doesn't dive deep. Stakeholder engagement should be an ongoing dialogue, and materiality assessments should not only drive reporting, but also business strategy, communications, and investment decisions.

By leveraging an effort already required as part of reporting efforts, companies can better understand impact, risks, and opportunities from all angles. With an aligned, meaningful ESG materiality effort, a company can glean the insights to create a strategic advantage and best position itself for the future.

Keys to effective materiality assessments

Include the right inputs

- PEER BENCHMARKING
- EXISTING EMPLOYEE SURVEYS
- EXISTING CUSTOMER INSIGHTS
- BUSINESS STRATEGY
- RISK MANAGEMENT TOPICS
- REPORTING FRAMEWORKS AND STANDARDS
- RATINGS AND RANKINGS

Engage the right stakeholders

- INVESTORS
- LEADERS/BOARD
- CUSTOMERS
- EMPLOYEES
- SUPPLIERS
- PARTNERS/NGOS
- AND MORE...

Ask the right questions

- TOPIC IMPORTANCE & IMPACT TO THE BUSINESS
- PERCEIVED PERFORMANCE & EXPECTATIONS
- COMMUNICATION CHANNEL & EFFICACY

Get optimal output

Materiality matrix & disclosure

+

Insights to guide:

- COMMUNICATION STRATEGY
- REPORTING STRATEGY
- ESG STRATEGY

thinkPARALLAX

thinkPARALLAX is a leading full-service ESG strategy and communications agency. We partner with influential companies across industries to drive meaningful sustainability progress, action, and conversation.

ABOUT MATERIALITY+

thinkPARALLAX's Materiality+ includes a GRI- and SASB-aligned assessment, matrix (or other visual), and reporting disclosure, PLUS in-depth insights into potential risks and opportunities, solutions to improve reporting and ratings, stakeholder-specific recommendations for transforming perception, and a roadmap for communications and disclosure. Materiality+ goes beyond simply defining the topics that are most important to your stakeholders and company, providing the insights and solutions to drive strategy.

CONTRIBUTORS:

Janna Irons,
VP of Strategy *Lead Author*

Nathan Sanfacon,
ESG Strategist *Author*

Mike Hower,
VP of Client Engagement *Editor*

Eden Roehr,
Marketing Coordinator *Editor*

Edison Miclat,
VP of Creative *Design Direction*

Etah Chen,
Designer *Design*

thinkPARALLAX.com

thinkPARALLAX

How to make materiality work

BE STRATEGIC

- TARGET QUESTIONS BY AUDIENCE
- SEGMENT RESPONSES

ASK WHY

- DIG DEEPER
- UNCOVER WHAT DRIVES PERCEPTIONS
- DISCOVER INSIGHTS TO INFORM STRATEGY

THINK AHEAD

- PRIORITIZE PRESSING ISSUES
- SET LONG-TERM GOALS FOR LESS URGENT TOPICS

BE HOLISTIC

- CREATE MEANINGFUL ENGAGEMENT
- THINK BEYOND REPORTING
- INCLUDE ALL STAKEHOLDERS

COLLABORATE

- DESIGN SURVEYS TOGETHER
- WORK ACROSS TEAMS