When looking to emerge from chaos, materiality will help!

By Paul Davies, Founder and Principal, Think Sustainability

The current pandemic has caused a seismic shift in the market, with businesses and governments alike looking to recalibrate their thinking, their recovery strategy and, in many cases, their business continuity just to survive the upheaval. Many will flounder around, uncertain about what matters to them and their customers, investors, employees and other key stakeholders. The more informed these organisations are, the better will be their response and the more likely they are to not only survive, but to thrive. Materiality can be a key part of their recovery, a proven tool that just needs to be pulled out of the cupboard.

Materiality has long been an essential part of good reporting for companies, in relation to both financial and sustainability performance. It is also a key feature of integrated reporting. Whether we're talking about disclosing financial outcomes, sustainability impacts or value creation, businesses should look to frame their accounting of performance in relation to stakeholders' interests. Only by doing so does reporting support robust, meaningful communication and raise stakeholders' trust and engagement with the business – be they investors, employees, customers or regulators.

But materiality also has a role to play beyond reporting, equipping businesses to anticipate and cope with a changing world, including the recent global derailment caused by COVID-19. It can help them to better recognise opportunities, to achieve or enhance competitive advantage, to better embed resilience within their business model, and to build capabilities and reputation around inclusiveness, responsiveness and accountability.

Materiality and strategy

Although materiality is a key link between stakeholder inclusivity and accountability in public reporting, the true value of materiality to strategy, resilience and risk management is still not widely understood or appreciated. The reasons for this are fairly clear.

Firstly, its purpose is often misunderstood – materiality is seen as an outcome rather than a process. You can expend a lot of time, money and effort to produce a list of material issues, which you then consider to be the end product. But the real value added is when you use those materiality outcomes to test and modify your existing strategy, business continuity planning (BCP) and risk processes so they actually identify and respond to those key issues.

Secondly, the materiality process itself can be undermined by the quality and breadth of inputs feeding into it, or the lack of sound and meaningful issue prioritisation criteria.

Thirdly, many believe that materiality can be a recipe-driven approach (i.e. A + B = C) yet fail to realise that there is often significant professional judgment needed in refining the outcomes of the process.

Taken together these weaken materiality's value to the business – producing vague and ill-defined outputs that identify generic material "areas" such as "diversity", "safety" and "emissions", rather than tightly defined material issues that can be accounted for and responded to in your risk process, continuity plan or business strategy. In the end, 'vague' inputs produce 'vague' responses that do little to add value to crucial business processes.

Materiality and business improvement

The power of materiality is its adaptability. It is this capability that leads on to what I believe has the greatest potential in terms of its application in business improvement.

The Global Reporting Initiative, which is the most widely adopted tool for non-financial reporting globally, continues to embed materiality as a core part of its framework. The significance of, and approach to, materiality has been strengthened in the most recent editions of the GRI's Standards. Whilst many businesses are still mainly focused on getting the best out of materiality for their reports, they should start to look beyond that to the real value materiality can add to the business itself. Materiality's real power lies in its intrinsic capability to sort through the clutter and identify things that can both help and hurt the business, or its stakeholders, across a broad spectrum of areas.

In my experience from working with a range of clients over 15 years, it would be fair to say that the application of materiality is typically siloed in one particular part of the business – often within the sustainability or communications team. When asked if there is any awareness or use of materiality in other parts of the business and the answer is usually "no". Materiality is still seen largely as a reporting process.

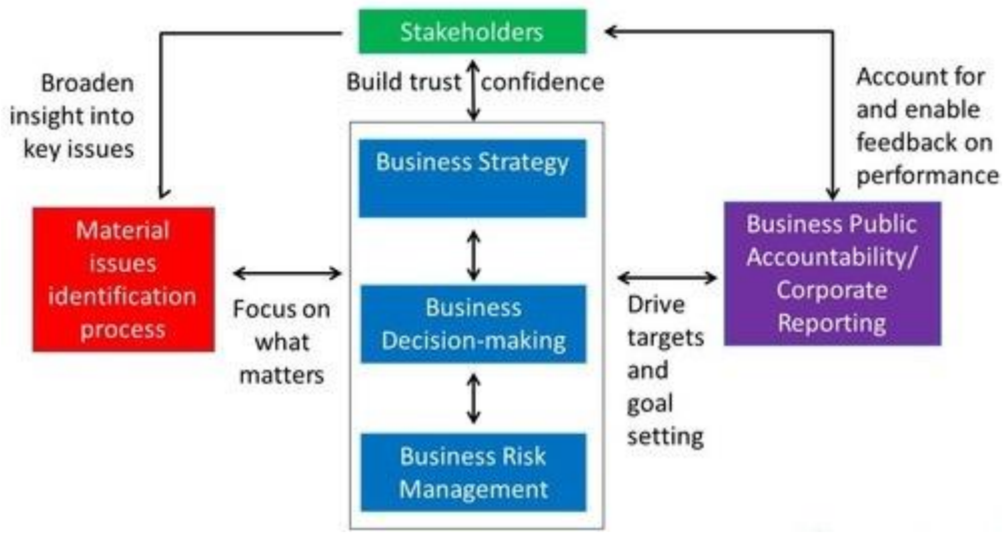
Materiality shares a lot of common ground with strategic planning, risk management and BCP, but they are not one and the same. Materiality is as much focused on identifying opportunities as it is on uncovering risk. Materiality also has the added benefit of applying an external lens on the business through its emphasis on stakeholder inclusivity, something not typically core to internal planning or risk evaluation processes.

To illustrate this, have a look at the GRI's management disclosure *102-15 - Key impacts, risks, and opportunities.* In this section are requirements that are equally as applicable to business processes as to reporting, such as:

- a description of its significant economic, environmental and social impacts, and associated challenges and opportunities;
- the range of reasonable expectations and interests of the organization's stakeholders;
- the approach to prioritizing these challenges and opportunities;

- key conclusions about progress in addressing these topics and related performance in the reporting period, including an assessment of reasons for underperformance or overperformance;
- the main processes in place to address performance, and relevant changes;
- the impact of sustainability trends, risks, and opportunities on the long-term prospects and financial performance of the organization;
- information relevant to financial stakeholders or that could become so in the future;
- prioritization of key economic, environmental, and social topics as risks and opportunities according to their relevance for long-term organizational strategy, competitive position, qualitative, and, if possible, quantitative financial value drivers;
- governance mechanisms in place specifically to manage these risks and opportunities, and identification of other related risks and opportunities.

By positioning materiality as part of the input process into strategy development, business decision-making, risk management etc, you are able to really leverage its full capabilities beyond reporting. Rather than sitting in isolation, reporting itself becomes the business' accounting mechanism for how well its management and decision-making processes are working. The following illustrates this:



This approach enables a flow of inputs and outputs within the business that ties together stakeholder engagement and accountability, materiality and reporting, business planning and goal setting in a meaningful, synergistic way that helps drive business performance.

Emerging from chaos

Materiality has already delivered much to businesses in terms of identifying key issues for their reporting. It provides their stakeholders with greater confidence that critical issues are being addressed and that the key performance indicators in your report are those most relevant to your business.

But beyond reporting, materiality can help your business to identify opportunities that deliver longer term value to the business, to better uncover and manage key business risks, to focus limited business resources on what matters most, and to better measure performance by zeroing in on the critical indicators. Not bad really.