Choosing your materiality dimension

The **objective** of this advisory note is to help you determine which dimension of materiality your company adopts when managing and reporting on your sustainability-related issues.

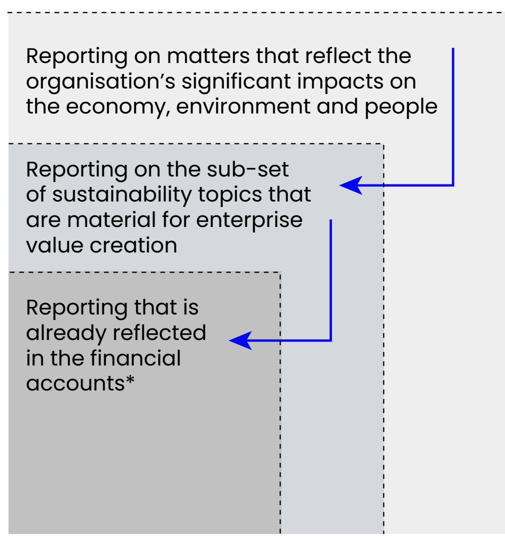
The general **definition of materiality** is the quality of being relevant or significant to the form or identity of something. In the context of regulatory disclosure obligations, information is considered material if "its disclosure would probably have an impact on the price of a security or if reasonable investors would want to know the information before making an investment decision."[1] By extension, an issue is material, and therefore worthy of disclosure, if investors take them into account when making their investment decisions. In the context of corporate sustainability, the concept of materiality has evolved - and broadened - to characterize **issues that substantively affect the company's ability to create, preserve, or erode value over the short, medium and long term.**[2] These issues can be of an economic or environmental, social, and governance (ESG) nature.

How you define value, or how you measure it, can vary depending on your perspective and intention. Therefore, choosing your materiality dimension is an important precursor to identifying the issues that are material to your company. It will also affect how you manage these issues, and how you measure performance.

Financial, impact, or double - the choice is yours

In corporate sustainability, **financial materiality** refers to the perspective of how ESG issues affect the company's operations and financial performance, risk profile, reputational capital, and access to capital.

Given that today, approximately 90% of public companies' market value is intangible – i.e., not based on the value of its real assets but on intangibles such as brand, reputation, resilience, and future prospects[3] – these effects cannot only be captured in the company's financial accounts, they are also captured in its enterprise value, which is the sum of the market value of the company's debt plus the market value of its equity.



[1] CFA Institute *(link)*
[2] *This definition is taken from the International Integrated Reporting Council (IIRC)*
[3] *Intangible Asset Market Value Study, Ocean Tomo, oceantomo.com website viewed on 23.05.2022 (link)*

On the other end of the spectrum, **impact materiality** refers to the perspective of how the company, through its activities, affects the economy, the environment, or society.

These effects are called dependencies and impacts and it is in this context that we can understand and describe the company's positive or negative contribution to sustainable development or sustainability. Therefore, if you intend to speak about your contribution to the Sustainable Development Goals (SDGs), you can only do so credibly in the context of impact materiality - something to keep in mind when choosing your materiality dimension.

The figure above illustrates how the different levels of materiality are embedded into another[4]. In the face of changing expectations of stakeholders, such as investors, lenders, customers, and employees, companies are increasingly expected to embrace both perspectives and to set intentions for managing issues and reporting accordingly.

Financial materiality "Value to the company"	Double materiality	Impact materiality "Value to society"
How ESG issues affect the company's operations and financial performance, risk profile, reputational capital, and access to capital.	The consideration of both.	How the business, through its activities affects the economy, the environment, or society.

An assessment is always best practice

When determining the issues to focus on, it's always best practice to do an assessment exercise. Your perspective and intention will influence how this exercise unfolds, in terms of the stakeholders you consult and the types of questions you will ask them.

When determining your financially material issues, consider conducting a materiality assessment, which will bring you to consult your investors, in addition to several internal stakeholders such as your Board of Directors, C-Suite, Risk Management team, and Finance team.

> Need a shortcut to financially material issues? Consult the Sustainability Accounting Standards Board (SASB) Standards, including their Materiality Finder. SASB has done the research to identify a baseline of issues that are potentially financially material for companies in your industry and prescribes relevant performance measures to disclose. If you determine that a specific issue or performance measure is not material for your company, you can always decide not to disclose it, as long as you explain your reason for omission. You can also disclose additional issues or performance measures that you deem financially material.

[4] *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting,* CDP/CDSB/GRI/IIRC/SASB, 09.2020

The activities with the greatest impacts, especially negative impacts, are those deemed material. While it is not itself an impact assessment tool, the Global Reporting Initiative (GRI) recommends companies identify and assess their potential and actual impacts on an ongoing basis as a precursor to identifying the material issues to report on. Part of this exercise will involve consulting stakeholders. A stakeholder is an individual or group that has an interest that is affected (or could be affected) by your activities[5]. External stakeholders include investors, suppliers, customers, or local communities.

Regardless of the perspective and intention you choose, it's important to keep in mind that materiality is a dynamic concept, in that the issues considered material tend to evolve over time. So, it's a good idea to refresh your materiality or impact assessment every few years.

Same issues, different measures

It is possible for some issues to be either financially material or impact material, while others are both. The differences reside in how the issues need to be managed and how performance is measured. (See examples of different perspectives in the appendix.)

When considering how issues affect the company's operating and financial performance, actions and performance are company-centric, and therefore quite within the company's scope of measurement.

However, when considering the impacts of business activities on the economy, the environment, or society, performance is largely outside of the company's scope of measurement and typically requires additional, macro-level information, sometimes referred to as impact value factors.

The visual below illustrates the different performance measures resulting from a company's activities; while the company can readily measure its outputs, it may not be able to measure outcomes and impacts, which require additional information.

Different performance measures along the logic model of producing goods and services

Inputs: What resources go in that could positively or negatively affect the SGD?	**Activities: What activities are undertaken?**	**What is generated through those activities?**	**Outcomes: What changes in the target population occured?**	**Impacts: What are the changes as a result of those outputs?**
Example: R&D, manufacturing, marketing spend ($ spent)	**Example:** Water purification tablet sales (qualitative description of marketing and distribution efforts).	**Example :** Tablets sold (# sold and demographic information regarding consumers buying the tablets).	**Example:** Purified water consumed (% of total water consumed)	**Example:** Reduced incidence of water-borne diseases (% reduction vs. pre-sales)

Source: SDG Compass

[5] *Global Reporting Initiative, October 2021*

You can do both

Considerations of financial materiality and impact materiality are not mutually exclusive, and it's quite possible for the company's positive or negative impacts on the economy, the environment, or society to have financial repercussions, and/or for investors to take them into account when making their investment decisions. Ultimately, a company is free to decide which perspective and intention to adopt when determining its material issues to manage and report on. In fact, you can choose to do both, in which case it helps to think of them as requiring distinct processes. Keep in mind, however, that disclosure regulations in several jurisdictions, namely in Europe, are becoming increasingly prescriptive about which materiality dimension companies need to apply.

For more help with articulating, socializing, or implementing a Basis for Preparation and Reporting, get in touch with your Novisto Customer Success Manager.