

SALTERBAXTER

Double materiality

A strategic opportunity
that's all too often missed

Double materiality

Double materiality is not a new concept. It was officially introduced into the reporting landscape with the release of the European Union's (EU) Non-Financial Reporting Directive (NFRD), but its new-found prominence is thanks to the NFRD's successor, the Corporate Sustainability Reporting Directive (CSRD). From this year onwards, around 50,000 EU (and qualifying EU subsidiaries of non-EU companies) are required to report on the environmental and social impact of their business activities, and on the business impact of their ESG efforts and initiatives. The European Sustainability Reporting Standards (ESRS), adopted officially by the European Commission on 31 July 2023, sets the rules and requirements for companies to comply.

Double materiality sits at the heart of CSRD and is the essential first step towards compliance, focusing businesses on the sustainability matters that are most relevant to organisations and their stakeholders. But, as with all materiality that has gone before, there is a danger of falling into the 'box-ticking' trap and simply performing double materiality assessments to meet regulatory reporting requirements and seeking confirmation of things you already know. The EU's far-reaching directive on sustainability reporting isn't, and shouldn't be, only about disclosure. Those that view it as such are at danger of missing the real value and opportunity it presents.

Double materiality can do more than identify and prioritise topics. When done right, it can uncover opportunities for value creation that may be going largely unnoticed. It can shape company strategy and deliver strategic insights to ensure you are focused on the right goals and milestones.

It can also help businesses to:

- > Identify blind spots and disruptive risk, both inside and outside their control

- > Manage future risk and the potential opportunities that arise from it

- > Evolve and develop future-fit sustainability strategies, shifting from short-term thinking to long-term planning

- > Understand the connections between the topics, e.g. climate and nature

- > Drive innovation and differentiation

- > Prioritise investments and resource allocation

- > Break down internal siloes and build capacity across teams

Businesses need to rethink their traditional approach to materiality, designing a process that brings both creativity AND credibility to the table. Materiality is, after all, a unique combination of an art and a science. This includes, as a starter for ten, resetting expectations for what double materiality can and should do in the first place (i.e. shifting from understanding “what could we do” to “what do we need to do to stay in business”) – engage a broader, more diverse group of stakeholders and move away from the ‘usual suspects’ and seek out challenge over reassurance. Also reconsider how you use the materiality outputs to drive strategic outcomes; understanding how topics are interconnected and leveraging your analysis to unpick the ‘so what’. Only then will you uncover compelling insights and generate strategic outcomes, not just outputs.

Having conducted many double materiality assessments over the last year, we wanted to share some important learnings to set you up for success...

01 Map out your value chain: Take the time upfront to develop an in-depth understanding, end-to-end

CSRD does not only require you to select ESG topics that are relevant to your own business operations but also to consider sustainability topics along your businesses' value chain (upstream and downstream).

As part of your process, you should take the time upfront to map your company's business model(s) and value chain to provide a common point of reference for use throughout the assessment. This will help identify the direct and indirect impacts your business has on the society/environment across the full length of the value chain. It will also help determine the most relevant stakeholders for inclusion in the double materiality process.

02 Stakeholder engagement: Emphasise quality over quantity

Gone are the days when companies would compete against each other to indiscriminately survey as many stakeholders as possible (with little consideration of their level of expertise or knowledge of the business). Given double materiality is focused on understanding actual impacts, risks and opportunities, companies need to carefully consider who and how to engage.

If you engage with the same stakeholders year in, year out, you're going to get the same outputs. Instead, ask yourself which stakeholder groups have traditionally not been a part of your materiality assessments? This is particularly important given the ESRS puts more emphasis on 'affected stakeholders', referring to those who may be significantly affected by a company's operations, products, services and supply chains. And how about considering under-represented voices such as youth groups, activists and campaigners, or finding ways to give nature a voice?

Beyond who you speak with, can you reimagine engagement mechanisms with an emphasis on qualitative over quantitative? Conversations are, in our view, far more valuable in the long-run than surface level data. By placing more emphasis on the quality of the qualitative and contextual insights, we are better able to drill down to the 'so what' and provide meaningful recommendations to inform decision making.

03 Don't reinvent the wheel: Draw on existing internal assessments and experts

There's no need to make double materiality more complicated than it already is. Much of what you are doing today with respect to ESG will be useful and applicable to your assessment. It is about enhancing existing practices and processes rather than building completely new ones.

Where possible, leverage existing assessments such as climate risk assessments, carbon footprints for the materiality of climate change mitigation, material flow assessments for resource use and circular economy, human rights impact assessments and employee surveys for various social topics. And for financial materiality, companies' current risk management frameworks can be used in your assessment. There's no need to increase the burden of implementation by introducing a new framework for assessing financial risks (and opportunities) when you already have a proven tool for the exact same purpose outside the context of ESG.

As CSRD is as much about strategy as it is reporting, consider assembling a cross-functional project team to encourage cross-pollination and share learnings to help define impacts, risks and opportunities. We recommend input from functions across the business including Sustainability, Supply Chain, Strategy, Finance, Risk, HR and Legal. For stakeholders not traditionally involved in the materiality process before, we recommend spending some time upfront to socialise the concept of double materiality with them and set out clear expectations. This will help ensure meaningful engagement throughout and build capacity for the business moving forward

04 Visualising materiality outputs: Rethinking the traditional matrix

None of the established standards recommend the use of a matrix today. So why, by default, are we still all reaching for the traditional two-by-two matrix? Our view is that a matrix can represent a misleading picture; an over-simplified snapshot and arbitrary positionings with regards to prioritisation that don't actually reflect how these issues are prioritised strategically.

We're of the view that it's time for a new approach. When considering alternatives, we don't recommend a one-size-fits-all approach and work with each client to explore and co-create a visualisation. Support materiality outputs with engaging copy and a clear narrative. It is crucial to bring the reader along the journey and leverage this to clarify the valuable 'so what' behind the visualisation of the double materiality outputs.

05 Be patient: Choose pragmatism over perfection in the early days

The CSRD confusion is real. You are not alone – the scale and complexity of the undertaking is starting to dawn on everyone. Jumping in with a fully CSRD-compliant double materiality may well be out of reach for many, but starting to incorporate double materiality principles and engaging with stakeholders not previously involved in the process will help you to get ahead of the game. We recommend you start to scope and plan for your double materiality sooner rather than later.

If you would like to find out more about our work in this area, or in wider sustainability strategy, execution and action, then please get in touch.

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