Towards a New Materiality

A review of the current practices of FTSE 100 and a possible path ahead

July 2018
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Running a sustainable business depends on understanding and focusing on what matters most – the activities and impacts most crucial for the success of a business, and that of its stakeholders, now and in the future.

To that effect, materiality has long been a part of the sustainability management lexicon, yet there has been so little innovation – in concepts, terminology, tools and presentation. An idea that entered the sustainable business vocabulary some 20 years ago is still the subject of vague, overly simplistic and perfunctory interpretation, with little value for either decision-making or accountability.

However, companies put in substantial effort, time and complexity towards the design and conduct of their materiality assessments – so they should expect the outputs to be meaningful and powerful.

Furthermore, through this project we are intending to engage the community of service providers in this conversation, whose advice underpins the materiality assessments of their clients, and whose role as the very engineers of materiality assessments gives them an important role to play in driving meaningful progress.

At Sancroft, we take this role very seriously and asked ourselves: to what extent are current materiality models sufficiently sensitive to capture the diversity of factors affecting business success, and sufficiently robust to hold up to scrutiny?

To answer this and other related questions, we looked into the public disclosures on materiality of the largest, and arguably most scrutinised, listed companies in the UK – the FTSE 100\(^1\). We also tapped into the experience and ideas of several practitioners and service providers.

In this report we share our findings and collective ideas with two objectives in mind: firstly, to assess the state of current practices among the FTSE 100, including common challenges and innovative solutions; and secondly, to inspire new thinking and start the conversation with the broader community of sustainability professionals.

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\(^1\) Financial Times Stock Exchange Index – a share index of the 100 companies listed on the London Stock Exchange with the largest market capitalisation, and combined market capitalisation of over £2,000 trillion. Information accessed on and accurate as of 23 May 2018 at [www.ftserussell.com](http://www.ftserussell.com).
Introduction & Overview

Materiality is both a concept and a practice. It’s easy to lose sight of the one when focused on the other:

Concept
Materiality is the quality of relevance or significance of information. Material information could influence the perceptions and decisions of users of that information, if omitted or misstated.

Practice
Materiality is a consultative and analytical process designed to make determinations on the relative importance of environmental, socio-economic and governance (ESG) issues.

In both of these dimensions, materiality is of fundamental importance to the meaningful management of sustainability performance, and also highly technical, esoteric and seemingly unconnected to the real world – of great interest to practitioners, but baffling for many day-to-day stakeholders of company activities.

Materiality arose in a sustainability context alongside the rise of sustainability reporting in the last two decades. Many early sustainability reports ran to hundreds of pages (indeed, some still do), addressing scores of topics without regard for their actual impacts on the environment, society, or company itself. In the face of such excessive information-sharing (dubbed ‘carpet-bombing’ in one influential study of sustainability reporting, in honour of its outsize and seemingly indiscriminate nature), the notion took hold that companies should be expected not to report anything and everything, but to focus on the right information about those things that made the most difference to its business model, its stakeholders, the planet, and that which affects its future risk and opportunity.

What is materiality used for?
The outcomes of materiality assessments, often referred to as material issues, are commonly used to inform sustainability disclosures, but they also play a role in devising strategies, justifying investments and engaging various parts of the business and senior management in raising the profile of sustainability topics.

While the concept is today widely-accepted, it nevertheless remains difficult, if not impossible, to assess ‘what really matters’ in an objective and transparent way.

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Who are the audiences for materiality, and related disclosures?

Investors and providers of capital

Interests:
1. What ESG issues have material impact on value creation and protection;
2. Assurance of a robust process including senior management.

Management

Interests:
1. What ESG issues have material impact on value creation and protection, AND represent material concern for key stakeholders (those that the business depends on or that have influence in the operating environment);
2. Assurance of a robust process, and efficient communication on what the business is doing on each material issue.

Civil Society

Interests:
1. What ESG issues have material impact on the environment, society and the economy;
2. Who has a voice in deciding those matters.

Figure 1. Audiences for materiality and related disclosures

‘I know it when I see it’

One result of this subjectivity inherent in materiality assessment is that readers of sustainability reports (or corporate decision-makers, investors or others using such reports or similar disclosures) fall back on their ‘gut feel’ when judging their reactions to a company’s selection of issues. The famous pronouncement of US Supreme Court Justice Potter Stewart – who, in 1964, attempted to describe his standard for what constitutes obscenity as: ‘I know it when I see it’ – comes to mind.
Figure 2. Material issues may derive from a variety of sources (Sancroft)

Even with a high degree of professional consensus around what might determine materiality, the actual assessment comes down to individual judgments – of companies, their management, their service providers, assurance professionals, and ultimately the stakeholders holding companies to account for their sustainability impacts and performance. At the end of the day, it seems, we know it when we see it.
Says who?

The recognition that perspective matters when assessing materiality led to the notion that ‘who gets to decide’ is as important as what topics are ultimately selected for prioritisation. Today’s materiality analysis often involves pitting the ‘company’s views’ against ‘stakeholders’ views’, with the result that an honest, dispassionate assessment is impossible. And a company’s most important issues come down to a mere popularity contest.

The well-worn materiality matrix – juxtaposing some version of ‘importance to stakeholders’ against ‘importance to the business’ – remains the classic vehicle for visualising and publishing the outcomes of a materiality assessment. Beguiling in its simplicity, the matrix holds the promise of a simple and straightforward calculation of what most affects a company. In reality, these are often based on little more than a wet finger in the air – and the seeming robustness of the underlying model tempts us to find meaning in a way that may in fact be an illusion.

Enter the Matrix

Forgive the analogy: In the 1999 Wachowski Brothers film The Matrix, Keanu Reeves’ main character is offered the opportunity to shake off the shell of comfortable illusion and see the world for what it really is – by swallowing either a red or a blue pill. The coloured pills represent the ways in which we choose to filter our experiences, and limit or expand the reality we want to be part of. Similarly, the x- and y- axes of the typical materiality matrix may in truth give us the illusion of regard for multiple perspectives while enabling us to discount those we prefer to ignore.

Does a 2x2 matrix populated with unlabelled dots serve the cause of accountability? Does a word-cloud, list or table do this any better? Our analysis of materiality in the FTSE 100 shows some diversity of presentation, but the enduring strength of the matrix suggests it is nigh-on settled good practice. But we nevertheless ask: is the materiality matrix a powerful tool for transparency and challenging of the status quo – or is it the sustainability professionals’ blue pill?
It is useful to explore the materiality matrix as an archetype – its strengths and weaknesses, and the extent to which it serves its intended purpose:

What makes the matrix appealing?

1. Visualisations spark interest, and thus are a good starting point for further conversations.
2. The matrix creates an impression of sophistication and rigour of analysis, especially in the eyes of management.
3. A matrix is great for presenting the relative importance of issues.

What are some of the downsides?

1. Overreliance on the materiality matrix as the driving force for the entire assessment, and the associated ranking of perceived importance/impact has set up a false popularity contest. It is easy to be distracted by numbers of clicks, and the general prevalence of views, and ignore the role and influence of stakeholders or other factors on a topic.
2. The attraction of ranking is contributing to materiality losing its original binary notion – material or not material – as terms such as ‘less material’ and ‘most material’ emerge.
3. Over time, matrices tend to confirm what companies already know or believe, as issues cluster around the 45-degree diagonal (as shown in Fig. 3). Among the matrices in our research, none portrayed issues of high importance to business that are simultaneously unimportant to stakeholders or vice versa.

Through the course of this project, we felt the time had come to question the fundamentals – to examine the very purpose of materiality, and what practices will actually meet those expectations. Through reviewing the disclosures of the FTSE 100, we found both a language to describe today’s current practices, as well as a window into what we may hope to see in the future.
The state of materiality in the FTSE 100

We recognise that just like an iceberg, only a fraction of the work done by these companies is visible in the public domain, and that full disclosure and transparency on materiality is a difficult challenge. In the state of materiality in the FTSE 100, we explore common aspects, point out the practices that stand out, and comment on what can be improved - by asking six key questions.

1. What is considered in the identification of issues?
Throughout our review we identified 5 factors that companies consider when identifying relevant sustainability issues:
- Risk
- Stakeholder views & concerns
- Standards & regulations
- Vision, mission & strategy
- Broader context & industry challenges

Stakeholder views & concerns are the most common factor by some distance. Clarity on which stakeholders, and how they were engaged would help improve transparency and counter the perception of materiality as a mere popularity contest.

2. How often is the materiality assessment conducted or updated?
Only about half (38) of the companies specify the frequency of conducting or updating their materiality assessment. Eight of these only mention the word “regularly”, while the remaining 30 have a set timeframe:
- Annually: 16
- Every 2 Years: 10
- Every 3 Years: 3
- Every 5 Years: 1

3. What determines the materiality of issues?
About a quarter of those describing their materiality process do not provide a definition of materiality. Among the remaining 58 companies, there are two prevailing approaches:

The Traditional
26 companies factor in how important an issue is to their stakeholders and to their business. One can still argue that these criteria may mean many things to different people, and are subject to bias.

The Refined
24 companies have updated the traditional approach by replacing the impact on their business. 5 of them take this approach one or two steps further and also consider the level of influence, level of opportunity, and/or the degree of alignment with vision, values, brand and geography.

4. What is the highest body that makes the determination?
Our analysis shows a lack of transparency in who is involved in making materiality determinations. Only 23 companies do this:
- Seek board level approval: 9
- Obtain consent from their senior leadership: 7
- Keep it within management: 5
- Consult their advisory board: 5

5. What standards & guidelines are used?
41 companies claim to follow the Global Reporting Initiative (GRI) principle of materiality, making it the most prevalent guidance among the FTSE.

6. How do companies present the outcomes of their materiality?
66 companies disclose their material issues
In nearly 1/3 of the cases, even if an issue is disclosed it is not clear whether it is deemed to be material or not.

Only 23 companies clearly describe the meaning of their material issues, thus limiting the risk of readers’ subjective interpretation. The use of all-encompassing vague titles requires greater explanation of their meaning. For example “Water” could relate to water scarcity, discharged water quality, water replenishment or all of the above.
Establishing the link to commercial drivers
Anglo American has provided a different lens on their material issues by showing how they create value, using their 7 ‘pillars of value creation’.

Source: Anglo American Sustainability Report 2017, p.17-18

Mondi Group has mapped their material sustainability issues to their ‘action areas’ and principal risks.


Taking a long-term-view
Unilever has demonstrated the breadth and foresight of their materiality by mapping their material issues to the UN Sustainable Development Goals.

Focus on impact boundaries
Johnson Matthey has effectively portrayed the impact boundary of each of their material issues from operations, through supply chain, to the wider society and global impact.

Source: Johnson Matthey Material Issues
A third dimension on the matrix
Centrica has assessed its ability to influence each issue, and represented that by a differently sized circle for each issue on their materiality matrix.

Source: Centrica – Key Issues: Materiality Matrix

Pearson, in a similar fashion, has indicated the degree of control over each issue on their materiality matrix.

Source: Pearson - Reporting on our material issues
To uncover further insight into current materiality practices, and the diversity of its representation, we looked into the approaches in the extractives and financial services sectors. We chose these sectors because they are in aggregate the two largest in the FTSE 100. Moreover, companies in these sectors populate the ranks of sustainability reporting companies at high rates globally. We looked at the overall approach to materiality, the factors considered in identification of material issues, the criteria used for prioritisation, and the material issues commonly uncovered.

**Extractives: Mining, Oil & Gas Producers, and Industrial Metals & Mining.**

**Materiality disclosure?**

Of the 10 companies, 9 claim to assess their material issues, and 8 disclose their approach.

**A common process**
Companies in the extractive sector use apparently similar methodologies. As shown on the graph, the majority consider the same factors in identifying their issues, and engage with the same types of stakeholders.

The criteria to define what issues are considered material are also aligned across the sector: Impact on the business, and stakeholder impact or relevance to stakeholders.

**Outcomes**

- 7 companies present their material sustainability issues
- 6 companies provide a clear description of what they mean by each issue
- 6 companies present the outcomes in a table or list

The extractives sector is associated with significant impacts, and operates under intense stakeholder scrutiny. Perhaps because of this, materiality is well understood and common practice in the sector. It is also natural to see a convergence of practices and outcomes thanks to the high degree of collaboration to define sector-wide performance and reporting standards through initiatives such as ICMM, IPIECA and GRI. Doubts remain, however, whether companies are in a ‘state of fatigue’: Is materiality still a useful tool to promote engagement with the business?

**Financial services: Banks, Nonlife Insurance, and Life Insurance**
Companies analysed: Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland Group, Standard Chartered, Admiral Group, Direct Line Group, RSA Insurance Group, Aviva, Legal & General, Old Mutual, Prudential plc, St. James’s Place plc.

**Materiality disclosure?**

10 out of the 13 companies assess their material issues and disclose their approach.

**Diversity of process**
Reflecting the nature of services provided, the companies in the financial sector present diverse materiality processes. Compared to extractives, there is a greater reliance on stakeholder views and risk, relative to the other factors.

The most common criteria for defining materiality are impact on the business, importance to stakeholders and to the business.

**Outcomes**

- 6 companies present their material sustainability issues & describe them clearly
- 5 companies present results using a materiality matrix
- 5 companies use other formats such as a table or a list

A growing number of stakeholders demand a more robust and transparent materiality assessment from companies in the financial sector. Companies are expected not only to disclose their material sustainability issues and justify them, but also clarify the decision-making process by which they were determined.

The presentation of outcomes is a crucial step when undertaking materiality. We have found that lists or tables are increasingly becoming popular and indeed these may be less likely to be misinterpreted.
Materiality 2030: a sneak peek into the future

In 2030, will we see the same emphasis on materiality analysis per se, or will it be absorbed into company strategy and communications? Will there be greater commonality and consistency? Is the matrix a thing of the past? Will standards fill the void, bringing comparability and generally accepted methods? And will materiality analysis in the end be overtaken by mandatory reporting requirements?

We have no crystal ball. But we see a future where the underlying process and outcomes of materiality analysis are more meaningful for being intrinsic to how decisions are made at companies. In realising this potential, we see five emerging principles:

1. Have a clear purpose beyond reporting
2. Start with the big picture
3. Take a holistic approach to risks and opportunities
4. Be smarter about making sense of data
5. Don’t hold back on transparency

1. Have a clear purpose beyond reporting

*Materiality must fulfil a clear purpose within the organisation’s strategic decision-making process beyond satisfying reporting and disclosure requirements.*

Materiality has played its role as a process to confirm what companies should report on. It is time to add greater value to strategic decision-making. In this journey toward a new, better role of materiality within the organisational decision-making context, businesses will inevitably experiment with new approaches and definitions, which after trying and testing, will reach a point of convergence – or even a universal definition of what makes an issue material – improving the quality of the insight and the credibility of disclosures, and allowing for more meaningful comparison and analysis by those interested in the outcomes.
The thinking behind developing science-based targets, as some companies currently model for reducing greenhouse gas emissions in line with their growth pathway, could have an important role in the evolution of materiality. It suggests that we can identify the inherent sustainability of activities based on ecological carrying capacity and, perhaps less convincingly, the ‘equitable’ allocation of non-physical resources or capitals. This remains an emerging philosophy and approach, but its robust development would contribute to the reliability of materiality assessment.

2. Start with the big picture
*The forces shaping the world and organisational vision, values and strategy are at the core of any materiality assessment – ensuring long-lasting relevance of the organisation in a fast-changing external and internal environment.*

In determining what matters most from a sustainability point of view, companies should consider not only current industry challenges and perceived megatrends, but also the forces that they envision will shape the world in 2030 and beyond, as represented by the UN Sustainable Development Goals. Companies should also identify the socio-economic, environmental, and governance issues that most closely support the fulfilment of their vision, the manifestation of their values and the achievement of their strategy. In other words, those factors that allow them to remain true to their fundamental purpose as an organisation.

3. Take a holistic approach to risks and opportunities
*Companies must integrate socio-economic, environmental and governance issues that have material impact on creating and protecting value into their risk process and vice-versa.*

In practice, establishing a regular two-way feedback loop between the risk and materiality processes is crucial in ensuring that financial and non-financial risks are considered in a holistic way. Where materiality differs from risk is that it considers both risks and opportunities in the identification, analysis and prioritisation of sustainability issues, as well as in factoring in the expectations and concerns of key stakeholders. Often, the latter is not an integral component of a company’s risk framework. In this respect, the materiality process can add further value by validating the feasibility of new opportunities with key stakeholders.
4. Be smarter about making sense of data

*Insight from stakeholder engagement may be complemented by Artificial Intelligence (AI), allowing companies to draw more meaningful conclusions from the myriad sources of information used in the identification and analysis of sustainability issues.*

There are many examples of how companies already embrace the advancement of technology, such as AI, to make sense of millions of points of unstructured data on a regular basis. AI has bearing in any task requiring intelligence – and companies are already applying it to capture market and consumer insight, monitor reputational risk and stakeholder sentiment, and accurately predict consumer behaviour, to name a few. The possibilities are endless. When applied to materiality, AI can generate further benefits. Firstly, the speed of analysis saves time over manual efforts. Secondly, it may improve the accuracy of analysis – for example, through diminishing the selection bias associated with the typical sample-approach to stakeholder engagement. Lastly, AI can make some aspects of the materiality analysis a continuous process – capturing not only the issues that matter and to whom but also how they trend over time.

5. Don’t hold back on transparency

*Companies present their approach to materiality in a meaningful and open way that satisfies the disclosure requirements of interested parties and facilitates accurate interpretation of outcomes.*

Investor expectations of reports and other company disclosures are shifting, and we see this as a key conduit for improving transparency. The sector-based approach that many rating and research agencies currently offer is proving insufficient to capture risks and opportunities specific to a company’s value creation model, operating context, and resource dependencies. Thus, investors will increasingly base their assessments on company-specific materiality analysis, which is able to demonstrate a robust process with board-level involvement in deciding material issues, clear outcomes and some form of independent verification.

Service providers will play a key role in driving meaningful progress in the above five areas. At Sancroft we aim to play our role in two ways:

1. **By convening forward thinking peers, fostering collaboration between practitioners, service providers, and others, and working together to remove some of the current hurdles companies face.**
2. **By enabling new practices. As the very engineers of materiality assessments, we bear the responsibility to provide innovative tools and solutions that will be fit for the new era of materiality.**
About Sancroft

Sancroft was founded in 1997 by former Secretary of State for the Environment, The Rt. Hon John Gummer, Lord Deben, and has been at the heart of sustainable business ever since. We are sustainability experts, the trusted advisors to scores of the world’s largest brands and companies. We challenge companies to think differently, empowering them to make sustainable profits.

We work with organisations that recognise the opportunities in sustainability, and that want to make profits they can be proud of. We provide bespoke insight and strategic advice, driven by values and purpose, which help you achieve your objectives. Our work helps you succeed.

Project Team

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Acknowledgements

We would like to thank the following organisations for contributing to this report by sharing their experience, views and ideas:

- Aviva plc, FTSE 100 company
- BP plc, FTSE 100 company
- Datamaran, Data intelligence service provider
- DNV GL, Advisory and assurance service provider
- Johnson Matthey, FTSE 100 company
- Polecat, Data intelligence service provider
- Unilever plc, FTSE 100 company
- UN Principles for Responsible Investment

The information in this report is based on the publicly available information of the following FTSE 100 constituent companies:
