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Materiality Matrices in the Environmental, Social and Governance Context

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Abstract— *Sustainability reports seek to communicate the performance of organizations in the Environmental, Social and Governance (ESG) dimensions in line with the Sustainable Development Goals of the United Nations. Since there is no homogeneity of criteria among the various companies, even in the same sector, the several* methodologies *seeks to establish specific disclosure standards on ESG factorsthat facilitate communication between companies and investors about relevant and useful information for decisions through the identification of material and immaterial factors for each of the sectors. Information is material if its omission or misstatement influences people's decisions – likewise, information is immaterial if its omission or misstatement makes little or no difference to the decision-making process. In an ESG context, something is defined as material if it is reasonably likely to affect a company's financial condition or operating performance in terms of the impact it has on its value chain. There are two objectives of this study, first, to identify the main ESG factors that impact companies and that are at the heart of a resource-efficient sustainability strategy through the application of the materiality matrix, second, to envision that after this identification, the company it can optimize its strategic orientation and direct internal management in responding to material issues. This is a descriptive research with a qualitative approach, using bibliographical, normative and documental sources. The study made it possible to analyze and conclude on the importance of the correct diagnosis of material and immaterial factors in the elaboration of the materiality matrix in a banking institution with an impact on the value chain and on the real contribution to the objectives of sustainable development.*

***Keywords*— ESG, Materiality Matrix, Sustainability Report, Sustainable Development Goals, Value Chain.**

I. INTRODUCTION

The Materiality Matrix is an element of the Sustainability Report prepared based on the guidelines of the Global Report Initiative (GRI), with the aim of "improving the quality, rigor and applicability of sustainability reports" [1]. In addition, the Materiality Matrix is presented as an important tool for building the sustainability strategy of companies, as it identifies aspects of the economic, environmental and social spheres of sustainability that are most relevant for stakeholders and for the company. The Materiality Matrix focuses the companies' sustainability actions on the most relevant aspects to be addressed.

II. THEORETICAL FRAMEWORK

The materiality matrix of ESG practices is essential for the entire business strategy. In addition, this process is essential for preparing a sustainability report that complies with the guidelines, or that directs the company to present a general, neutral overview with the greatest possible credibility in relation to the company.

For GRI [2} materiality is the process of identifying and prioritizing relevant aspects for its stakeholders that affect the company's business.

There are three methodologies that use materiality as a relevant criterion [3]:

ISE B3

B3's Corporate Sustainability Index includes the screening of material topics at the beginning of its rigorous methodology, requiring the organization to have already identified what its stakeholders care most about and what causes the most impact for the company.

GRI

The GRI is a global standard for sustainability reporting designed by organizations and investors to measure business performance, was a pioneer in standardizing the information contained in these reports, bringing several advantages from the proposed models.

SASB

The Sustainability Accounting Standards Board has its own tool for establishing material topics, also considering which topics are most relevant to investors.

Any company wishing to disclose its ESG conduct will need to go through one of these methodologies. A well-presented materiality process will ensure that the company's sustainability reports will cover the most relevant topics for stakeholders and the company.

Materiality has one more fundamental item that is extremely important for predicting crises, implementing risk management in each area. If, for example, a company has a low reputation on any of the material topics mentioned, it is essential that it:

- Carry out an analysis on this material topic;

- Disclose that you are aware of this issue;

- Demonstrate in your sustainability report what your plans and goals are for the future.

According to the study by Madison and Schiehll [4] the impact of the materiality of ESG practices demonstrate a significant change in ESG scores, the result of this study suggests that the company's materiality affects the informative value of ESG scores and ratings, allowing the identification of investment opportunities in companies with high scores on business-critical ESG questions.

According to the stakeholders' perception of the most important ESG topics, it is fundamental for the company to be consistent in prioritizing and directing efforts and resources towards the topics that will generate greater value for the company and its stakeholders.

Environmental, social and governance issues such as climate change, diversity, inclusion, transparency have been knocking on companies' doors and it is perceived that companies have difficulty in dealing with these issues. The materiality matrix is a great tool to prioritize both the interests of stakeholders and the company [5].

From the perspective of [5] the important steps for building the materiality matrix are:

1. Identify themes: via engagement with internal and external stakeholders, a sustainability benchmarking, and a media analysis, it is possible to define all themes that potentially have an impact on the business.

2. Evaluate the impact on the business: identifying how each topic helps to, for example, reduce costs, increase market share or create pricing power, the methodology allows determining the significance of each topic for the company's business.

3. Weighting the stakeholder's point of view: surveys and conversations with external stakeholders make it possible to understand which topics are most significant for essential stakeholders such as customers, or for most stakeholders in general.

4. The weightings that allow the elaboration of an "impact on the business" versus "importance for stakeholders" matrix where themes that have high significance both for external stakeholders and for the company are prioritized [5].

Currently, there are several concepts of materiality according to each reporting framework, all of which are very similar concepts. According to the EFRAG [6] definition, materiality is a criterion for inclusion of information to be disclosed by companies to their stakeholders. That is, it reflects the significance of the information in relation to the theme it intends to explain or portray, as well as the capacity it will have to satisfy the expectations of the organization's stakeholders, and of the organization itself, allowing adequate decision-making and, in a way more generally, the needs for transparency that respond to the public interest. Complementarily, the materiality principle of the AA1000 Principles of Accountability Standard [7], determines that "Decision makers must identify and clarify the sustainability topics that are relevant", and the definition of this concept indicates that a material topic is a topic that will significantly influence and impact the assessments, decisions, actions and performance of an organization and/or its stakeholders in the short, medium and/or long term.

Dual materiality is the union of impact materiality and financial materiality. A material topic fulfills the dual materiality criteria if it is material from an impact perspective, or from a financial perspective, or both. Thus, companies should consider each materiality perspective and should disclose relevant information from both perspectives, as well as relevant information from only one perspective. The assessments of impact materiality and financial materiality are interconnected and the interdependencies between the respective verified themes must be considered in these assessments. In general, the assessment of the materiality of the impact can be assumed as a starting point, since this impact can become financially material, and it is possible that it translates into financial effects [16].

A sustainability topic is material from an impact perspective if the company is the source of significant impacts, actual or potential, on society or the environment, in the short, medium or long term. It includes impacts caused directly, or with the contribution of the company, in its operation, products or services, and impacts that are linked to its value chain (upstream and downstream of the company) and not limited to contractual relationships. The materiality of an actual impact is determined by its severity (scale, scope, or irremediable character), while the significance of a potential negative impact is determined by the severity and likelihood of the impact [8].

The definition of financial materiality for sustainability reporting differs from the definition of the concept of materiality used in the process of determining what information should be included in the financial report. A sustainability topic is material from a financial point of view if it has the potential to trigger significant financial effects on the company, that is, if it can generate risks or opportunities capable of influencing future cash flows and, therefore, the value of the company in the short term, medium or long term, but which are not covered, or not in their entirety, by the financial reports to date. A sustainability topic that is financially material may relate to risks and opportunities that arise from past or future events and can therefore have an effect on cash flow [9].

The company depends on the availability of economic, natural and social resources at appropriate prices and quality, which configure sources of financial risks or opportunities. Stimuli for financial effects can be attributed to two groups [10]:

-Influence the company's ability to continue to obtain the resources it needs for its business activity, as well as the quality and price of these resources;

-Affect the company's ability to rely on the relationships necessary for its business activity on acceptable terms, and vice versa. Financial risks and opportunities, related to sustainability, are measured as a combination of the probability of occurring and the magnitude of the financial effects.

Sometimes, a material issue has the same importance from the point of view of both impact and finance, but a different approach may be required in each area.

Although, informally, many companies already have certain sustainability actions as part of their culture, more and more organizations seek to integrate sustainability aspects into their decision-making processes and strategy. Unavoidably, they came across terms such as “materiality matrix” or “material themes”, initially unknown and difficult to implement, taking into account the various frameworks available. However, as they analyze and select the criteria applicable to their business context, terms such as those mentioned above become increasingly natural and essential to the proper functioning of companies and the transparency of their relationship with their respective stakeholders. If, initially, the materiality matrix used in the GRI reporting approach may seem strange and unnatural, it quickly becomes an essential tool for identifying the company's ESG impact, supporting the development of new goals and action plans [11].

According to the 2020 Edelman Trust Barometer Special Report: Institutional Investors [12], 88% of investors believe that companies that prioritize ESG measures have better long-term return opportunities than those that do not. As an example, reflecting on a concrete material topic such as decarbonization solutions, in the case study How ESG will drive the next wave of transformation14, PwC explains that true decarbonization represents a change in the business model, also referring to that a more holistic approach with regard to reporting involves greater transparency, greater clarity in the definition of sustainable objectives and regular assessments of the status of progress regarding these measures, thus leaving three important aspects – authenticity, quality of consistent data and standards [13].

The identification of material topics allows, above all, a better integration of ESG topics into a company's business strategy. In this context, the determination of materiality can and should contribute to the business strategy, supporting the identification of the respective impacts on the environmental, social, economic and corporate governance footprints of the companies, and of the respective stakeholders involved, assuming the challenge of authenticity and data quality in light of international standards and the specificities of the business. Upstream, this is the importance of the materiality matrix: supporting the current diagnosis and defining the steps to follow. Downstream, this relevance translates into the commitment of the report as a demonstration of this initial analysis and the evidence that supports decisions based on the problems identified. This should allow a framework of the company's impact on the environment and society, as well as the quality of its governance. One of the main contributions of the determination of materiality to the strategy and to the various aspects related to it has to do with challenging the way business is done, the type of products and the way they are produced or marketed, with the identification gaps, as well as the needs that make the company more sustainable and differentiated from competitors.

To this end, the materiality matrix should make it possible to define the weighting of each of these aspects in decision-making, assess risks and opportunities, obtain a comparison and monitor the company's evolution in ESG matters, identify the company's ESG impact, encourage the discussion in the management team and support the establishment of new goals and action plans.

Once the ESG themes have been identified and the company's ESG ambitions questioned, these must, along with the specific themes of each dimension “E”, “S” and “G”, be compared with the expectations of relevant stakeholders in the medium term. and long-term, with the corporate strategy and with the financial model. Consequently, it becomes necessary to integrate ESG initiatives into corporate strategy and operating models and execute change while seeking to minimize the risks of change [14].

Once the materiality has been determined and disclosed, namely through the report, the company makes it visible and commits itself to all interested parties, who may be questioned by them about the progress and fulfillment of potentially assumed goals. As a precondition, it is necessary to know the strategy and, therefore, the top management must be directly involved in the determination of materiality and the most relevant indicators, hence the materiality must be measurable, auditable and manageable and contain a level of adaptability that allows maintain in the long term. In order for the determination of materiality to play a relevant role and adapt to the company's reality, in addition to the commitment of top management, it is recommended that it be carried out by a multidisciplinary group involving the various functional, business and business support areas. This involvement will allow the degree of acceptance to be generalized and will be an accelerator in the implementation of the materiality matrix. Particularly relevant can be the contribution, for example, of the Quality Management Systems team, which has knowledge and skills in the preparation of this type of documents, in alignment with the financial areas in the definition and measurement of impacts and dissemination of goals and results achieved in the annual reports. Although the materiality matrix may not be elaborated, in an initial phase, with real and in-depth knowledge of the subject and of the company on sustainability issues, it makes it possible to identify these gaps and point out needs. In addition, it requires an in-depth knowledge of the company, not only in terms of sustainability, but also in relation to all cross-cutting issues that are interconnected with sustainability, allowing one to understand that material issues are present in its activities. Therefore, the materiality matrix makes it possible to better understand the value chain of an organization and its impact on the United Nations Sustainable Development Goals for 2030 to be achieved.

A study prepared by BCSD Portugal [11] on the main difficulties experienced in the materiality assessment process and in collaboration with the member companies of the task force (TF), took place in two phases:

1. Brainstorming workshop with TF members, which allowed identifying the main challenges;

2. Questionnaire applied to members of GT Sustainable Finance, which allowed the quantification of the main difficulties experienced by companies.

In terms of results, most respondents indicated greater difficulty with the valuation of externalities and intangibles (23%), the analysis of scenarios (short, medium and long term) (17%), the different expectations/needs of the parties interested parties (14%) and in determining the topics to be consulted (11%). With regard to companies that have not yet carried out a materiality assessment process, which were also surveyed, the valuation of externalities and intangibles was also identified as the main difficulty (28%), however, unlike companies that have already carried out a process of materiality assessment, the absence of clear guidelines based on scientific criteria for the identification/quantification of impacts (18%) and knowledge of the subject, from a technical-theoretical perspective (18%), were identified as the main challenges to carry out the process. These results highlight the need to consider materiality holistically for the business, from a strategic perspective, which will allow the company to have a comprehensive enough view to identify and prioritize its material issues and their respective influence on the organization itself and parts stakeholders in the short, medium and long term.

III. METHODOLOGY

To achieve the proposed objectives, descriptive research with a qualitative methodology was adopted, using standards analysis and literature review.

IV. ANALYSIS OF THE MATERIALITY MATRIX OF SANTANDER BANK 2021

According to the 2021 Responsible Banking Report [15], the materiality assessment methodology reflects good practices in terms of stakeholder involvement, including direct contributions from different categories of stakeholders. It also complies with the requirements of various sustainability standards and frameworks, and the recommendation of the proposal for the new European Directive on Corporate Sustainability Information (CSRD) regarding the application of the principle of dual materiality.

In this context, the materiality matrix reflects: financial materiality (impact of ESG issues on Santander's financial performance) and environmental and social materiality (how Santander's ESG initiatives may impact society and the environment). In preparing the matrix, the following analysis phases were considered:

Phase 1 - Document analysis, which focused on the international context, key trends, regulatory framework and business model. Impact mapping, and subsequent identification of fifteen material themes.

Phase 2 - Involvement of external and internal stakeholders through focus groups, interviews and surveys, with the aim of prioritizing impacts and evaluating the identification of new material topics. Engagement was carried out with customers, employees, the Bank's senior management, and with a number of organizations, representing investors and civil society.

Phase 3 - Consolidation of the analysis results and consultation to stakeholders, with attribution of weights to the different inputs (document analysis, surveys, interviews and focus group).

Compared to the material themes of 2021, the following conclusions were obtained:

-Customer satisfaction continues to be one of the most relevant topics, maintaining a position similar to that of the previous materiality exercise. The theme “financial inclusion and training” gains importance and repositions itself as a crucial topic.

-Reflecting the new regulatory framework and European environmental goals, the themes “green finance” and “alignment of the portfolio to net zero by 2050” gain great relevance, when compared with the more moderate importance that the homologous themes assumed in the previous materiality exercise.

- “Privacy, data protection and cybersecurity” is the theme with the higher quotation, reflecting the current national context. A “corporate governance” and the topic “culture, conduct and ethical behavior” are repositioned with increased importance compared to the previous year.

V. DISCUSSION

The materiality analysis allowed identifying and prioritizing ESG topics in terms of crucial topics, important topics and topics of moderate importance.

Crucial topics: customer experience, satisfaction and financial well-being, privacy data protection and cybersecurity, financial inclusion and empowerment, culture conduct and ethical behavior Green Finance and alignment of the portfolio to net zero by 2050.

Important topics: integration of ESG criteria into risk management equality, equality, diversity, inclusion and well-being, talent management and development, Operational and business resilience and corporate governance.

Topics of moderate importance: education and other support to Communities, biodiversity, responsible procurement and environmental footprint.

The 2021 materiality review led to an ambitious action plan for 2022-2025, focusing on key topics and meeting public commitments and regulatory requirements.

E - Achieve the ambition of being net zero by 2050, setting decarbonization targets, supporting the transition of customers and maintaining carbon neutral banking operations.

S -Support inclusive growth through financial empowerment; supporting education, entrepreneurship and employment, and building a diverse and talented team.

G - Incorporate behaviors, processes, policies and governance to ensure responsible action, listening to stakeholders and treating them in a simple, close and fair manner based on solid governance and prudent risk management.

VI. CONCLUSION

Organizations are increasingly aware of the importance of developing a sustainability strategy to maximize long-term value creation and mitigate the increase in risks related to socio-environmental impacts.

To satisfy investors, promote transparency and build business resilience, companies must establish a robust sustainability strategy and integrate it into their business operations. The materiality diagnosis makes it possible to identify the main ESG factors that impact companies with a view to adopting a resource-efficient sustainability strategy.

This study achieved the proposed objective, on the one hand the application of the materiality matrix at Santander Bank made it possible to identify and prioritize ESG issues for the different groups of stakeholders and that have a great impact on the entity's value creation, on the other hand, it is a contribution to the development of future studies in order to analyze how material issues can influence the optimization of strategic orientation in companies.

These results highlight the need to consider materiality holistically for the business, from a strategic perspective, which will allow companies to have a comprehensive vision to identify and prioritize their material issues and their influence on the organization itself and on stakeholders in the short term, medium and long term.

As future studies, it is suggested to continue investigating the main difficulties with companies that have not yet carried out the materiality assessment in the preparation of materiality matrices in order to strengthen the sustainability and ESG plans framed in the UN SDGs.

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