EDGE International

2019 Integrated Report Survey—Materiality

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Edge International, Inc.

The Edge Research Institute has announced the results of the 2019 Integrated Report Survey—Materiality. At the Company's Corporate Value Reporting Lab, we have surveyed companies that produce an integrated report. From among those companies, we target those listed on Japanese stock exchanges, then examine and analyze what the current status of their materiality disclosure is. The 2019 survey marks its third iteration. We believe that this survey will be a tool for more effective dialogue among companies and long-term investors. Furthermore, we will provide the results of the survey at the request of institutional investors.

■ Survey Objectives

To ascertain the current situation of how companies that produce integrated reports disclose information about materiality

■ Survey Summary and Results

Targeting Japanese companies that are listed on stock exchanges and produce their own integrated reports,[1] we examined whether the following materiality-related factors were disclosed in said reports.

① Disclosure of materiality: 68.8% (335 companies)
② Disclosure of materiality from an investor's perspective: 25.3% (123 companies)
③ Disclosure of ② is divided into opportunities and risks: 16.4% (80 companies)
④ Disclosure of materiality from a multi-stakeholder perspective: 55.0% (268 companies)
⑤ Disclosure of both ② and ④: 11.5% (56 companies)
⑥ Disclosure of the materiality assessment process: 33.7% (164 companies)
⑦ Possession of a reference indicator for the assessment process

SDGs: 21.6% (105 companies), GRI: 15.2% (74 companies), ISO 26000: 14.8% (72 companies), ESG Rating Agency Criteria: 9.0% (44 companies), SASB: 4.1% (20 companies), the U.N. Global Compact: 3.5%

(17 companies), and the OECD Guidelines for Multinational Enterprises: 1.6% (8 companies)

⑧ Review of materiality from the previous year: 12.7% (62 companies)

⑨ Establishment of key performance indicators (KPIs) for materiality: 22.2% (108 companies)

⑩ Definition of the relationship of relevant materiality with the SDGs: 44.8% (218 companies)

⑪ Disclosure of opportunities and risks for each business segment: 20.9% (102 companies)

⑫ Provision of examples of disclosure that aligned with TCFD recommendations: 12.1% (59 companies)

⑬ Guidelines referenced in the formulation of editorial policy

IIRC: 46.2% (225 companies), The Ministry of Economy, Trade and Industry, Guidance for Collaborative Value Creation: 33.1% (161 companies), GRI: 25.6% (125 companies), The Ministry of Environment, Environmental Reporting Guidelines: 17.7% (86 companies), ISO 26000: 14.0% (68 companies), and the U.N. Global Compact: 1.0% (5 companies)

1 Survey carried out by the Company's Corporate Value Reporting Lab (Management: Edge International, Inc.) of the List of Organizations in Japan Engaged in the Publication of Self-Declared Integrated Reports (2019), applicable to 487 companies listed on Japanese stock exchanges out of a total 513 companies.
https://www.edge-intl.co.jp/wp-content/themes/edge-intl/assets/pdf/01_reserch/02/list2019_E.pdf

Notes:

1. Applicable to reports that did not include the word "materiality" but whose content contained similar words
2. Validity does not matter regarding identified materiality

■ Inquiry

Materiality, as the basic concept of every corporate report, indicates information that aids readers in evaluating and analyzing results, as well as in ascertaining the evaluation criteria of such information. However, the main users of this information are divided into two groups: investors and multi-stakeholders (including investors).

Continuing on from last year, in this year's survey, materiality from the perspective of multi-stakeholders, the latter of the two groups, appeared in the reports of more than half of the applicable companies—268 (55.0%). This materiality is based on the material items required by the GRI, a CSR report disclosure guideline, and represent the "prioritization of social issues that corporations can help resolve through their businesses."

Meanwhile, materiality from an investor's perspective, represented by SASB definitions, is a phenomenon that is estimated to impact on the creation of corporate value over the medium to long term. As such, there has been interest in ensuring the sustainability of business models and in the impact on financial performance. However, while there was a year-on-year increase in companies whose reports contained materiality from the investor's standpoint, to 123 (25.3%), they are still a minority. From these, 80 companies (16.4%) disclosed opportunities and risks.

While the main readers of integrated reports, as defined by the IIRC, are investors, many of the reports currently being released in Japan are based on CSR reports. Against this backdrop, it currently appears as though the multi-stakeholder perspective has become more conventional as an explanation of materiality.

Last summer, Business Roundtable, an association of chief executive officers from some of America's leading companies, prepared a statement that said they were reconsidering the idea of shareholder primacy, while at the AGM of the World Economic Forum earlier this year, there were calls for a shift to stakeholder capitalism. This trend is strengthening due to the COVID-19 pandemic. Moreover, there is a tendency among certain investors, who better understand their investees' responsiveness to and impact on social issues, including achieving the SDGs, to pursue a social impact as well as financial returns when measuring the returns on investment of an investment portfolio. This trend seems to align with the growing number of customers that are disclosing materiality from a multi-stakeholder perspective.

However, while solving social issues and contributing to the SDGs can represent growth opportunities for companies, doing so does not guarantee sustainable corporate value creation. In the case of Japanese companies, the history of corporate management is different from that of the West. Japanese companies are on a path to improving their capital efficiency and reforming their governance. Accordingly, investors do not wish to see Japanese companies regress to the past when consideration of multi-stakeholders was used as an excuse to overly neglect stakeholders. Due to the COVID-19 pandemic, companies themselves are showing more interest than ever in terms of being adaptable and resilient to sudden and uncertain environmental changes and social issues. For Japanese companies, there is a need to show the relationship between a company's initiatives aimed at considering multiple stakeholders and contributing to a sustainable society, which have been deeply ingrained by Japanese companies up to now, and that company's structural competitive advantage and revenue growth, and reflect that relationship in their management strategies and resource allocation. Also, there is a need for companies in Japan to enhance the validity of their medium- to long-term corporate value creation stories and maintain confidence in their feasibility.

It is also worth noting that the climate change-related information contained in the European Commission's June 2019 Non-Financial Reporting Directive (NFRD) advocated the concept of double materiality. The NFRD calls for a twofold -method of judging the importance of disclosing non-financial information. One is financial materiality, the influence of sustainability on areas such as corporate performance, and the other is environmental and social materiality, a company's impact on the environment and society. This classification is roughly equivalent to "materiality from an investor perspective" and "materiality from a multi-stakeholder perspective" in this survey. Furthermore, as in the case of climate change, double materiality links a company's contribution to responding to and solving social issues to its acquiring business opportunities and minimizing business risks. As these two perspectives already partially overlap, this overlap of double materiality is likely to increase in the future. In light of this, it has become necessary for companies to reaffirm the purposes and targets of their information disclosure and review their definitions of materiality.

Materiality originally differed depending on the company or type of industry and changed with trends in the external environment. This year, the number of companies that reassessed their materiality from the previous year was small—62 (12.7%). However, in the face of substantial changes to the external environment, such as the COVID-19 pandemic, it should be expected that the number of companies reexamining their materiality will increase next year. In January 2020, the U.S.-based ESG data provider, Truvalue Labs, announced the concept of "dynamic materiality." In a fast-moving and highly uncertain world, this concept shows that identifying the ESG issues important to companies is more fluid than ever. The same phrase, "dynamic materiality", was used at the World Economic Forum in March, which indicates that it has become an essential skill for companies and investors to predict issues that are not important now but may become important in the future. It is vital for companies to monitor social trends and constantly review the validity of identified materiality through frequent dialogue with investors and other stakeholders. When a company identifies materiality, the disclosure of its assessment process is expected to be transparent and involve the participation of its board of directors.

After the assessment process is complete, setting appropriate KPIs and implementing a PDCA cycle helps formulate effective initiatives. This year, the number of companies who set KPIs was limited to 108 companies (22.2%) which was only roughly 30% of companies that disclose materiality. However, since many reports stated that KPIs were being formulated, reports on the specific progress of initiatives related to materiality will likely increase from next year.

There were 102 companies (20.9%) who disclosed materiality from an investor's perspective in their surveys, especially related to opportunities and risks, such as SWOT analyses in each business segment. As for holdings companies and conglomerates that own companies in different industries, in addition to identifying comprehensive materiality, examining materiality by business segment is an effective approach for such companies.

The disclosures of 59 companies (12.1%) followed the TCFD's recommendations. However, as of the end of May, 271 companies and institutions in Japan have expressed their support, so it is expected that more reports will implement relevant disclosure practices from next year. Among a wide range of ESG issues, the TCFD specializes in climate change, which can have a huge impact on the finances of many companies. The TCFD recommends the disclosure of information concerning four items: governance, strategy, risk management, and metrics and targets, while the framework for assessing and disclosing countermeasures based on the two viewpoints of risks and opportunities, as well as the impact on the sustainability of a company under various scenarios, is itself materiality from an investor's perspective. When not only climate change but also other ESG issues have a significant impact on the sustainability of a company's business model and its ability to create corporate value, utilizing the TCFD framework for analysis and disclosure will be useful for showing the resilience of a company.

■ References

The 2018 survey summary and results are as below. Applicable to 398 companies

① Materiality from an investor’s perspective: 17.8% (71 companies)

② Disclosure of ① is divided into opportunities and risks: 9.0% (36 companies)

③ Disclosure of risks and countermeasures as well as of opportunities and risks of climate-change: 20.4% (81 companies)

④ Disclosure of opportunities and risks in each business segment: 17.1% (68 companies)

⑤ Materiality from a multi-stakeholder perspective: 47.5% (189 companies)

⑥ Materiality assessment process: 24.6% (98 companies)

⑦ Taking of the SDGs into account in ⑥: 23.1% (92 companies)

⑧ Reference to the SDGs: 76.1% (303 companies)

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