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Harmonising financial and impact materiality for corporate excellence

They must go hand in hand to achieve true and balanced excellence.

BY LAWRENCE LOH AND HUANG MINJUN

CORPORATE excellence is typically measured by evaluating the capability and the resilience of a business itself. This is addressed by criteria such as financial performance, valuation, market leadership or risk profile.

In essence, financial considerations in themselves define corporate excellence.

This is the traditional "outside in" notion of financial materiality, which is determined by external forces such as industry and competition or even sustainability and governance concerns. However, amid the evolving landscape, businesses are expected to create impact on the outside world. For example, businesses might be expected to utilise their resources to address climate change, nature and biodiversity as well as social and community issues.

This "inside out" notion of impact is gaining increasing traction particularly among the multitude of stakeholders beyond the shareholder. This so-called impact materiality cannot be neglected by businesses in the quest for corporate excellence.

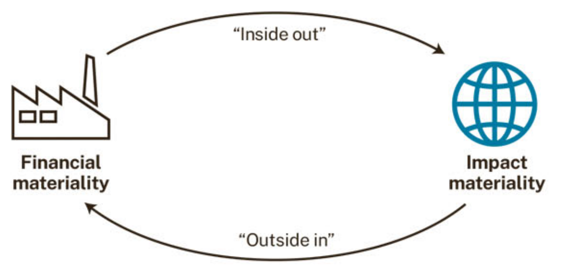
Indeed, the double conceptualisation of financial materiality and impact materiality will be the new basis for corporate excellence. This is a duality that has to be harmonised in the inevitable era of sustainability that will confound businesses into the future.

When the word "materiality" was first articulated, it had a singular, clear focus – to address the needs and interests of investors.

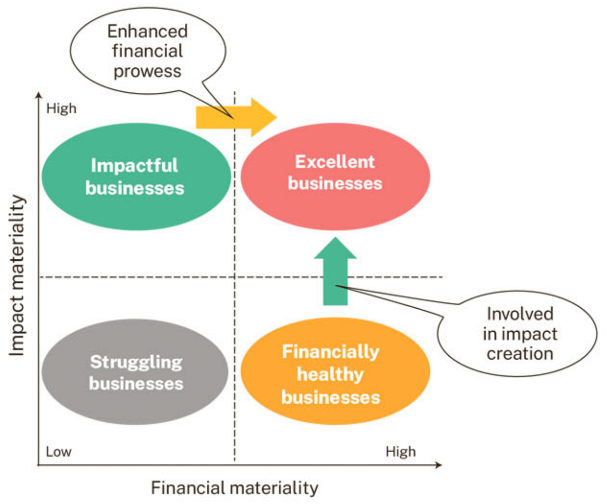
As the world grapples with challenges such as climate variation, social inequality, and ethical governance, the meaning of materiality is expanded. It now caters to a wider group of interested parties.

Corporate excellence is driven by the interconnectedness and balance of financial materiality and impact materiality. PHOTO: PIXABAY

Duality in corporate excellence



SOURCE: CENTRE FOR GOVERNANCE AND SUSTAINABILITY (CGS)



SOURCE: CENTRE FOR GOVERNANCE AND SUSTAINABILITY (CGS)

Financial materiality: safeguarding the bottom line

Businesses start with a simple goal – to become financially sustainable and achieve stable profits.

The pursuit of innovation fuels the competitive edge of businesses, enabling them to pioneer new markets and redefine industries.

Amid competition and economic fluctuations, businesses are dedicated to creating innovative products and services and translating these into viable revenue streams to ensure their prosperity.

Financial prowess determines business capabilities for survival.

Another layer of financial materiality lies in business resilience in dealing with risks and opportunities outside the company, in particular, those relating to sustainability. More and more organisations acknowledge that the environmental, social and governance (ESG) implications of business operations can be materialised into financial risks and opportunities.

To illustrate, a coastal commercial property might face risks from rising sea levels as a result of climate change. This, in the end, might negatively affect its financial performance.

In another vein, the widening digital divide might increase the difficulties for businesses to attract new customers, resulting in stagnant growth.

Business resilience, to address sustainability risks and opportunities, is vital to keep the company alive.

In short, financial materiality views issues from the "outside in" perspective. It includes capabilities for competition and resilience to address risks and opportunities, which forms the bottom line of every business.

Impact materiality: navigating into the future

While the financial materiality determines a business' ability to survive, impact materiality determines the length and the depth of the life of the business.

Impact materiality sees issues from the "inside out" perspective – that is, business activities that will impact society and the planet should be considered material.

Impact materiality signifies a recognition that the choices made within the business' walls possess the potential to ripple outward, affecting the society, the planet, and ultimately, the economies in which the companies operate.

In considering sustainability issues, businesses should be aiming to create actual changes to the world, rather than just show a philanthropic gesture. These actual changes, or impacts, might in return enhance their financial viability.

Following from the earlier illustration, the coastal commercial property may lower carbon emissions by installing environmentally friendly cooling systems. This in its own way contributes to slowing the progress of climate change, thus reducing the threat of rising sea levels. Also, for companies embarking on their digitalisation journey, helping to narrow the digital divide might eventually enlarge the customer bases, boosting financial growth.

As the world faces even more environmental and social challenges, the emphasis on creating impact on the outside world provides a basis for businesses to stop and think where they are and where they should be navigating.

It also offers the prospects for businesses to reconsider their business models, their means to growth and their purpose.

Harmonising

Financial materiality and impact materiality have to be effectively harmonised to attain corporate excellence. Neither can stand alone, and both act in unison and reinforce each other in the duality.

The concept of duality draws from established tenets of Eastern philosophy. Dualism encapsulates the coexistence of two opposing and complementary forces or aspects within a single framework.

Further, complementary dualism believes that contrasting elements, such as dark and light, inner and outer, coexist and contribute to a greater whole.

The most widely known representation of dualism is the yin-yang concept. This originated in ancient Chinese philosophy and illustrates how opposite forces may be interdependent and interconnected and how these forces may give rise to each other as they interrelate to one another.

The Indian concept of polarities – yoni and linga – are also analogous to the yin and yang for duality. These, too, represent the fundamental importance of the union of opposites.

Indeed, duality shapes much social and cultural thinking, as well as discourses; it has the potential to inform businesses too.

Besides emphasising the coexistence of two forces, striking a dynamic balance sits at the core of dualism. The resultant harmony forms the basis for double materiality.

Corporate excellence is driven by the interconnectedness and balance of financial materiality and impact materiality.

Practising duality

Sustainable businesses value both financial and impact materiality. The route to double materiality must come from both the financial prowess and the impact creation routes. There are many examples of double materiality for corporate excellence in leading global businesses.

Patagonia, the eco-conscious outdoor apparel retailer, demonstrates how companies can be responsible for the planet and its people while increasing growth and value. Since its founding in 1973, Patagonia has prioritised people and the planet. After achieving US$10 million in sales during its 2021 Black Friday event, it decided to donate every penny to environmental organisations.

Nvidia Corporation, the US gaming and computer graphics giant, has done more than meeting its ESG goals. It also helped to fight climate change through artificial intelligence technology, which attracts ESG investors.

Tesla's relentless pursuit of sustainable electric transportation indicates that corporations can excel in financial terms as well as drive societal progress.

Steering the journey to corporate excellence

The duality of corporate excellence, when framed within the concept of double materiality, offers a comprehensive perspective on the intricate interplay between financial viability and impact on society and planet. It underscores that true corporate excellence lies not merely in financial triumphs, but in an organisation's ability to recognise and address the interconnectedness between its actions and the outside world.

The dual compass guides the journey for businesses, large and small, to achieve corporate excellence. Financial materiality and impact materiality must go hand in hand to achieve true and balanced excellence.

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