ESG Research

ESG Materiality Map

Retailing (Food)

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Customer health and safety is the most material factor for the industry. Social factors are generally more material than environmental factors. Examples of material environmental factors are climate transition risk and waste and recycling.

This report does not constitute a rating action

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ESG Materiality Map Retailing (Food)

In line with the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, S&P Global Ratings is publishing research on the ESG materiality map for the retailing (food) sector. We provide an illustration of our current view of the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. The materiality map does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis.

Retailing (Food) Sector

The sector includes entities that derive a majority of their revenue from selling food or food services directly to individual consumers through stores, restaurants, or online--or a combination of these channels. We include restaurants, grocers, and food distributors in this sector.

Key Takeaways

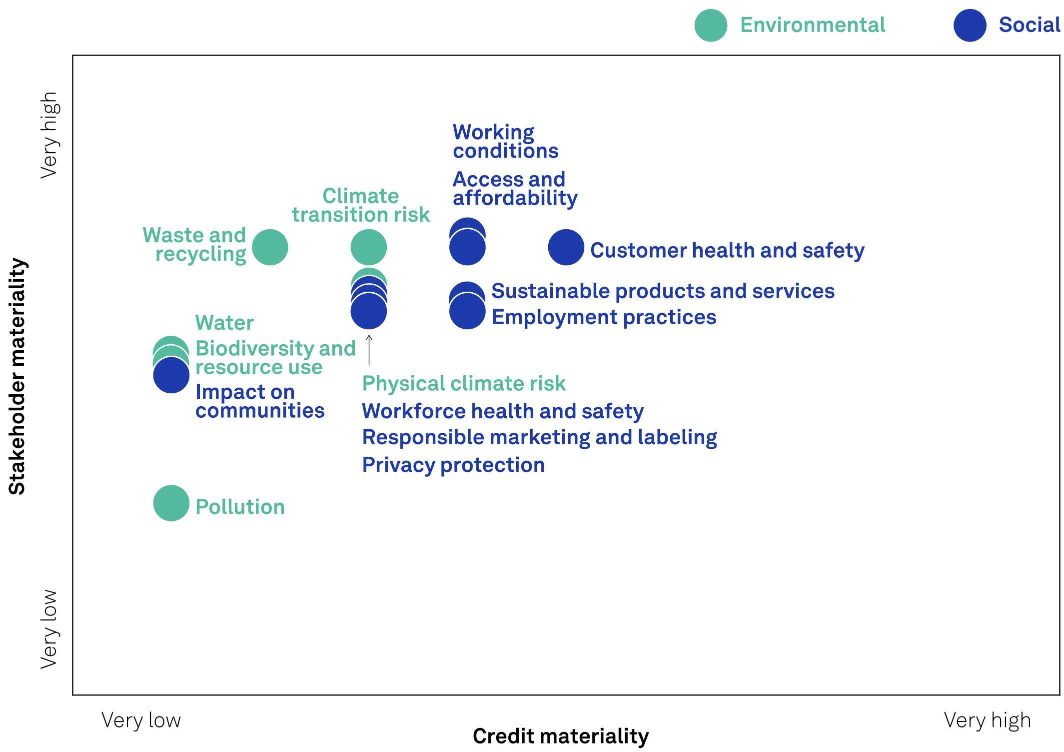
– We believe materiality for stakeholders is greater than credit. For credit, the level of costs food retailers can pass to customers mitigates those associated with environmental and social factors. However, the ability and magnitude of cost pass-through vary depending on the market segment and competitive environment.

– Customer health and safety, employment practices, and sustainable products and services are the most material social factors for both stakeholders and credit. Driving this is the large workforce, potential impacts of food safety and nutrition on customer health, and consumers' evolving preferences for sustainable products and services.

– Other environmental and social factors are moderately material for stakeholders but have low materiality for credit. Environmental factors stem from climate impacts on agricultural supply chains and energy use in refrigeration and transportation. Potential data privacy breaches and access to affordable food are important social considerations for customers.

See materiality map on the following page.

ESG Materiality Map For The Retailing (Food) Sector



The materiality map provides an illustration at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. It does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG Criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis. Source: S&P Global Ratings.

How To Read The ESG Materiality Map

The stakeholder materiality (Y axis) reflects our assessment of the relative level of impacts and dependencies of the sector on the environment, society, and economy.

The credit materiality (X axis) reflects our assessment of the relative level of potential and actual credit impact for the sector. The credit implications for the factors positioned on the left side to the middle of the X-axis would be more limited and absorbable. On the right side, there is higher potential for these implications to be more disruptive. We assess credit implications for an entity based on its individual characteristics.

Assessing E&S factors' materiality: We consider both the likelihood of the impact from a given factor, as well as the magnitude of the impact. The materiality of the factors varies depending on the perspective (stakeholder or credit) as well as the evolving and dynamic interactions between these two dimensions.

The main areas of the map:

- The upper-right quadrant displays the most material, on a relative basis, E&S factors identified for the sector from both a stakeholder and credit perspective.
- The upper-left quadrant presents factors that are more material from a stakeholder than credit perspective. These factors have the potential to become more material from a credit perspective.
- The bottom-left quadrant shows factors that are less material for both stakeholders and credit. Their materiality may evolve over time and this dynamic may not be linear.

Examples Of Material Factors

Below we provide the rationale of some of the material factors to illustrate the above findings.

Customer health and safety

Customer health and safety is a highly material factor for both stakeholders and credit. Much of the food retail sector offers highly processed foods, which can be perceived to have negative health impacts on customers. As a result of rising regulatory actions and public attention to wellness, many retailers and restaurants, particularly in developed markets, are adapting their food offerings to include healthier foods and ingredients. Additionally, food safety incidents (related to foods prepared at retail store kitchens or from packaging facilities) can cause acute illness and on rare occasions fatalities. From a credit perspective, incurred costs of food safety incidents can arise from damaged brand reputation, notifying consumers, potentially lower demand, removing food from shelves, and paying damages as a result of lawsuits. There are also costs associated with investing in the food safety tracking and traceability systems (including new technologies) to effectively prevent and manage these risks. However, retailers are generally less exposed to food safety issues as the responsibility of distributing damaged products is generally shared across the value chain and the ultimate responsibility often lies with the food manufacturers.

Sustainable products and services

Rising demand for sustainable food products across the industry makes this factor material for both stakeholders and credit. We think consumer demand will continue growing for healthy, sustainable, quality products with lower environment impacts. Many retailers are stocking more locally sourced products and healthier foods, with less chemical, carbon, and water-intensive production methods. Shifting consumer preferences are driving this evolution and may require major changes in the retailers' supply chains to adapt. From the stakeholder view, more sustainably produced foods can potentially reduce the environmental and social externalities of agriculture and manufacturing, while healthier, more nutritious foods are beneficial for consumer health. From the credit lens, whilst price positioning remains the primary driver of competition within the industry, having a sustainable product offering is increasingly seen as a differentiating factor among retailers, and therefore a potential growth and profitability lever for the industry.

Employment practices

We see employment practices as highly material to stakeholders and one of the more material social factors for credit. Work in this sector is often low wage and, particularly for restaurants, can involve long hours and high-pressure work environments. Additionally, the effects of the COVID-19 pandemic brought to fore the essential nature of many food sector jobs, underscoring the importance of employment practices that support retention, including competitive wages and benefits, work-life balance, and safety. The growing pressure from regulations, unions, and employees to address competitive wages and worker wellbeing is of key concern for both stakeholders and credit. Measures to address this may include raising wages and benefits to continue attracting and retaining a productive and stable workforce. This may impact the margins of both smaller and larger operators who may not be able to fully pass on higher labor costs to consumers this will affect. However, food retailers and restaurants may partly mitigate these impacts through increasing the use of technology and digital automation of processes.

Climate transition risk

Climate transition risks are material for stakeholders particularly for consumers and suppliers such as logistics, but less material for credit. The food retail sector's direct greenhouse gas emissions come from distribution transport, refrigerants, food production, waste, and energy use to power retail facilities. The increase in e-commerce also has significant implications on food distribution and logistics. Therefore, climate transition risk could become more material from a credit perspective as consumers demand more delivery services from retailers. It is still uncertain how significantly environmental regulations in retailers' supply chains could affect credit materiality. Based on the current regulatory trajectory where retailers and suppliers gradually decarbonize to address the stakeholder concerns, we believe the financial materiality will be incremental and manageable.

Access and affordability

Materiality of this factor is higher for stakeholders than for credit. Spikes in food prices, such as those related to supply constraints for basic food inputs like grains, tend to be passed onto consumers, hence reducing access and affordability to part of the population materiality. In addition, sustainable products and services, including healthier food options, tend to carry higher prices, with negative implications on access for lower-income consumers. Similarly, if macroeconomic and geopolitical factors raise food prices, then these too could be passed onto consumers, putting a strain on affordability, possibly leading to customer or regulatory backlash. If, on the other hand, the sector is unable or unwilling to pass on cost increases (for example, entities that operate in the discount segment and thus lose competitiveness if they raise prices), they could face margin pressures and resultant credit impacts. At the same time, facilitating access and affordability of products and services in the food retail sector is a positive growth story for credit.

Waste and recycling

Waste and recycling is material for stakeholders, stemming mainly from single-use plastics and high food waste across the sector's value chain. According to the UNEP Food Waste Index report of 2021, 17% of total global food production was wasted in 2019. Although we can attribute a relatively minor share of this to retailers and food service providers, the absolute amount of total food waste (931 million tons) is large enough for this sector to still have a high impact on stakeholders. We believe this factor is, however, less material for credit. We expect waste-related regulations will become increasingly prescriptive and material for the sector through regulation to address both waste streams. Consumer awareness of negative environmental consequences of plastic and food waste could gradually shift demand for more sustainable food packaging and delivery methods. Already companies began implementing strategies to reduce waste including better management of perishable foods. In some instances, we believe innovation in packaging and utensils present new business opportunities and revenue channels that could yield a positive financial impact to some more advanced or innovative retail players.

What is our approach to research on the ESG materiality map?

Referring to the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, this research is built on the ESG materiality concept that considers ESG issues as material when they could affect stakeholders, potentially leading to material direct or indirect credit impact on entities. It considers that all businesses, through their activities and interactions, impact and depend, directly or indirectly, on stakeholders such as the environment (natural capital), society (human and social capital), and economy (financial capital). Using this ESG materiality concept, S&P Global Ratings has worked toward identifying a common, global, cross-sector set of E&S factors that we believe are material to stakeholders, and either are already, or have the potential to become, credit material for entities. The materiality map we propose provides an illustration at a point in time, of our findings on the relative materiality of those factors, from both the stakeholder and credit perspectives.

How does the sector ESG materiality map relate to credit ratings or ESG evaluations?

The sector materiality map is a visual representation of the factors that we consider impactful to the sector from a stakeholder and credit perspective for the purposes of this research. It does not represent any new analytical approach to the E&S factors in our credit ratings.

The relative materiality of the factors indicated on the materiality maps may inform the E&S Risk Atlas scores and the weights of the E&S factors used in ESG evaluations.

They may also inform our discussions with issuers on those factors' existing or potential credit materiality.

Related Research

- Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors, May 18, 2022
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- ESG Evaluation Analytical Approach, Sept. 20, 2022