Corporate Negative Externalities on Society: How TISFD Makes the Invisible Visible

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Over the past twenty years, the integration of ESG (environmental, social and governance) factors into investment decisions has spread widely across global capital markets. Governance reforms and the development of stewardship codes in many jurisdictions have stimulated dialogue between companies and investors, helping to enhance market transparency and efficiency. In addition, the emergence of international disclosure standards such as the Task Force on Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB) has strengthened the information infrastructure that underpins ESG, creating an environment in which investors can more appropriately assess companies' medium- to long-term profitability and risks.

The Structural Limits of Entity-Level ESG

Yet despite companies' and investors' increasingly active ESG efforts, the deterioration of environmental and social systems has not stopped. Climate change is intensifying, ecosystems are being degraded, and inequality is widening across the world. In other words, we are seeing a "dual structure" in which improvements at the level of individual companies coexist with growing fragility at the system level.

This is where the structural limits of entity-level ESG become apparent. Companies can reduce their own greenhouse-gas emissions, but decarbonization will not progress if national transition policies stall in the face of social backlash. Companies can strengthen supply-chain management, but if distortions in wage structures across an industry or entrenched procurement practices remain unchanged, distributional imbalances will persist.

How, then, can we overcome this problem where "corporate efforts advance, but the system continues to deteriorate"? This is the core question now confronting companies and investors. System-level risks such as climate change, destruction of nature and social vulnerability are interconnected and mutually reinforcing; dealing with them is anything but straightforward.

Climate change and the degradation of natural capital interact to weaken Planet's environmental foundations, and their effects then bounce back onto society (People) in the form of a "negative spiral." Climate change undermines the resilience of ecosystems, while ecosystem damage and deforestation reduce carbon absorption and increase the risk of natural disasters. These developments place direct pressure on the foundations that underpin our societies and economies—food production, water resources, infrastructure and more. Their impact falls first and most heavily on low-income groups and vulnerable regions, destabilizing livelihoods, widening inequality and deepening social vulnerability.

As social vulnerability increases, the political feasibility of climate policies declines. When inequality grows, resistance to measures such as carbon taxes intensifies, and the ability to implement necessary climate policies is shaken. As the Yellow Vest movement in France showed, in a context of fragile social foundations, even scientifically well-justified policies struggle to secure political support.

Countries with higher income inequality tend to experience more severe health, social and environmental problems.

Source: Wilkinson, R. G., & Pickett, K. E. (2024). 'Why the world cannot afford the rich'. Nature 627: 268–70.
https://www.nature.com/articles/d41586-024-00723-3

The interaction between Planet and People is complex, and contemporary risks tend not to manifest in isolation but as cascading crises. It is no longer sufficient to address either People or Planet in isolation. What is required is an approach that refuses to separate the two, and instead focuses explicitly on their interaction—a shift from additive thinking, “2P (People + Planet),” to multiplicative thinking, “P^2 (People × Planet).”

People as the Third Pillar

In the world of disclosure, international standards are gradually being put in place on the Planet side: TCFD for climate, and the Taskforce on Nature-related Financial Disclosures (TNFD) for nature. By contrast, there has been no comprehensive framework for treating People in a systematic way. Filling this gap, the Taskforce on Inequality and Social-related Financial Disclosures (TISFD) was launched in autumn 2024, and work has begun to design an international sustainability standard focused on People. In October 2025, a discussion paper setting out the underlying concepts and conceptual framework for standard-shaping was published, and work is now underway toward final recommendations scheduled for 2027.

TISFD aims to establish the first international standard that places Planet and People as equal pillars and treats their interlinkages as a matter of institutional design. This symmetry is a crucial perspective in an era of polycrisis, in which multiple crises unfold simultaneously. Only when the three domains of climate, nature and society are all in view can we grasp the full picture of system-level sustainability and build a foundation for dealing with intertwined crises.

Like TCFD and TNFD, TISFD will follow a four-pillar framework of governance, strategy, risk management, and metrics and targets, but it extends the focus into the social domain. This makes it possible to conduct an integrated assessment that cuts across climate, nature and society.

TISFD provides a framework that systematically visualizes how a company’s business model affects People and how it depends on People. Its defining feature is that it focuses on the “inequality-generating mechanisms” embedded in the business model itself.

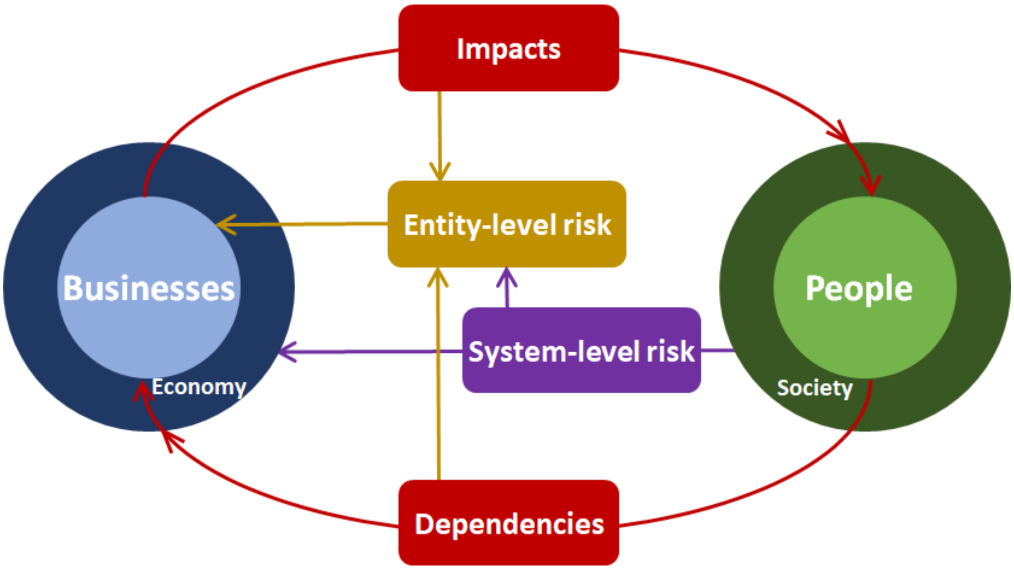
To date, most labor and human-rights related disclosures have been limited to entity-level management indicators. They have lacked a perspective on how structural factors—such as failure to achieve living wages, skewed value distribution along supply chains, or the vulnerability of local communities—have been created within companies' business models.

TISFD seeks to evaluate these factors using an international common yardstick. In this sense, it is innovative in shifting the focus from "ex post redistribution" through fiscal policy and similar tools, to the "ex ante distributional structure (predistribution)" generated by corporate business models.

When risks stemming from inequality and social issues embedded in corporate business models accumulate across the economy and begin to cascade from one company to another, they transform into system-level risks that threaten the stability of the socio-economic system as a whole. Concretely, the spread of low wages and precarious employment undermines human capital and social capital, pushing down productivity and growth at the macro level.

Concentrations of wealth create a structure in which low-income groups rely increasingly on debt while the wealthy channel excess funds into financial assets, amplifying vulnerabilities in the financial system through imbalances in credit markets. Ultimately, such system-level risks erode the profitability of many companies and depress market-wide returns. In this sense, inequality, like climate change and ecosystem degradation, is a major risk that affects investors' portfolios as a whole.

Relationship between Businesses and People



TISFD's Institutional Role: Making Externalities Visible

The significance of TISFD lies in the fact that it brings into the disclosure regime domains that companies have long chosen "not to see." Precisely because this information has been missing, stakeholder capitalism—despite being repeatedly championed—has not led to meaningful changes in corporate behavior.

In 2019, for example, the U.S. Business Roundtable declared a shift away from shareholder primacy, stating that companies should be accountable to a broad range of stakeholders, including customers, employees, suppliers and communities.

Yet judging from subsequent corporate behavior, it is hard to say that any fundamental structural transformation has taken hold. Labor's share of income has not improved, and the proportion of workers earning less than a living wage has not declined. Corporate investment in local communities has not expanded dramatically. Meanwhile, share buybacks and shareholder payouts have reached record levels, and the structure of value distribution remains heavily skewed toward shareholders.

Behind this gap between rhetoric and reality lies a structural problem: the social externalities generated by companies have been kept outside the boundary of corporate finance, neither measured nor evaluated, and left invisible. What is not measured is not managed. The reason incentives for improvement failed to arise within companies is precisely this invisibility.

This "invisible structure" has often been called the market's "Unmentionable Foot." While Adam Smith's "Invisible Hand" supports market efficiency, the negative externalities that companies impose on society are left unspoken and unattended—an empty space for which no one takes responsibility. This space lies at the heart of today's polycrisis and is exactly what TISFD seeks to bring into the institutional framework.

TISFD expands the scope of People affected by corporate activities from a company's own employees to the entire value chain, consumers and communities. This can be thought of as a "social version of Scope 3" analogous to Scope 3 in the climate domain. It brings the wellbeing of a broad range of people—who have been invisible under conventional disclosure regimes—inside the institutional perimeter, and provides the basis for moving from a mere *idea* of multi-stakeholder capitalism to its *implementation*.

The Invisible Hand and the Unmentionable Foot

Note: This figure is based on Duncan Austin's essay, "Invisible Hand and Unmentionable Foot" (2021, Both Brains Required).

Bringing System Health into Company–Investor Dialogue

Looking ahead, companies and investors will increasingly be expected not only to manage entity-level ESG risks, but also to broaden their perspective to system-level risks that shape the health of society and markets as a whole. This trend structurally mirrors what happened after the 2008 global financial crisis, when financial supervision shifted its emphasis from micro-prudential to macro-prudential regulation.

In the mid-2000s United States, rising real-estate prices reduced non-performing loan ratios on the surface and kept credit costs down at individual financial institutions. Yet asset price bubbles and leverage were expanding behind the scenes, and systemic vulnerabilities were quietly accumulating. The lesson of the 2008 crisis is that even if each financial institution complies with micro-prudential regulations and appears sound, if the system as a whole weakens, the soundness of those very institutions will ultimately be undermined.

Reflecting on this, financial authorities introduced macro-prudential tools such as countercyclical capital buffers, which raise capital requirements when the ratio of credit to GDP overshoots.

No matter how far individual companies advance their ESG initiatives, if externalities such as climate change, degradation of natural capital and widening inequality accumulate across the socio-economic system, the profitability of companies operating on top of that system will eventually be impaired. Against this backdrop, system-level perspectives are gaining prominence in responsible investment by institutional investors such as pension funds and insurance companies.

Numerous analyses showing that the bulk of institutional investors' portfolio returns are driven by market-wide returns (β), and that excess returns (α) from individual stock selection contribute only marginally, have also reinforced this shift.

How, then, should investors concretely work to reduce system-level risks? The key is to act at a scale that takes into account the health of social and environmental systems, rather than stopping at entity-level ESG assessments.

In engagements with companies, the starting point is to move away from siloed, theme-by-theme approaches—such as focusing only on climate or only on governance—and instead to encourage companies to respond from an integrated People-and-Planet (P^2) perspective, taking into account the full range of externalities, including living wages, ecosystems and transition plans. At the same time, externalities are often tied to a country's industrial structure and public systems, so there are limits to what can be achieved through company-by-company dialogue alone. Investors need to broaden their scope of action toward "system-level stewardship," working collaboratively to influence entire industries and, where appropriate, engaging with policymakers as well.

To make such efforts effective, we must redesign the criteria by which companies are evaluated—specifically, whether their strategies are aligned with the outcomes needed to maintain the sustainability of environmental and social systems.

For example, if a 1.5°C scenario requires a 70% reduction in sector-wide emissions from the power sector by 2030, but a particular power company is content with a 20% reduction, its efforts diverge from the system-level requirements. To identify such gaps, we need outcome-based indicators such as carbon budgets, ecosystem degradation and the living-wage gap, and companies need to redefine the target levels that answer the question: "How far do we need to change?"

The establishment of TISFD and the current shift among institutional investors from entity-level to system-level perspectives are no coincidence. As intertwined crises in climate, nature and inequality simultaneously advance and shake the very foundations of society and the economy, it has become clear that efforts at the level of individual companies alone cannot safeguard the stability of markets as a whole.

By integrating Planet and People, making the accumulation of externalities visible and treating them in an integrated way, TISFD provides a framework to catalyze change across companies, industries and policy. In this sense, the emergence of TISFD is less a matter of choice than a necessity.

For responsible investment to move to its next stage, investors must adopt approaches that explicitly consider system health within their investment processes. TISFD will serve as the institutional infrastructure that supports this transition.

About the Author

Takeshi Kimura joined the Bank of Japan in 1989. After a secondment to the Federal Reserve Board's Division of Monetary Affairs, he served as Director of the Monetary Affairs Department, Associate Director-General of the Financial System and Bank Examination Department, and Director-General of the Payment and Settlement Systems Department at the Bank of Japan. He has been involved in international discussions on financial frameworks as a member of the FSB's Analytical Group on Vulnerabilities (FSB/AGV) and the Committee on Payments and Market Infrastructures (CPMI) at the Bank for International Settlements (BIS).

He joined Nippon Life Insurance Company in 2020. In 2021 he was appointed to the Board of the Principles for Responsible Investment (PRI). Since 2025 he has served as a member of the TISFD Steering Committee. He holds a Doctor of Engineering and a master's degree in economics.

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