

Why long-term diversified investors need a system-level view of inequality

A conversation with Takeshi Kimura, Special Adviser to the Board, Nippon Life Insurance Company; Member, TISFD Steering Committee



For investors that invest over the long term across a broad range of companies, looking only at risks and opportunities at the level of individual entities is not always enough. Takeshi Kimura explains why system-level risks can affect the long-term returns of a diversified portfolio, how a system-level lens complements entity-level analysis, and how TISFD is seeking to bring this wider view into its framework.

Q. Why do long-term diversified investors need to look beyond risks at the level of individual companies?

Takeshi: System-level risks can affect many companies across the economy and cannot be adequately diversified away simply by increasing the number of holdings. These can include declining economy-wide productivity, labour shortages across industries, weakening household purchasing power or social instability.

For a long-term diversified investor, these risks can therefore affect the returns of the portfolio as a whole.

This is why there is value in applying a system-level lens alongside entity-level analysis: looking beyond individual companies to the wider social and economic system and understanding what changes arise as the activities and impacts of multiple actors interact.

Q. What does applying a system-level lens mean in the social domain?

Takeshi: The relationship between businesses and people does not begin and end within the boundaries of a single business.

Businesses depend on skilled workers, consumers' purchasing power, relationships of trust with local communities, stable societies, effective institutions and functioning public services.

At the same time, business activities and impacts, together with those of governments, households and other actors, can help shape social and economic systems, including income distribution, human capital, labour markets, consumer demand and social trust.

Businesses are then affected by the state of those systems. A system-level lens therefore broadens the unit of analysis beyond the individual entity to the social and economic system itself.

Q. How can decisions that benefit an individual company create risks for a diversified investor?

Takeshi: Decisions that are rational for an individual company do not necessarily align with the interests of an investor holding a broadly diversified portfolio.

Containing labour costs, for example, may be rational for one company. But if similar behaviour becomes widespread, it may weaken household purchasing power and consumer demand.

Likewise, if many companies reduce investment in workforce development and rely instead on recruiting workers with the required skills externally, the result may be labour shortages, skills mismatches and, through lower productivity, potentially weaker growth.

An action that benefits an in-

dividual company in the short term may therefore impair long-term portfolio returns if negative externalities weaken the social and economic system on which many investee companies depend.

Q. How can individual companies be connected to system-level risks?

Takeshi: There are two different ways.

The first is through contribution: a company's activities and impacts on people, together with those of other actors, can contribute to changes in social and economic systems and to the formation of system-level risks.

The second is through exposure: a company may itself be affected, through its dependencies, by risks and opportunities arising from changes in those systems.

The distinction matters because the two do not necessarily correspond. A company may have only a limited effect on income distribution across a country, but if it depends heavily on domestic household consumption, it may be significantly exposed to weakening purchasing power and consumer demand.

A small contribution to a system-level risk therefore does not imply a small exposure to that risk.

Q. Why does it matter for investors to understand both a company's contribution to system-level risks and its exposure to them?

Takeshi: Analysing exposure can inform company assessment, investment decisions and portfolio risk management.

Analysing contribution can help investors assess how widespread corporate behaviour generating negative externalities has become and where action may be needed to mitigate system-level risks.

For long-term diversified investors, looking at both can provide a clearer basis for understanding risks that affect many investee companies and assessing portfolio-wide exposure.

Q. How is TISFD seeking to support a system-level view?

Takeshi: TISFD is developing a framework to help businesses and financial institutions understand, assess and report on their impacts and dependencies on people, and related risks and opportunities.

TISFD is seeking to bring this wider, system-level view into its framework. It does not replace the existing approaches of financial and impact materiality. Rather, it aims to provide an additional and complementary lens that connects

entity-level activities and information to broader social and economic systems, helping to capture how companies both affect and are affected by those systems.

The aim is not to seek an ever-expanding range of information from companies, but to identify information on important drivers and pathways associated with system-level risks and determine which information can support cross-company analysis and investor decision-making.

For long-term diversified investors, this can provide a clearer basis for understanding risks across investee companies, assessing portfolio-wide exposure and considering the appropriate level of investor response.

[You can access Takeshi's Nippon Life Institute Paper: Why TISFD Emphasises System-Level Risks here.](#)