The Limitations and Possibilities of ESG as the Multifaceted Phenomenon: A Study of Japan

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Abstract

Environmental, social, and governance (ESG) considerations have become a key aspect of global investment and corporate governance. A substantial amount of capital is allocated worldwide with ESG considerations in mind. While the rules for ESG continue to evolve, their precise legal and governance implications remain ambiguous. Scholars debate whether ESG can prompt a shift in the corporate focus from shareholder wealth to broader stakeholder interests. Drawing on Japan's experience, this study posits that ESG, when combined with specific legal frameworks such as environmental and labour laws, can influence the way companies are managed by influencing the perception of executives of ESG-related risks. The findings contribute to the ongoing discourse on ESG's role in corporate governance and its potential to reshape managerial decision-making.

Keywords: ESG; company law; corporate governance; investor engagement; sustainability disclosure; shareholder value.

[A] INTRODUCTION

Taking environmental, social and governance (ESG) matters into consideration in investment and business has become a global phenomenon. ESG gained prominence when institutional investors worldwide signed the UN-led Principles for Responsible Investment (PRI), which envisaged that the investors "will incorporate ESG issues into investment analysis and decision-making processes" (Principles for Responsible Investment nd). More than USD30 trillion are invested with ESG considerations in mind worldwide (Global Sustainable Investment Alliance 2023: 10). Japan is no exception. Although it took a decade for Japan to make serious efforts to catch up with European forerunners, ESG is spreading. As of 2022, USD4 trillion are invested with ESG considerations in mind in Japan (ibid: 10). ESG rules have evolved as both the Stewardship Code and the Corporate Governance Code require investors and companies to take ESG matters into consideration.

However, it remains to be seen what changes ESG will bring to the law and corporate governance in each jurisdiction. Henderson (2020: 141) expects ESG to be a game changer, potentially encouraging investors to focus more on environmental and social factors to improve the performance of their portfolios, thereby promoting a long-term view of companies away from the shareholder wealth maximization norm. Câmara (2022: 21) argues that ESG potentially redefines the duty of the boards so that they understand the impact of their decisions on stakeholders. On the other hand, Bebchuk & Tallarita (2020: 176) argue that encouraging company executives to focus more on the stakeholder interest is an inadequate and substantially counter-productive approach to addressing stakeholder concerns.

In this study, we argue that ESG could potentially change the way companies are managed by working with laws in specific areas such as environmental law or labour law through investor engagement that influences the perceptions of executives on risks the company faces in the long term. In addition to ESG for investors, researchers and practitioners are also highlighting, as a part of ESG, laws in individual areas that serve the interest of a wider range of stakeholders regardless of their impact on shareholder value. These two areas interact with each other, potentially affecting how companies are managed.

This article is organized as follows. Section B explains the background of ESG rules in Japan. Section C analyses the ESG rules, showing that ESG for investors and ESG for stakeholders interact with each other. Section D examines how ESG is implemented in Japan, with a case study showing how a failure in ESG can materialize various risks. Section E explores the limitations and possibilities of ESG. A short conclusion follows.

[B] ESG FOR INVESTORS, ESG FOR STAKEHOLDERS AND THEIR BACKGROUND

ESG is widely recognized as a multifaceted phenomenon. Its origins can be traced back to the incorporation of ESG considerations into the investment decisions by institutional investors. To support these investment decisions, investee companies are required to disclose ESG-related information. Moreover, investee companies are expected to integrate ESG factors into their business strategies. These three areas—investment, disclosure, and management—interact with another dimension of ESG: ESG rules in specific areas designed to serve a wider range of stakeholders.

The background of ESG investment

For a decade after the PRI, ESG investment among Japanese institutional investors remained relatively small, but it has since expanded (Global Sustainable Investment Alliance 2023: 10). A major shift began in September 2015, when the Government Pension Investment Fund (GPIF), Japan's largest institutional investor, became a PRI signatory (Government Pension Investment Fund 2015).

This shift is often attributed to the growing influence of universal owners (Noda 2019: 376). These investors hold large, diversified portfolios spanning multiple industries, effectively making them owners of the entire economy. Their primary concern is the long-term sustainability of society and thus the environmental and societal risks, rather than the profitability of individual investee companies.

This shift was also partly driven by government and ruling party policy aimed at revitalizing Japan's economy after a 20-year recession by improving company profitability. In 2015, a study group in the ruling Liberal Democratic Party revealed its intention to request the GPIF to sign the PRI. The study group envisaged that ESG investment would enhance investment performance and support the Japan Revitalization Strategy (ESG Toshi Kokurenn Toshi Gensoku Benkyokai 2015). First introduced in 2013 by the Government, the Japan Revitalization Strategy aimed at "[u]nleashing the power of the private sector to the fullest extent" (Cabinet Office 2014: 14). In response, the Financial Services Agency prepared the Stewardship Code in 2014, requiring investors to consider companies' risk management on social and environmental risks (Stewardship Code 2014: 3-3). As Tamaruya and Yukioka explain (2024: 451), the Code was intended to increase the value of Japanese companies. The GPIF and other investors' commitment to ESG investment was, in part, a product of this policy-driven agenda to boost the profitability of companies.

The background of ESG disclosure

The profit- and risk-centred nature of ESG is also evident in ESG disclosure practices. As ESG investment expanded, companies were required to disclose ESG-related information to aid investors' decision-making. A key example is the 2022 Amendment to the Cabinet Office Ordinance on the Disclosure of Corporate Affairs, etc, which mandated listed companies to disclose their "sustainability-related views and initiatives" in annual securities reports (form no 3, part 1, section 2). This legislation evolved from voluntary disclosure in integrated reports, where companies had been voluntarily disclosing ESG information to better communicate with institutional investors (*Nihon Keizai Shimbun* 2015). Whether statutory or voluntary, these disclosures primarily serve investors by providing information regarding company profitability and risks. This investor-centric approach is evident in government guidelines to define materiality in disclosure based on its impact on company value and performance (Financial Services Agency 2019: paragraph 2-2, 3).

Beyond disclosures for investors, companies also publish sustainability reports, corporate social responsibility (CSR) reports, and environmental reports for a broader range of stakeholders. Environmental reporting dates back to voluntary environmental reporting in the late 1990s (Kozuka 2019: 451). Today, large companies are legally required to make efforts to publish environmental reports under Article 11 of the Act on the Promotion of Business Activities with Environmental Consideration by Specified Corporations, etc, by Facilitating Access to Environmental Information, and Other Measures (Act No 77 of 2004). Over time, environmental reports evolved into CSR reports and then into sustainability reports, which cover social matters.

Disclosure requirements aimed at a wider range of stakeholders often seek to promote socially beneficial management activities. A notable example is the Health, Labour and Welfare Ordinance (No 104 of 2022). Implementing the Act on the Promotion of Women's Active Engagement in Professional Life, which aims to promote women's activities in their professional lives, the Ordinance requires large companies to disclose gender diversity-related information. It is hoped that the disclosure will encourage companies to take steps to promote women's professional activities, thereby narrowing Japan's wide gender gap.

The background of ESG management

As ESG investment and disclosure regulations expanded, taking ESG matters into consideration has become a practical norm at the investee company level (Osugi 2019: 160). The primary source of ESG management rules is the Corporate Governance Code 2021, the background of which is the intention to enhance shareholder wealth (Kozuka 2019: 454). Kozuka highlights a paradox in its approach: while the Corporate Governance Code aims to maximize shareholder value, it requires companies to take ESG matters into consideration for the interest of a wider range of stakeholders. This contradiction can be explained by the business case scenario—the idea that responsible company actions ultimately benefit long-term shareholder value. The Corporate Governance Code explicitly acknowledges this, stating that "appropriate actions of companies based on the recognition of their stakeholder responsibilities will benefit the entire economy and society, which will in turn contribute to producing further benefits to companies" (Notes on General Principle 2). However, the central focus of ESG management remains shareholder wealth.

ESG management at the investee company level is also required by sector-specific regulations, which, unlike the Corporate Governance Code, require companies to comply regardless of their impact on profitability. These regulations cover areas such as environmental protection, climate change mitigation, labour rights, and consumer protection. One widely discussed topic is "business and human rights" (Hashimoto 2024: 84). In 2022, the Government promulgated the "Guidelines on Respecting Human Rights in Responsible Supply Chains" (Inter-Ministerial Committee 2022), requiring businesses to "strive in efforts to respect human rights in their business enterprise, group companies, and suppliers". These guidelines are applicable regardless of their impacts on profitability as the objective of the guidelines is not to mitigate management risks but to mitigate adverse impacts on human rights (Matsui 2023: 15). Similar principles apply to sector-specific rules in other ESG areas.

[C] THE EVOLVING RULES OF ESG IN JAPAN AND HOW THEY CHANGE THE WAY COMPANIES ARE MANAGED

Rules for ESG investment: a narrow-minded concept

For ESG investment, the Stewardship Code serves as the primary regulatory framework. First introduced in 2014, the Stewardship Code required institutional investors to "fulfil their stewardship responsibilities with an orientation towards the sustainable growth of the companies", taking into account various factors, including "governance … and risk management (including … risks arising from social and environmental matters) of the investee companies". The Stewardship Code, revised in 2017, further emphasized ESG consideration by requiring institutional investors to consider not only risks but also business opportunities arising from social and environmental matters (principle 3-3). The 2020 revision further evolved the ESG rules, revising the definition of the stewardship responsibility so that it explicitly requires that ESG factors be taken into consideration.

However, the ESG considerations required by the Stewardship Code remain narrow in scope. The code focuses only on the sustainability of individual investee companies, rather than broader societal sustainability. This contrasts with the United Kingdom (UK) Stewardship Code, which emphasizes the sustainability of society, stating that "Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society." The Japanese Stewardship Code's cautious approach is reflected in its requirement that ESG considerations must be "consistent with their investment management strategies". Tamaruya and Yukioka (2024: 453) suggest that this provision was likely to avoid any implication that the ESG considerations could take precedence over investment returns.

Rules for ESG management: robust shareholder wealth

At the investee company level, ESG management is primarily governed by the Corporate Governance Code, which listed companies are required to either comply with or explain deviations from. General principle 2 requires, on a comply-or-explain basis, listed companies to consider the interests of a wider range of stakeholders, including employees, customers, business partners, creditors, and local communities. With its 2021 revision, the Corporate Governance Code explicitly incorporated ESG considerations by requiring listed companies to take appropriate measures regarding sustainability issues (principle 2.3) and defining sustainability as "mid-to long-term sustainability including ESG factors". Such issues, according to supplementary principle 2.3.1, include climate change, human rights, workers' health and working conditions, and fair transactions with suppliers and customers.

Despite the explicit references to ESG, the mainstream academic consensus maintains that ESG considerations do not override the shareholder wealth maximization norm in company law. Although Japan's Companies Act 2005 does not explicitly mandate shareholder value maximization, scholars argue that directors are implicitly obliged to maximize shareholder value, even if they may also consider stakeholder interests within their business judgement discretion (Kozuka 2019: 449). Kubota (2021: 38) argues that this position is similar to the enlightened shareholder value principle in the UK Companies Act 2006. Even as ESG gains prominence, Japanese scholars still continue to uphold the shareholder wealth maximization norm (ibid: 39). As a result, ESG management can only be justified through a business case scenario—that is, it must ultimately contribute to company profitability.

One illustrative case is gender diversity. The Corporate Governance Code justifies ESG-driven gender diversity initiatives based on their potential to enhance profitability. Principle 2.4 of the Code requires companies to promote gender diversity, stating that diverse perspectives and values support corporate sustainable growth. Building on this principle, Matsunaka (2021: 32) argues that the Code's promotion of gender diversity serves primarily to enhance corporate profitability. Researchers have extensively analysed the relationship between board diversity and firm performance, reinforcing the prevailing shareholder wealth maximization perspective. Despite early attempts to justify gender diversity regardless of its impact on profitability (Takahashi 2022: 77), progress in academic discourse regarding ESG's role in promoting societal sustainability remains slow.

Rules for ESG disclosure: possible interaction

ESG disclosure is the most advanced area in the ESG rules in Japan. Listed companies are legally obliged to disclose their "sustainability-related views and initiatives" in their annual securities reports under the Cabinet Office Ordinance. This statutory requirement was preceded by the Corporate Governance Code. The Corporate Governance Code 2015 required, on a comply-or-explain basis, listed companies to disclose non-financial information (general principle 3). The 2018 revision clarified that non-financial information includes ESG matters (Note to general principle 3). The 2021 revision went further, requiring listed companies to disclose their own sustainability efforts (supplementary principle 3-1(3)). These matters are disclosed in corporate governance reports in accordance with the listing rules of the Tokyo Stock Exchange.

The evolving rules on ESG disclosure aim to address a key issue: the lack of reliability and consistency in non-financial reporting (Tamaruya & Yukioka 2024: 455). To enhance reliability and consistency, companies and investors have increasingly relied on international disclosure initiatives, such as the Task Force on Climate-related Financial Disclosures (TCFD). This reliance on global standards has shaped Japan's ESG disclosure framework. The Corporate Governance Code 2021 requires, on a comply-or-explain basis, companies listed on the Prime Market to "enhance the quality and quantity of disclosure based on the TCFD recommendations ... or an equivalent framework". The four-element structure of the TCFD recommendations—"governance", "strategy", "risk management" and "metrics and targets"—has been incorporated into the statutory disclosure in annual securities reports (form 2, note 30-2 of the Cabinet Office Ordinance on the Disclosure of Corporate Affairs, etc). Moreover, in 2024, the Sustainability Standards Board of Japan (SSBJ) released a draft standard, which is expected to become a legal standard for non-financial disclosure in Japan (Financial Services Agency 2022). These initiatives are intended to respond to the demand of investors for comparable and consistent disclosure.

Although ESG disclosure for investors and ESG disclosure for broader stakeholders have different objectives, they increasingly influence each other. Investor-focused ESG disclosure primarily aims to improve investment decision-making by providing insights into corporate profitability and risk. In contrast, stakeholder-focused ESG disclosure is designed to serve the interests of a wider audience, irrespective of profitability considerations. Despite these differences, disclosure rules benefiting broader stakeholders have begun influencing investor-oriented disclosure requirements. For instance, under the Ministry of Health, Labour and Welfare Ordinance (No 104 of 2022) companies with 301 or more employees must publicly disclose the wage gap between men and women, one item from eight items under "Providing opportunities related to professional life for female employees" and one item from seven items under "Balancing work and family life" (Article 19). The former includes “the percentage of women in managerial positions” and the latter includes “the rate of taking childcare leave by gender” among others. These requirements are taken into the disclosure requirements for investors. The securities regulations require companies disclosing the wage gap, “the percentage of women in managerial positions”, or “the rate of taking childcare leave by gender” to include such information into their annual securities report (form 2, note 29 (d-f) of the Cabinet Office Ordinance on the Disclosure of Corporate Affairs, etc).

This interaction between investor- and stakeholder-oriented disclosure rules potentially encourages greater ESG consideration among both investors and companies, as institutional investors rely on this information when they engage with investee companies. The report of Cabinet Office Gender Equality Bureau (2023: 9), which surveyed institutional investors that were signatories of the Stewardship Code, found that about 65% of institutional investors use information on women’s active engagement in their investment decisions. This suggests that investor-focused ESG frameworks can indirectly reinforce stakeholder-driven ESG objectives, effectively supplementing government efforts to advance gender equality.

[D] IMPLEMENTATION OF ESG IN JAPAN AND HOW FAILURE CAN MATERIALIZE RISKS

The endeavour to foster aspirational disclosure

Due to the multifaceted nature of ESG, the quality of ESG disclosure is critical. ESG disclosure bridges investment and management, providing investors with information and encouraging investee companies to take ESG issues into account. However, companies are afforded considerable discretion in the disclosure of non-financial information. If companies opt for boilerplate disclosure, it neither facilitates informed investment decisions nor enhances ESG management. Action is therefore needed to improve the quality of ESG disclosure.

Currently, discussions are underway regarding the introduction of mandatory ESG disclosure in line with detailed standards. This framework will require companies listed on the Prime Market to disclose sustainability-related matters in accordance with the standards issued by the SSBJ (SSBJ Standards), which have been developed in alignment with the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards (ISSB Standards). In addition, the mandatory disclosure will entail assurance requirements. This system is expected to be implemented in phases, and, once introduced, it will resemble the

European Corporate Sustainability Reporting Directive of 2022. However, such mandatory regulation has yet to be implemented, and efforts to enhance the quality of ESG disclosure have remained limited to improving the quality of voluntary disclosures.

The Government, stock exchanges and institutional investors have all sought to support the efforts of companies that wish to voluntarily make aspirational disclosures. In 2018, the Ministry of Economy, Trade and Industry prepared the guidance for the TCFD recommendations. The purpose of this guidance is to provide commentary and references for companies disclosing in accordance with the TCFD recommendations (Ministry of Economy, Trade and Industry 2018: 3).

Japan Exchange Group, the parent company of the Tokyo Stock Exchange, published *The Practical Handbook on ESG Disclosure* in 2020. To encourage aspirational disclosure by companies, the *Handbook* provides a detailed description of the methodology for identifying materiality. It provides examples of companies that, as a first step, have listed a wide range of ESG issues, drawing on international disclosure frameworks, and then identified materiality by assessing the significance of the listed issues, thereby avoiding omissions. For identifying materiality, the *Handbook* presents a methodology for assessing the link between each issue and the value of each company, including considering the company's purpose, conducting interviews with key stakeholders and being aware of the time horizon.

The Financial Services Agency has published the *Collections of Good Practice in the Disclosure of Non-financial Information* since 2018 (Financial Services Agency 2024). This publication highlights good examples from annual securities reports filed in the previous year. Since 2021, these collections have included best practices in ESG and sustainability disclosure to help spread good practices in ESG disclosure to other companies.

The GPIF has also presented best practices in integrated reports since 2018 (Government Pension Investment Fund 2018). This publication presents integrated reports submitted in the previous year that were highly rated by asset managers. It includes comments from the asset managers on integrated reports selected as best practices, so that companies can understand what the asset managers value highly.

The above measures to encourage aspirational disclosure appear to have improved the quality of ESG disclosure and enhanced investor engagement. Furthermore, voluntary ESG disclosure in securities reports in accordance with the SSBJ Standards is expected to become more prevalent, both among companies outside the scope of mandatory requirements and those awaiting future mandatory implementation. However, there is ongoing debate about whether such enhanced disclosure will achieve its intended effect. Noda (2023: 12) argues that disclosure tailored to an image that conforms to investor expectations could potentially lead companies to avoid addressing more difficult but important issues. Therefore, the efficacy of ESG disclosure in providing information to investors, enhancing investor engagement and facilitating ESG management must be continuously evaluated.

The failure of a pharmaceutical company and the materialized risks

One example of an unsuccessful outcome can be observed in the case of Kobayashi Pharmaceutical. Kobayashi Pharmaceutical is a manufacturer of various health care goods and food products, listed on the Tokyo Stock Exchange. In 2024, the company announced that multiple customer deaths had been reported in connection with health problems related to its dietary supplement products. This scandal led to the resignation of both the Chair and the President (da Silva 2024; Kajimoto 2024). The following account is based on the report of the company's Fact-Finding Committee (2024) and other media sources.

This case highlights a failure of ESG implementation despite the company's apparently robust ESG framework. Kobayashi Pharmaceutical had comprehensive ESG disclosure initiatives, including integrated reports, corporate governance reports, and CSR reports. Its CSR Report (2022b: 78) states that the company's initiative in social matters includes product safety, with a dedicated Reliability Assurance Division overseeing quality audits across product development and manufacturing.

From a governance perspective, the company appeared to follow best practices. Until 2021, the board consisted of seven directors, including three independent directors. From 2022 onwards, independent directors formed the majority (four out of seven). Furthermore, three of the four independent directors were identified as having skills in "ESG and sustainability" and "legal and risk management" in the skills matrix disclosed in accordance with the Corporate Governance Code supplementary principle 4-11-1 (Kobayashi Pharmaceutical 2022: 131). All independent directors have attended all board meetings from 2021 onward, according to the Corporate Governance Reports (2022a: 11; 2023: 11; 2024b: 12). The CSR Report (2022b: 136) states that in times of crisis, a Crisis Management Headquarters would be set up to manage risks. Despite these measures, none of these mechanisms prevented the crisis.

The crisis became public in March 2024 when Kobayashi Pharmaceutical announced that health problems had been reported by doctors in connection with its dietary supplement products, which were advertised as having health benefits by lowering LDL cholesterol and blood pressure (Otake 24 March 2024). According to the initial announcement, the company received reports of kidney problems from 13 people (Otake 24 March 2024). The problems were reportedly caused by Beni-Koji fermented rice contained in the product. In response, the company voluntarily recalled the products and notified government authorities. Later that month, it was announced that deaths possibly related to the products were reported (Benoza 2024). It was later revealed that the kidney problems were caused by a component of blue mould that occurred during the manufacturing process and entered the product (Otake 18 September 2024). By November 2024, the company reported that 125 people had died, while 540 had been hospitalized due to suspected links to the product (Kobayashi Pharmaceutical 2024a).

The Fact-Finding Committee highlighted the potential cause of the incident, citing the following testimony obtained during the interview (2024: para 4.2.4.3). In the drying process, a malfunctioning dryer left the Beni-Koji from the affected batch undried for an extended period. Blue mould was discovered inside a fermentation tank lid, but quality control dismissed concerns. Additionally, a clogged exhaust duct may have led to poor ventilation in the production facility. Moreover, the quality control was almost entirely left to the on-site personnel, and a shortage of personnel was a common situation.

Kobayashi Pharmaceutical was widely criticized for its delayed disclosure (Inoue 29 March 2024). The company received six reports of serious health cases between January and February 2024 and had been advised by doctors to warn users of potential health risks. However, the company failed to issue an alert or report the matter to government authorities until more than a month later. Further criticism emerged in June 2024, when government authorities disclosed that 79 additional deaths had been reported as potentially linked to the product, marking a sharp increase from the previously acknowledged five fatalities (Inoue & Tang 2024).

The company was also criticized for its “dysfunctional” governance despite its idealistic appearance (*Mainichi* 2024). Questions have been raised about the effectiveness of the board of directors. The health problems were officially disclosed to the independent directors only one day before the announcement in March. The governance problems were also highlighted in the board's post-crisis response. Despite the resignation of both the Chair and the President, the board decided that the Chair would remain as *Tokubetsu-Komon* (special advisor) (ibid). The company was criticized for appointing the advisor and paying JPY2 million in monthly remuneration (*Nihon Keizai Shimbun* 2024). This criticism is in line with the recent criticism over the practice of appointing advisors due to their undue influence over the company without authority and responsibility (Johnston & Miyamoto 2023: 287).

The ESG failures at Kobayashi Pharmaceutical have materialized various risks. The first is liability risk, according to the categorization in Sjåfjell (2020: 11). One of the users who allegedly suffered kidney problems sued the company for damages (Otake 18 September 2024). In Taiwan, where local manufacturers used Beni-Koji supplied by Kobayashi Pharmaceutical, a consumer advocacy group brought a class action, seeking damages of TWD170 million (*Japan Times* 28 September 2024). The company decided to compensate its users for damages related to the products (Inoue 8 August 2024). The second is the reputational risk (Sjåfjell 2020: 12). This is evidenced by the suspension of recruitment activities for students graduating the following year (*Japan Times* 3 April 2024). The last is policy risk. In the aftermath of the incident, the Government tightened regulations on the health food labels that the product carried. The regulations include reporting health problems and implementing higher quality management standards (*Japan Times* 31 May 2024). This policy risk materialized not only for the company, but for all companies involved in health foods with such labels as predicted by Sjåfjell (2022: 70). As a result, the profitability of Kobayashi Pharmaceutical's food business was affected. For the six months following the announcement, the company's net profit plunged by 81.7% from the same period a year earlier (Inoue 8 August 2024).

[E] WORKFORCE ENGAGEMENT IN JAPAN AND THE LIMITATIONS AND POSSIBILITIES OF ESG

Given the need for global harmonization to address ESG-related challenges (Reiser 2019: 131; Câmara 2022: 29), Japan is expected to adopt an approach to ESG rules and practices similar to that of other countries. Governments, the private sector, and scholars have collaborated to align ESG frameworks internationally. Despite some differences in implementation, Japan shares several key ESG characteristics with other regions.

First, risk management is fundamental to the concept of ESG. This is in accordance with the observation made by Pollman (2024: 425) that ESG has evolved from an investment analysis tool for investors to a risk management strategy for investee companies. The case study above illustrates the potential consequences of inadequate risk management. Second, the justification for ESG is based on the expectation that taking ESG matters into consideration will improve performance at both the investor and investee company levels. It is anticipated that ESG will influence the decision-making processes at various levels, originating from investors, extending to investee companies, and even affecting businesses in supply chains. This aligns with the concept of the "cascade effect" of ESG, as postulated by Câmara (2022: 21). Third, Japan and other regions also share the same problems. One of the significant challenges in implementing ESG is ensuring the reliability and consistency of ESG disclosure (Pollman 2021: 662; Câmara 2022: 29).

Notwithstanding the apparent similarity, there are notable differences in the background of ESG. While ESG in the global context emerged as a voluntary initiative driven by institutional investors (Câmara 2022: 7), Japan's approach has been shaped to some extent by government policy. This has resulted in a reluctant stance in the Stewardship Code, which does not seek to advocate the sustainability of society but rather focuses on the sustainability of individual investee companies. This makes it challenging to pursue the sustainability of society regardless of the profitability of individual companies, which serves as evidence of the robust shareholder wealth maximization norm.

The robustness of shareholder wealth can also be observed in the detail of issues that ESG addresses. For example, workforce participation has been a major topic in ESG discussions in the UK (Johnston & Samanta 2024: 158). A key policy issue in UK corporate governance reform is how to amplify the voice of the workforce, including the potential appointment of non-executive directors from among employees. In contrast, in the United States, workforce engagement is treated as a human resource management issue overseen by the board (ibid: 176). Japan's situation is more nuanced.

In Japan, the issue of workforce participation is less frequently discussed, arguably because it is assumed that the voice of the workforce is adequately heard. This assumption is rooted in Japan's employment and managerial market practices, where employees typically remain with the same company for an extended period. This lifetime employment practice serves to emphasize the notion of a company as a community of employees (Shishido 2000: 202). Japanese executives are often promoted internally, meaning the majority of corporate leaders have an employee background (Araki 2005: 27). These connections and shared interests between management and employees contribute to the perception that the voice of the workforce is heard (Sarra & Nakahigashi 2002: 339). Hideki Kanda (1992: 23) argues that Japan did not adopt the German co-determination system because the workforce were already the owners of the company. Kozuka (2021: 34) asserts that, in the context of the recession that began in the 1990s, prioritizing workforce interests has been viewed as a challenge to corporate profitability rather than a solution.

However, the assumption that workforce voices are adequately heard is flawed. Even before the economic downturn of the 1990s, employee representation primarily reflected the interests of male workers. Japan's remarkable pre-1990s productivity and stable employment conditions in large corporations were sustained at the expense of subcontractors, who in turn relied on low-paid female workers who would otherwise have been engaged in unpaid family work (Osawa 2020: 96). These female workers were systematically excluded from lifetime employment (Sarra & Nakahigashi 2002: 340; Gordon 2017: 15; Heinrich & Imai 2021: 83), and, as a result, their voices were not heard.

Furthermore, since the 1990s, the limitation of heard voices has broadened, reflecting the growth of non-regular workers. This category of workers includes part-time workers, hourly workers, fixed-term contract workers and dispatched workers (Gordon 2017: 9; Osawa & Kingston 2022: 129). Following the economic downturn in the early 1990s, large companies were compelled to downsize their redundant workforces. In response, many companies reduced the recruitment of new graduates, rather than dismissing existing workers, in order to maintain the practice of lifetime employment. Consequently, the scale of lifetime employees within companies diminished, forming a "small core" that remained to provide the internal managerial market (Ono 2010: 23). Since then, the labour shortage has been met on a large scale by non-regular workers, who serve as shock absorbers for economic fluctuations. As of 2023, non-regular workers account for 37% of all workers (Statistics Bureau of Japan 2024), leaving a significant portion of the workforce without a voice in corporate governance.

Researchers have identified a variety of social risks associated with the expansion of non-regular workers. These workers not only receive lower wages but also have limited access to social security and benefits (Fu 2021: 269; Heinrich & Imai 2021: 88; Osawa & Kingston 2022: 128). They are also excluded from the opportunities to develop their professional skills, which can result in a lack of skilled workers in the future as Matsui (2019: 45) indicated in the context of independent service providers. Some researchers even correlate the growth of non-regular workers with Japan's declining marriage and fertility rates (Osawa & Kingston 2022: 133; Gordon 2017: 10). All of these factors arguably contribute to depressing consumption and productivity, thereby undermining the sustainability of pension and health care insurance systems (Gordon 2017: 10; Osawa & Kingston 2022: 137). Ultimately, deteriorating labour conditions may give rise to the risk of societal breakdown (Sjåfjell 2020: 2).

While companies may partially bear such societal risks due to their potential negative impact on business performance, it is challenging to rely on the companies' voluntary commitment to tackle these issues. First, the voices of regular workers are already reflected, leaving non-regular workers in a vulnerable position, thereby rendering it particularly difficult for their voices to be heard. This difficulty is exacerbated by the exclusion of non-regular workers from trade unions, which are often organized within an individual company. Second, addressing the non-regular worker issue presents a free-rider problem. Improving working conditions could reduce short-term profitability, making companies hesitant to act. Additionally, executives who have spent their careers in the lifetime employment system may fail to recognize the long-term risks potentially caused by socially unfavourable, non-regular labour practices (Matsui 2019: 49). The question is what can ESG do to address such problems?

The Corporate Governance Code exerts a considerable normative influence, as many companies opt for compliance over explanation as Johnston and Samanta (2024: 175) asserted in the UK. Nevertheless, its perspective is somewhat limited in that the implementation of ESG is justified only when it contributes to profitability while laws in specific areas intended for the interest of a wider range of stakeholders often fail to facilitate companies' responsibility to internalize the cost of unfavourable management activities due to the political power of business. In contrast, the Stewardship Code can have a wider potential scope, particularly for universal owners interested in the sustainability of society. However, its normative force remains weak, and it offers limited guidance on concrete actions. This gap can be potentially addressed by laws in specific areas, even without strong enforcement. Laws such as disclosure rules and obligations to make best efforts can express clear values, providing institutional investors with a framework for action and encouraging investor engagement, as shown in Section C. This engagement, in turn, has potential to shift executive perceptions of ESG-related risks, which may offer a way out of the impasse. A clearer articulation of societal sustainability within the Stewardship Code, rather than a narrow focus on the sustainability of individual companies, should serve to accelerate progress in this domain.

[F] CONCLUSION

A decade after the inclusion of ESG principles in the PRI, Japan has initiated actions in this area. The incorporation of ESG at both the investor and the investee company levels through the Stewardship Code and the Corporate Governance Code represents a significant step forward. Additionally, ESG-related rules are evolving in specific areas, including environmental, labour, and human rights law.

Despite this progress, the pace of evolution remains slow. The Stewardship Code places an emphasis on the sustainability of individual companies rather than that of society. ESG management is primarily required when it contributes to company profitability. The rules pertaining to specific areas are largely limited to non-binding guidelines or disclosure requirements (Kozuka 2019: 446). From an academic perspective, scholars are closely examining the evidence pertaining to the efficacy of ESG, with a particular focus on foreign developments (Matsunaka 2021; Kubota 2022; Okuno 2023). Japan is still awaiting a societal transformation where meeting ESG requirements results in profitability (Matsui 2019: 49). This represents the robustness of shareholder value norm.

Despite the robust shareholder value norm, ESG has the potential to offer a path out of the current impasse. Even without strong enforcement, rules in specific areas provide guidelines for investors and encourage investor engagement. This engagement potentially influences the perceptions of executives on ESG-related risks. However, it remains to be seen which types of laws are likely to be incorporated into investor engagement, and how this engagement will influence executives' risk perception.

Japan is gradually developing ESG rules and practices, but the path out of the impasse remains narrow. If the world must change together as Câmara and Morais (2022: ix) suggest, it is essential for every jurisdiction to attempt to change and share its experience. Such an approach will facilitate a deeper understanding of the unique circumstances shaping ESG implementation in different jurisdictions.

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