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How Should We Respond to the Increasing Presence of Activist Investors?

Domestic and foreign activist investors are increasingly investing in Japanese companies.
In this issue of *My Vision*, we explore the issue of how companies should respond to the activist approach against the background of increasing investor interest focused on the Japanese market.

About This Issue

How Should Japanese Companies Respond to the Increasing Presence of Activist Investors? - How Can We Link Increased Corporate Value to the Growth of the Japanese Economy?

Yuri Okina
Executive Vice President, NIRA / Chairperson, The Japan Research Institute, Limited

Domestic and foreign activist investors are increasingly investing in Japanese companies. While some investors seek to increase corporate value over the medium- to long-term, there are concerns over the fact that others sell their shares after making demands based on the pursuit of short-term profit. With increasing investor attention focused on the Japanese market, how should Japanese companies respond to activist investors' aggressive approach? How do market participants view the current situation? We asked experts from a variety of fields, including the CEO of an investment advisory firm, a researcher, and a market manager.

Activist investor: An investor who seeks to gain financial benefit by exercising their shareholder rights and actively proposing and demanding corporate management strategies and shareholder return policies. An investment fund of this type is called an activist fund.

Keywords…Attention from foreign investors, long-term growth of companies, revitalization of communication between investors and companies, Tokyo Stock Exchange market reform

Expert Opinions

How Should We Respond to the Increasing Presence of Activist Investors?

How should we consider activist investors' increasingly assertive approach towards Japanese companies? How should companies respond to activist investors?

With Increased Attention from Foreign Investors on the Japanese Market, Companies Should Link the Changes Resulting from Generational Shift to Corporate Growth

Oki Matsumoto
Chairman of the Board, Representative Executive Officer & Chairman*, Monex Group, Inc.

Keywords…Presence of "vocal stakeholders," generational shift, irreversible change, outside voices

Companies Should Make Use of Outside Knowledge in Order to Enable Constructive Engagement with Activist Investors

Kimie Iwata
Outside Director, Ajinomoto Co., Inc. / Resona Holdings, Inc.

Keywords…Monitoring board, emphasis on dialogue with shareholders, transparency regarding beneficial shareholders

Increasing Corporate Value Through Enhanced Financial Disclosure and Reform of the Companies Act

Yo Ota
Attorney at Law, Nishimura & Asahi (Gaikokuho Kyodo Jigyo)

Keywords…Ownership and management, limitation of shareholder rights, understanding of beneficial shareholders, disciplined market participation

Companies Should Take the Initiative and Prepare for the Suggestions of Activist Investors

Hidetaka Kawakita
Professor Emeritus, Kyoto University

Keywords…Enhancement of corporate value, utilization of knowledge and experience from outside the company, competition among companies

Promoting Communication Between Companies and Investors Is Important

Naotaka Ikeda
Senior Manager, Planning Group, Listing Department, Tokyo Stock Exchange, Inc.

Keywords…Responses without preconceptions, parent-subsidiary listings, polarization of corporate response

Interview period：January - February, 2025
Interviewer: Kozue Sekijima (Associate Senior Fellow, NIRA), Hinako Suzuki (Research Coordinator & Research Fellow, NIRA)

(*) At the time of the interview

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How Should We Respond to the Increasing Presence of Activist Investors?
- How Can We Link Increased Corporate Value to the Growth of the Japanese Economy?

Yuri Okina
Executive Vice President, NIRA / Chairperson, The Japan Research Institute, Limited

Since the beginning of the year, Japanese stock prices have continued to be affected by a series of tariff hikes and other measures effected by re-elected U.S. President Donald Trump. Nevertheless, stock price levels over the past one to two years have finally recovered to the record highs of 30 years ago. It is now widely known that U.S. investor Warren Buffett has begun to pay attention to the business model of Japanese trading companies and has commenced long-term investments, and foreign investors are focusing on Japanese companies that are implementing structural reforms as the nation's economy turns the corner. Meanwhile, prompted by a weak yen, there have been moves toward companies with large market capitalizations, such as a takeover bid proposal by a Canadian company for Seven & i Holdings.

Against this backdrop, domestic and foreign activist investors are becoming more active in Japan's capital markets. As of 2024, there were 133 large shareholding reports (Nikkei aggregate) that listed "important proposed actions" as the purpose of ownership of the holdings, and the number of shareholder proposals to general shareholders' meetings regarding matters such as shareholder returns and the election of directors have also increased. Among the factors underlying the increased presence of domestic and foreign activist investors are the fact that the Corporate Governance Code enacted in 2015 has taken root and cross shareholding and policy shareholding have declined, that the Tokyo Stock Exchange made a request for management that is conscious of cost of capital and stock price in 2023, that Japanese companies are making the transition to management that is conscious of capital efficiency, and that the Ministry of Economy, Trade and Industry (METI) released "Guidelines for Corporate Takeovers." While some activist investors press companies to raise dividends in the short term, enabling them to sell off their shares for a profit, others seek to increase corporate value over the medium term. In this issue of *My Vision*, we asked experts familiar with Japan's capital markets how we should view the growing presence of activist investors from the perspective of Japan's economic growth, how Japanese companies should respond to this trend, and what institutional issues need to be addressed.

Facing the Risk of Activist Investors Proposals; Relationship with Long-Term Growth

Increased pressure from capital markets has resulted in increased opportunities for corporate management to discuss corporate value with investors, a trend which should be viewed as fundamentally positive in that it could promote the long-term growth of Japanese companies. Oki Matsumoto, Chairman of the Board, Representative Executive Officer & Chairman of Monex Group (at the time of the interview), who is involved in engagement with companies as an investor himself, emphasizes the importance of imposing strict discipline from the outside to help Japanese companies become stronger over the long term. However, several interviewees express concern that compared to the U.S., Japan has a problem with investors who seek short-term gains. Nevertheless, as Mr. Matsumoto indicates, this trend is irreversible, and even large companies now have to face the risk of receiving a variety of proposals from activist investors if they are perceived by investors as having management that does not consider capital efficiency. Corporate executives must heed the message presented here and work to enhance their corporate value.

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Corporate Management Should Take Strategic Actions to Increase Corporate Value

How should companies respond to this situation? Professor Emeritus Hidetaka Kawakita of Kyoto University, a student of the stock market for many years, tells us that it will be important for companies to take action before activist investors point out problems. In other words, strategic measures are needed, such as actively utilizing the knowledge and experience of outside directors and others, drawing up plans and formulating measures to increase corporate value, and discussing the company business model at board meetings. Kimie Iwata, who possesses extensive experience as both a corporate manager and an outside director, points out the importance of changing the mindset of corporate management and outside directors. She tells us that the awareness that "stock price is the CEO's report card" has become entrenched at the management level; she herself is committed to realizing thorough dialogue with, and the dissemination of information to, investors. In particular, it is important to note that the responsibilities of outside directors have become even heavier. Given the increasing number of takeover bids and management buyouts, and the fact that outside directors now make up the special committees that independently judge the merits of these proposals, there are many issues to be addressed, including how outside directors should be selected and how their qualifications can be improved. Naotaka Ikeda, who has been leading reform of the awareness of management and outside directors for the past several years within the Tokyo Stock Exchange, explains the importance of corporate management having an understanding of specific types of investors among the various types there are, of then determining whether or not the proposals made by these investors contribute to the common interests of shareholders from the perspective of increasing corporate value over the medium to long term, and of responding to matters that should be addressed without preconceptions.

Improving Corporate Value Through Legislation and Market Reforms

In light of the increased presence of activist investors our interviewees point out a number of issues. First, as several interviewees indicate, transparency with regard to beneficial shareholders is extremely important, and the revision of the Companies Act to realize effective dialogue between investors and corporate management is an urgent task. Yo Ota, an attorney well-versed in both domestic and foreign law and practice, tells us that the scope of the right of shareholders to make proposals is broader in Japan than it is in Europe and the United States, and this includes the ability to make proposals regarding matters related to business execution. In addition to the need to consider limiting these overly broad shareholder rights through legislation, he points out that it will also be important to ensure effective compliance with the rules, given that violations of the rules by activist investors are on the rise. Toshiba's response to proposals by activist investors in 2020 has attracted attention, but with geopolitical risks growing, the company will also need to be prepared for economic and security risks. At the same time, we are also presented with the opinion that prudent judgment will be needed in reducing the scope of shareholder rights, and this will necessitate the review and examination of various systems from concrete and multifaceted perspectives. We are hopeful with regard to future efforts on the part of the Tokyo Stock Exchange to reform the market in order to reinvigorate communication between investors and companies and increase corporate value. The government, those involved in corporate management, investors, exchanges, and other market participants must all recognize the importance of linking Japan's capital markets, which are beginning to be revitalized, to the medium- to long-term improvement of the corporate value of Japanese companies and the growth of the Japanese economy, and must respond quickly to a variety of issues.

Dr. Okina is an Executive Vice President of the Nippon Institute for Research Advancement (NIRA) and Chairperson of the Japan Research Institute (JRI). She holds a Ph.D. in economics from Kyoto University. Dr. Okina is Chairperson of the Government Tax Commission, the acting Chairperson of the Fiscal System Council of the Ministry of Finance, and a member of the Social Security Council of the Ministry of Health, Labor and Welfare, among numerous other public positions.

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Expert Opinions

With Increased Attention from Foreign Investors on the Japanese Market, Companies Should Link the Changes Resulting from Generational Shift to Corporate Growth

Oki Matsumoto
Chairman of the Board, Representative Executive Officer & Chairman*, Monex Group, Inc.

In the arena of corporate management, the presence of "vocal stakeholders" who externally impose strict discipline is an important factor. In the prewar period, *zaibatsu* (conglomerates), and in the postwar period, the former Ministry of International Trade and Industry (MITI) and banks played the role of providing external governance of companies and offered guidance on the redistribution of resources, including business restructuring and corporate mergers. However, these organizations were, respectively, dismantled or eliminated by U.S. postwar rule and public pressure. Without external checks, Japanese society experienced a period of stagnation for the next 30 years.

But the situation has changed over the past three years. The Ministry of Economy, Trade, and Industry (METI) has allowed hostile takeovers, and institutional investors have emerged as activist investors. In conjunction with the Tokyo Stock Exchange's (TSE) PBR reforms and the transition to cost-of-capital-conscious management, specific improvements are being demanded from companies, including higher stock prices, increased dividends, and management reforms. There is a growing recognition that the presence of actors who actively voice their opinions within the capital market mechanism can start companies moving and have a positive impact on stock prices.

Another factor driving change is the generational shift that is underway in companies and among institutional investors. The generation of managers who commenced their careers after Japan's growth began to show signs of slowing have tended to learn from best practices around the world and incorporate "outside opinions," such as those of activist investors and outside directors. In addition, institutional investors, who had previously been hesitant to meddle in corporate proposals, are now actively evaluating shareholder proposals and the opinions of engagement funds as a result of this generational shift. The generational shift has also led the TSE to take the stance of requesting companies to implement cost-of-capital-conscious management.

These are irreversible changes. It will be important to connect these trends together in a direction that will make Japanese companies stronger in the long term. Amid recent falls in long-term interest rates in countries including China and Germany, and fears of slowing economic growth and falling asset prices, funds from around the world are about to flow into the U.S. and Japan. As indicated by the fact that Warren Buffett's investment firm has issued long-term yen-denominated bonds and made large-scale purchases of Japanese trading companies, foreign investors have high expectations of Japan's ongoing structural changes.

The Monex Activist Fund, for which I also conduct engagement activities, is one of the few activist funds in the world for private investors, and focuses on both the short and long term. Most of the companies I talk to respond positively, and the majority are interested in outside opinions. When a meaningful dialogue cannot be established, the Fund publicly expresses its opinion, and in some cases, these opinions become the impetus for management reform. Listening to outside opinions should be a factor in spurring Japanese companies toward sustainable growth.

(*) Titles as of the time of the interview.

Mr. Matsumoto graduated from The University of Tokyo's Faculty of Law in 1987, following which he joined Salomon Brothers Asia Securities. He next took up a position at Goldman Sachs Securities, where he became the youngest General Partner at that time. In 1999, he founded Monex, Inc. and led its rapid growth as a pioneer in online securities services. He continued to lead Monex Group, Inc. as President and CEO, taking his current position in June 2023. Mr. Matsumoto has also served as a member of the government's Economic Council, and as an outside director of the Tokyo Stock Exchange and a number of other listed companies. In 2020, he founded Japan Catalyst, Inc., an investment advisory firm which seeks to revitalize Japan's capital markets and pursue returns on investments through engagement with listed companies.

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Expert Opinions

Companies Should Take the Initiative and Prepare for the Suggestions of Activist Investors

Hidetaka Kawakita
Professor Emeritus,
Kyoto University

With the emergence of investors such as private equity funds in recent years, while some activist investors are demanding immediate shareholder returns, we are also seeing demands being made and proposals offered to management from a slightly longer-term perspective in order to improve corporate performance and realize profits. In the sense that opportunities for companies and investors to discuss corporate value have increased, this trend is commendable.

However, there are still few activist investors in Japan who invest from a long-term perspective. There continues to be a tendency to attempt to increase share prices through short-term measures such as divesting businesses or changing capital policies, and this remains a significant problem for the Japanese market. The ultimate goal of activist investors is to sell their shares and earn a return within three years. The fact that the weak yen encourages the buying up of shares in Japanese companies means that the current situation appeals to foreign investors as a tremendous opportunity to make returns. As demonstrated by the targeting of Seven & i , even companies with a market capitalization of as much as 10 trillion yen can become the focus of activist investors.

Companies will need to respond strategically. The key will be to draw up and implement plans and measures to enhance the company's corporate value prior to the emergence of proposals from activist investors. This will prepare the company to counter these investors. To this end, companies should actively make use of knowledge and experience from outside the company. Currently, many companies only incorporate outside directors as a formality, and do not have a culture of active discussion at board meetings. Outside directors should not be limited to those with management experience, but should include people with specialized expertise in areas such as finance and accounting who can express their opinions, and they should engage in in-depth discussions regarding matters including the appropriateness of the company’s business portfolio and the cost of capital from a long-term perspective. While seeking advice from consulting or asset management firms is of course a good idea, it is important for companies to make independent efforts to gather information through a variety of channels to ensure that discussions do not end on a superficial level.

On the institutional side, it will be important not only to discuss Corporate Governance Code from a political perspective and develop rules, but also to foster a culture in which companies and investors understand and put into practice the meaning of the Code and encourage competition among listed companies. Noteworthy is the Tokyo Stock Exchange's (TSE) revisions of TOPIX, which will reduce the number of constituents to around 1,200 by 2028; I believe that this number should be further narrowed down to the top 100 to 200 companies by market capitalization in order to encourage competition based on business performance. The S&P 500, a standard stock price index in the U.S., encompasses the top 500 companies. Companies are evaluated by investors and strive to be among the top. It is our hope that the TSE will function as a “shadow activist,” so to speak, motivating companies to actively strive to increase their corporate value while maintaining a focus on the perspectives of long-term investors.

Dr. Kawakita holds a Ph.D. in economics and specializes in securities investment theory and securities market analysis. After graduating from Kyoto University, he joined Nippon Life Insurance Company. Following dispatch to the Ministry of International Trade and Industry (now the Ministry of Economy, Trade and Industry) and secondment to the NLI Research Institute, he was engaged in macroeconomic analysis, research and analysis of stocks and bonds, and development of securities investment methods, ultimately serving as the Chief Portfolio Manager. After retiring from Nippon Life Insurance Company, he served as a specially-appointed professor in Chuo University’s Graduate School of Accounting, a professor in Doshisha University’s Faculty of Policy Studies, and a professor in Kyoto University’s Graduate School of Management before assuming his current position in 2016. He has also served as Editor-in-Chief of the Securities Analysts Journal of the Securities Analysts Association of Japan, President of the Nippon Finance Association, and External Director of Japan Exchange Regulation.

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Expert Opinions

Companies Should Make Use of Outside Knowledge in Order to Enable Constructive Engagement with Activist Investors

Kimie Iwata
Outside Director,
Ajinomoto Corporation /
Resona Holdings, Inc.

"An increasing number of companies are considering shifting their boards of directors from management boards, where execution and supervision are led by executive directors, to monitoring boards, where execution and supervision are separated and the supervisory function is strengthened. While in the past decision-making on individual matters was the central agenda of the board of directors, the new role of the board is to determine management policy, supervise the process of execution of that policy, and take risks to improve corporate value over the medium to long term. Offering perspectives and experiences that differ from those of the executive side, outside directors are now expected to express their differing views without anticipating and deferring to the opinions of the board, in some cases opposing proposals made by the executive side. The responsibilities of outside directors have therefore become even heavier.

There are now more opportunities for outside directors to be involved in investor relations and shareholder relations, previously the responsibility of the CEO. At meetings, for example, I offer frank opinions from my specific perspective, including my assessment of the company's issues and its efforts to address them, but at the same time, as an outside director, I try to learn from investors' expectations and ideas about the company. Close attention to dialogue and the dissemination of information will make it possible to identify investors who will contribute to corporate value over the medium to long term, and help increase the number of such investors.

Companies emphasize dialogue with shareholders because the awareness that stock price is the CEO's "report card" has become entrenched in management, and it has become commonplace to set ROE and ROIC as management targets and focus on how to increase corporate value while improving capital efficiency. Management wants to know what investors think about their companies and their intentions to make additional investments, and seeks to build a beneficial relationship with them over the medium to long term. Therefore, it is vital for companies to understand at an early stage who they should be in dialogue with, and mechanisms must be created to realize transparency with regard to the beneficial shareholders who hold shares in other names. Disclosure of information regarding beneficial shareholders will also help institutional and general investors to make decisions on holding such shares, which will ultimately benefit investors.

At the same time, it is often pointed out that shareholders have strong rights in Japan, but in actuality it is not clear to what extent the abuse of shareholder rights affects business practice. But even when a shareholder makes a proposal, in most cases companies will presumably devise ways to ensure that this does not interfere with the progress of the general shareholders' meeting. In addition, it can be a positive experience for a company to hold discussions with investors and learn their thoughts before tabling a proposal. It is difficult to judge whether weakening shareholder rights under the Companies Act would really be a good thing.

Following her graduation from the University of Tokyo's College of Arts and Sciences in 1971, Ms. Iwata entered the Ministry of Labour (now the Ministry of Health, Labour and Welfare). In the Ministry, her main responsibilities included women's labor and international labor issues. She left the Ministry of Health, Labour and Welfare in 2003 after serving as Director-General of the Equal Employment, Children and Families Bureau. Since leaving the Ministry, she has served in a variety of positions, including as Representative Director and Executive Vice President of Shiseido Co., Ltd., and as an outside director of Kirin Holdings Co., Ltd., Japan Airlines Co., Ltd., and Sumitomo Corporation. Ms. Iwata is a member of the Ministry of Economy, Trade and Industry's Study Group on Corporate Governance toward the Enhancement of Earning Power.

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Expert Opinions

Promoting Communication Between Companies and Investors Is Important

Naotaka Ikeda
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The Tokyo Stock Exchange (TSE) is promoting measures to enable listed companies to increase their corporate value in cooperation with investors, such as reorganization into three new market segments and requesting management that is conscious of cost of capital and stock price. During this period, domestic and foreign investors' interest in the Japanese market has increased. Although I view this recent trend as positive, it is of course the case that corporate transformation requires time, and market reforms are only beginning to take hold.

Activist investors are often seen as oriented towards the short-term, but I actually don't think that the term "activist investor" should be used as a collective designation. There are various types and styles of investors, and it is important for companies to understand them correctly. It is desirable for companies to respond to investors without preconceptions, taking into consideration whether or not their proposals contribute to the common interests of shareholders from the perspective of improving corporate value over the medium to long term. I believe that the idea of adopting "countermeasures" in response to activist investors may therefore also be called into question.

What is also required of companies is to be aware of their own position, for example their return on capital and their market valuation. There is a correlation between proposals made by investors and the company's position, for example, in cases in which the emphasis is on business restructuring and in cases in which the emphasis is on shareholder returns. Companies that do not understand these factors and hence stubbornly refuse to engage in dialogue with investors or become excessively defensive in response to investors' proposals and opinions may inadvertently find their reputation declining in the market.

Another area in which investors have an issue is "parent-subsidiary listings." Investors are very interested in the rationale for having a subsidiary listed as part of group management. In addition, there are an increasing number of cases in which a company has a capital and business alliance with a major shareholder that owns between about 20to 50% of the company, even if the relationship does not amount to a parent-subsidiary relationship. Of course, this type of listing is not prohibited, but it may be seen as incomplete compared to cases in which the company has a controlling interest, or in cases in which, for example, there is effective control through the dispatch of directors, it may be seen as opaque; further explanation to and communication with investors are necessary.

Today, attitudes toward the disclosure of information and dialogue with investors have become polarized, and this is resulting in differences in performance in the market. The TSE intends to encourage companies that are particularly proactive in their responses, and is working to create an environment that facilitates greater mutual understanding, for example, by means of disclosure of gaps between company and investor perspectives. We will continue to promote market reforms with the overarching goal of creating a market in which companies and investors communicate with each other in order to enhance corporate value.

Mr. Ikeda Joined Tokyo Stock Exchange, Inc. in 2005. After joining the company, he worked in the Listing Examination Department before assuming his current position in June 2010. He oversees rulemaking and other matters related to the overall listing system at the TSE, including review of market segmentation, studies towards the enhancement of corporate governance, and the development of systems involved in the fostering of startups. In recent years, the TSE has been actively working to reform the capital markets; efforts include formulating a Corporate Governance Code in 2015, implementing a review of market classification in 2022, and requesting management that is conscious of cost of capital and stock price in 2023.

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Expert Opinions

Increasing Corporate Value Through Enhanced Financial Disclosure and Reform of the Companies Act

Yo Ota
Attorney at Law,
Nishimura & Asahi
(Gaikokuho Kyodo Jigyo)

As awareness of the importance of the Corporate Governance Code and cost-of-capital-conscious management has become more entrenched in the market, activist investors have become more active in Japan. The ongoing depreciation of the yen, the influx of Chinese funds, and Tokyo Stock Exchange-led efforts to improve PBR are providing a tailwind for activist investors.

Although activist investors are now as active in Japan as they are in the U.S., the content of their proposals differs between the two countries, and companies are at a loss as to how to respond. In the U.S., many proposals take into account the medium- to long-term interests of the company, such as review of business portfolios and management strategies. In Japan, however, numerous proposals by activist investors seek short-term gains, such as increasing shareholder returns, or concern individual matters related to business execution, such as the sale of policy shareholdings. Differences between Japan and Europe and the U.S. with regard to the separation of ownership and management is the reason for this.

In Europe and the U.S., shareholders cannot make proposals on matters related to business execution, but in Japan, shareholders' rights are relatively strong and the scope of shareholder proposals is broad; even proposals related to matters of business execution, such as disclosure of cost of capital, sale of policy shareholdings, and establishment of third-party investigation committees, which would be impossible in Europe and the U.S., can be put forward by shareholders in the form of proposals to amend a company's articles of incorporation. In addition, the percentage of voting rights that allow a request to be made for an extraordinary shareholders' meeting is 3%, which is considerably lower than it is in Europe and the United States. And further, the lack of legal means for companies to identify beneficial shareholders who are not listed in the shareholder registry and weak enforcement in relation to violations of large shareholding reporting regulations also make it difficult for companies to respond to activist investors and hinder effective dialogue. Japan offers a favorable environment for activist investors, as shareholders have numerous tools at their disposal to sway companies.

To address this situation, it will be necessary to limit excessively strong shareholder rights to the same level as Europe and the U.S., and to urgently improve laws to enable companies to identify their beneficial shareholders. Companies will also need to take measures to convince institutional investors and ordinary shareholders, including disclosing how they use their own cash flow and demonstrating that they are not simply building up retained earnings.

Since the 2000s, Japan has made the transition from an ex-ante preventive approach centered on administrative guidance to an ex-post approach emphasizing corporate accountability, but the fact that such an approach necessitates an assurance of effective compliance with the rules has been cast into the shadows. There have been conspicuous violations of the rules, such as intentional delays in the submission of large shareholding reports. Without the guarantee of effective regulation and its enforcement, the market is free to do as it pleases. It will be important to consider how to ensure compliance with the rules, including strengthening enforcement by the authorities.

Mr. Ota graduated from The University of Tokyo's Faculty of Law in 1991, and registered as a lawyer and joined Nishimura & Sanada (now Nishimura & Asahi (Gaikokuho Kyodo Jigyo)) in 1993. He took an LL.M. (Master of Laws) degree from Harvard Law School in 2000. Mr. Ota has extensive experience in a wide range of areas of corporate law, including hostile takeovers, shareholder activism, and M&A transactions, including cross-border transactions. He was ranked No. 1 overall in the Corporate Law category of the Nikkei's ranking of the "Most Successful Lawyers in 2024."

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