Japanese Corporate Governance: Evolution or Revolution?

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Thank you very much for the kind introduction and thank you very much to FinCity.Tokyo for kindly inviting me to share my thoughts. It is a great honor and pleasure.

Let me answer the question right up front. Since the early 1990s, the corporate governance system in Japan has undergone a near-continuous evolution. Had this evolution been compressed into a few years, it would have been tantamount to a revolution. That much has changed.

Could there be a real revolution in corporate governance in Japan in coming years, one that ushers in a much more active and contestable market for corporate control and sees surging M&A (mergers and acquisitions) and takeover activity? I think that is a distinct possibility.

What *is* this 35-year evolution in Japanese corporate governance that I speak of? What has it evolved from and what is it evolving to?

Let's go back to 1990. The notorious asset price bubble of the 1980s had peaked and was starting to burst. What did Japanese corporate governance look like then?

That is something I wrote about in my 1986 PhD thesis[1] – wow, that's dating me! The system revolved around what I characterized as an "internal capital market," one that facilitated the "lifetime" employment system for white collar workers, including importantly top management itself, and the skilled blue-collar workforce. In order to guarantee employment security, companies needed protection from hostile takeovers – the Western-style market for corporate control had to be internalized within a group of friendly companies. That's where interlocking shareholdings came in: typically 70 to 80 percent of a company's shares would be held by other group or friendly companies with which the company did business. Companies held these shares as "stable shareholders" (安定株主), which protected incumbent management and made hostile takeovers virtually impossible.[2]

The system also needed mechanisms to support companies in financial distress and to restructure them – there was no lifetime employment if a firm

[1] Paul Sheard, 1986: *Corporate Organization and Structural Adjustment in Japan*, a thesis submitted for the degree of Doctor of Philosophy at the Australian National University.

[2] Paul Sheard, 1994: "Interlocking Shareholdings and Corporate Governance," in Masahiko Aoki and Ronald Dore (eds), *The Japanese Firm: Sources of Competitive Strength*, Oxford: Oxford University Press, pp.310-349.

went under. The so-called “main bank” system played a critical role here, as well as other mutual risk-sharing mechanisms among groups of affiliated firms.[3]

This system worked well in the earlier high growth period when Japan was playing technological catch-up and companies were accumulating the associated human capital, but it is ill-suited to the digital era of rapid innovation and creative destruction. As Japan’s population ages and labor becomes tight, generating enough income for a comfortable retirement becomes more important for society than guaranteeing job security.[4]

So, what were these corporate governance changes that started to happen in the 1990s? An important first step as early as 1992 was to start to deregulate the asset management industry.[5] Previously, managing pension funds had been the preserve of trust banks and life insurance companies, financial institutions that had been at the center of the traditional system.

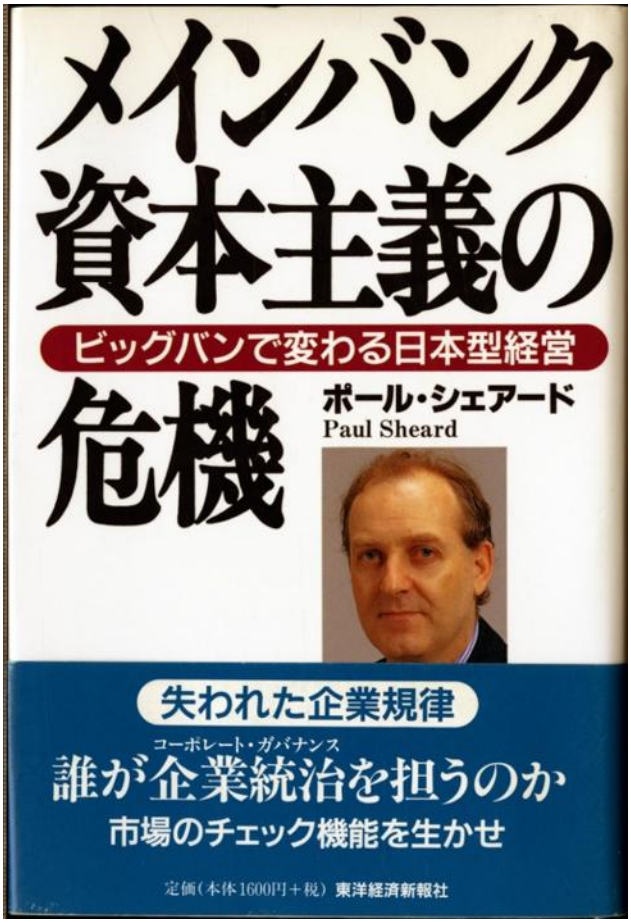
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[3] Paul Sheard, 1994: “Main banks and the governance of financial distress,” in Masahiko Aoki and Hugh Patrick (eds), *The Japanese Main Bank System: Its Relevance for Developing and Transforming Economies*, Oxford: Oxford University Press, pp.188-230.

[4] In a medium-fertility/medium-mortality scenario, Japan’s population is projected to decline by 31 percent in the fifty years to 2070 and the proportion of the population aged 65 and over is projected to rise from 28.6% to 38.7%. See National Institute of Population and Social Security Research, 2023: *Population Projections for Japan (2023 revision): 2021-2070 Summary of Results*. Japan’s total fertility rate in 2024 was 1.15 births per woman, down from a recent peak of 1.45 in 2015. See World Bank, World Development Indicators via Federal Reserve Economic Data.

[5] Hiroshi Naka, Akio Nakamura, Atsushi Yamashita and Scott Siegler, 1993: “Introduction to the Financial System and Securities & Exchange System Reform Act in Japan,” *Pacific Rim Law & Policy Journal,* 2(1), pp.191-220.

But things really got going in 1996, so much so that I was moved to write this book on Japan's financial "Big Bang" and what it meant for corporate Japan. The title in English is *The Crisis of Main Bank Capitalism: How Japanese-style Management Will Change With Big Bang*.[6] Those changes are still playing out today.



The financial Big Bang reform agenda aimed to dismantle the traditional financial system and build a new open and deregulated one. The financial Big Bang, like other Japanese reforms, was really a long-game evolutionary

[6] Paul Sheard, 1997: *Mein Banku Shihon Shugi no Kiki: Biggu Ban de Kawaru Nihongate Keiei,* Tokyo: Toyo Keizai Shinposha.

process. It was the center-piece of six structural reforms announced by the Administration of then Prime Minister Ryutaro Hashimoto; the other five were: a broader deregulation agenda; administrative reforms; social security reforms; fiscal reforms; and education reforms.[7] I have a soft spot for Prime Minister Hashimoto because I served on one of his economic advisory panels.[8]

The Hashimoto reforms laid the groundwork for a comprehensive deregulation and structural reform agenda that continues to this day, and includes ongoing corporate governance reforms and initiatives to make Tokyo a leading global financial center, particularly in the area of asset management. Later, we will hear from Mr. Uchida, the President of the Government Pension Investment Fund (the GPIF). The GPIF itself is a product of these reforms.

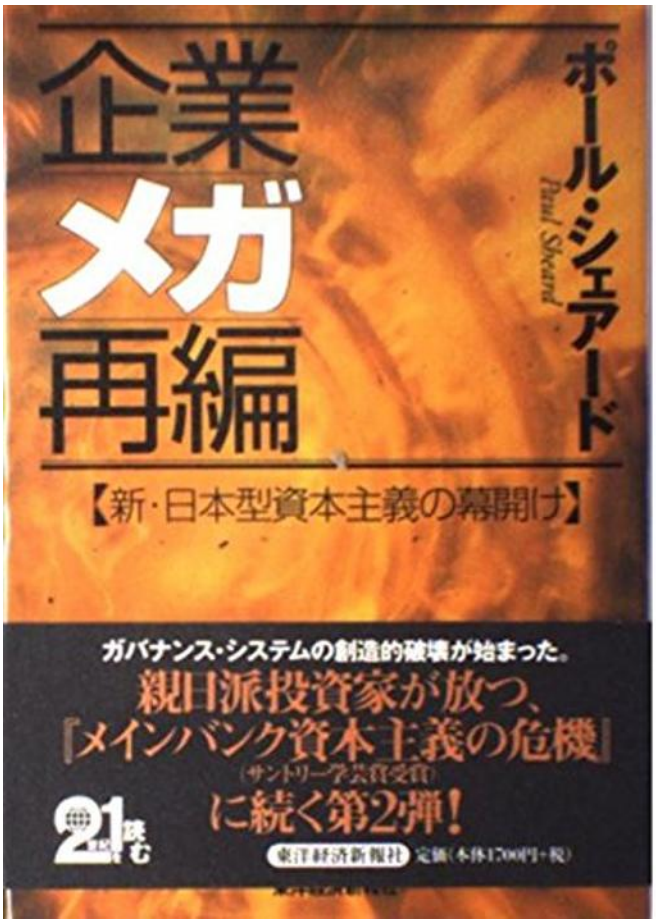
By 2000, so much had happened to transform the institutional underpinnings of corporate governance that I was moved to write another book, this one tilted in English *Corporate Mega Restructuring: The Curtain Opens on a New Japanese Capitalism*.[9] Publishers like eye-catching titles. I may have been a quarter of century early in foreshadowing the ushering in of this new era, but the list of reforms already underway then was compelling.

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[7] *Dai 140kai kokkai ni okeru Hashimoto naikaku sori daijin shisei hoshin enzetsu* (Policy Speech of Prime Minister Ryutaro Hashimoto at the 140th Diet Session), January 20, 1997, Wikisource.

[8] Economic Deliberation Council Committee on the Role of Economic Sectors (Keizai Shutai Yakuwari Bukai), 1997-98.

[9] Paul Sheard, 2000: *Kigyo Mega Saihen: Shin·Nihongata Shihon Shugi no Makuake*, Tokyo: Toyo Keizai Shinposha.



Pure holding companies had been banned in Japan by the occupation forces as part of the postwar reforms. In 1997 they were made legal again. The immediate policy intent was to facilitate the sweeping consolidation of the banking and financial sector that subsequently took place. But this was a landmark change, because it allowed the strategic aspects of management to be separated from the operational ones and encouraged top management to start to think in terms of managing portfolios of business assets and made it easier to restructure business operations and engage in M&A.[10] According

[10] Paul Sheard, 1998: "Keiretsu no kozai to mochikabu geisha donyu no shogeki (The merits and demerits of *keiretsu* and the shock of the introduction of holding companies)," in *Shukan Toyo Keizai Rinji Zokan Kigyo Keiretsu Soran '98*, Tokyo: Toyo Keizai Shinposha, pp.17-23.

to one estimate, about 15 percent of listed companies in Japan are now constituted as holding companies;[11] six of the top ten stocks by market capitalization are.[12]

Another landmark change was to allow share buybacks. Companies buying back their own shares is a very efficient way operationally and tax-wise of returning surplus funds to shareholders. The Commercial Code was amended to also allow companies to hold stock they bought back as treasury stock, rather than having to cancel the shares. This made share buybacks more attractive because companies could easily reissue shares later if they needed to raise capital.

Other important changes were made to the Commercial Code to promote corporate restructuring. These included making it easier for companies to spin off divisions and to do M&A and management buyouts (MBOs). One important change was to allow companies to use their own stock to acquire other companies via stock swaps.

Yet another landmark development was the so-called Accounting “Big Bang” of the late 1990s aimed at improving corporate disclosure. The centerpiece

[11] See Koki Nishimoto, 2023: “Mochikabu gaisha no kinji doko (Recent trends in holding companies),” *Deisukuroja & IR*, Vol.27, Nov. 2023, pp.19-25. There are no official data in Japan on whether a listed company operates as a pure holdings company, as a mixed holding company, or as an operating company.

[12] The six companies are: Mitsubishi UFJ Financial Group, Inc.; Softbank Group Corp.; Kioxia Holdings Corporation; Recruit Holdings Co., Ltd.; Sumitomo Mitsui Financial Group, Inc.; Fast Retailing Co. Inc. See Japan Exchange Group, “Ranking of Stocks by Market Capitalization (Sep. 30, 2026).”

was to change the accounting standard in Japan from a parent company basis to a consolidated accounting one. Large Japanese companies typically have tens if not hundreds of subsidiaries and affiliates. Reporting just the parent company financial results is not very useful for analysts trying to evaluate the company's finances and future prospects. They need to see the financial data for the whole consolidated entity, including subsidiaries and affiliates.

One of the most monumental corporate governance reforms was the introduction of external "independent directors." In 2003, the Commercial Cod was amended to introduce a new "committee system" type of corporate board (委員会等設置会社). Up until then, the board of directors was essentially the executive committee of the company; its job was to run the firm not to represent the interests of shareholders and oversee top management. The board *was* top management. The Commercial Code required that companies have at least three statutory auditors to keep an eye on management, but these auditors were typically insiders and provided at best a weak governance check.

Under the new system, companies could choose to move to a board of directors with three committees – an audit committee, a nomination committee, and a remuneration committee – with each of them needing to have a majority of independent directors. The committee system has been amended further and now virtually all listed firms in Japan have adopted some form of committee system.[13] This has led to an explosion in the number

[13] Spencer Stuart estimates that 20 percent of Nikkei 225 companies have adopted the three-

of independent directors and they are starting to play a leading role in corporate governance. But outside directors cannot be independent in name only – they need to step up.

As well as making changes to the "hardware" of corporate governance, there have been important changes to the "software" too. A key element of Abenomics was the attempt to strengthen corporate governance. The Financial Services Agency (FSA) shepherded into existence a Stewardship Code aimed at ensuring that institutional investors fulfil their fiduciary duties and engage constructively with corporate management to that end.[14]

The FSA worked closely with the Tokyo Stock Exchange (TSE) to develop a Corporate Governance Code, setting out key principles of good corporate governance.[15] The TSE has made the Code a part of its listing requirements on a "comply or explain" basis. The Exchange has also been putting pressure on listed companies to be more responsive to the interests of shareholders

committee boards structure, 32 percent have adopted the supervisory committee board structure, and 48 percent retain the traditional *kansayaku* (statutory auditor) board system. But, it notes that over 90 percent of the companies with *kansayaku* boards or supervisory committees have established voluntary committees, and many are appointing external directors as committee chairs. See Spencer Stuart, 2026: *2025 Japan Spencer Stuart Board Index*, p.6, 8.

[14] Financial Services Agency, *Principles for Responsible Institutional Investors: Japan's Stewardship Code – to promote sustainable growth of companies through investment and dialogue*. June 26, 2025.

[15] Tokyo Stock Exchange, *Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Medium- to Long-Term*, July 21, 2026.

and to improve the efficiency of capital allocation and raise return on equity (ROE).[16]

Meanwhile, the Ministry of Economy, Trade and Industry (METI), together with the Ministry of Justice, has worked to clarify the rules and norms around corporate takeovers and defenses, issuing important guidelines in 2005 and 2023, further clarifying the latter ones in July of this year.[17]

Perhaps the most powerful force for change is the rise of the arms-length shareholder in Japan, as cross-shareholdings have steadily unwound and, spurred by deregulation and pension system reform, the funds management industry has grown in size and sophistication. Given Japan's unique corporate history, it is possible to classify the shareholders of listed companies into two broad types: "relationship shareholders" that have long-term business ties and own shares under cross-shareholding arrangements and "arms-length shareholders" that hold shares purely for financial investment purposes.[18]

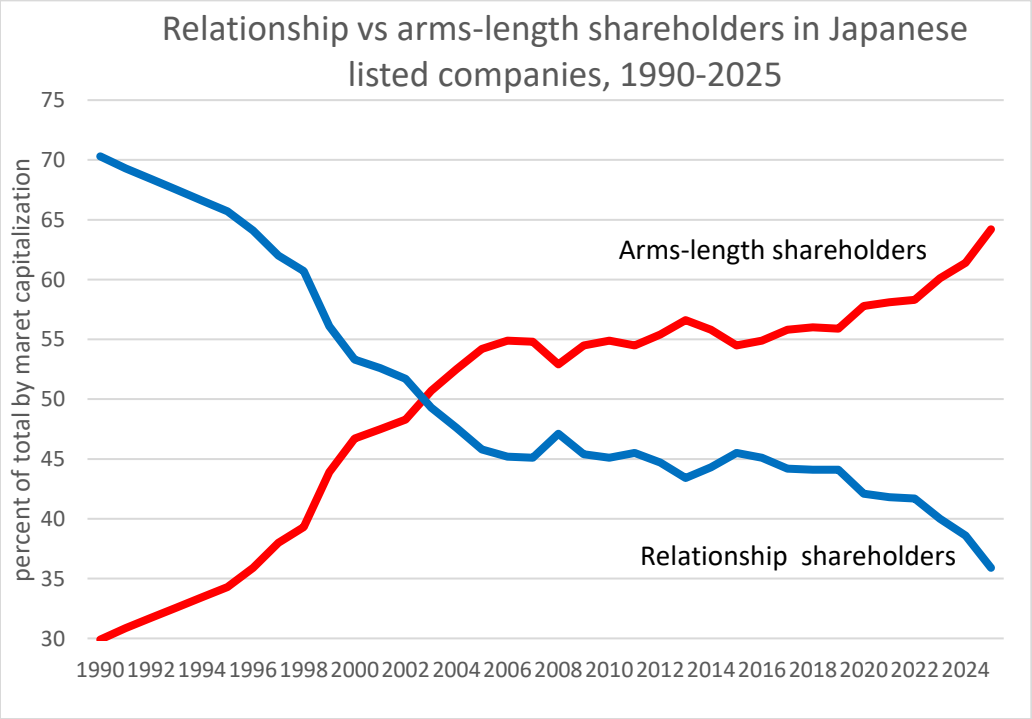
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[16] Tokyo Stock Exchange, *Management that is Conscious of Cost of Capital and Stock Price: Situation in the Fourth Year and Future Approaches*, October 27, 2026.

[17] Ministry of Economy, Trade and Industry and Ministry of Justice, *Guidelines Regarding Corporate Defense for the Purpose of Protection and Enhancement of Corporate Value and Shareholders' Common Interest*, May 27, 2005; Ministry of Economy, Trade and Industry, *Guidelines for Corporate Takeovers: Enhancing Corporate Value and Securing Shareholders' Interests*, August 31, 2023; Ministry of Economy, Trade and Industry, *Key Points of the Guidelines for Corporate Takeovers: Reconfirmation of the Intent for More Appropriate Action*, July 30, 2026.

[18] I approximate the respective total shareholding shares of the two kinds of shareholder as follows (2025 percent holdings in parenthesis). Relationship shareholders (sub-total: 32.1%): City and regional banks (1.7%); Trust banks (9.9%); Securities companies (2.8%); Business corporations (17.7%). Arms-length shareholders (sub-total: 68.0%): Government and local government (0.2%); Investment trusts (11.2%); Annuity trusts (0.6%); Life insurance companies (2.7%); Non-life

The last few decades has seen a complete reversal of the relative importance of relationship and arms-length shareholders. In 1990, relationship shareholders owned at least 70 per cent of listed Japanese shares (by market capitalization); arms-length investors owned at most 30 percent.



Source: Japan Exchange Group, "2025 Shareownership Survey," July 2, 2026.

Note: Data for 1991, 1992, 1993, 1994 interpolated from 1990 and 1995 values.

Fast forward to today, and arms-length shareholders own around two-thirds of listed shares and relationship shareholders own about one-third, hardly enough to muster a blocking coalition. Foreign investors owned just 5 percent of listed Japanese stocks in 1990; now they own 34 percent.

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insurance companies (0.5%); Other financial institutions (0.7%); Foreigners (34.7%); Individuals (17.4%).

Suffice it to say that arms-length shareholders exert a lot more pressure on top management to be attentive to the interests of shareholders than relationship shareholders do The top managements of Japanese listed firms now face much more pressure from shareholders, directly or indirectly, to maximize corporate value and, if they don't, they face much more risk than in the past that they will be the target of a proxy fight or a takeover bid, whether ostensibly friendly or overtly hostile.

This trend of Japanese companies being increasingly owned by arms-length investors is only likely to continue and the pressure on Japanese management to increase shareholder returns is bound to intensify.

M&A activity in Japan has picked up substantially in recent years both within Japan and cross border in both directions.[19] Private equity (PE) in Japan is booming, as founder or family-run companies increasingly face succession challenges and foreign PE firms start to see Japan as the Private Equity paradise that it is. Shareholder activism is on the rise and a new breed of domestic activist shareholder has appeared. It is not just foreign "barbarians at the gate," but domestic ones too.[20]

That there remains abundant scope for corporate restructuring in Japan to release substantial hidden value is indicated by the large number of listed

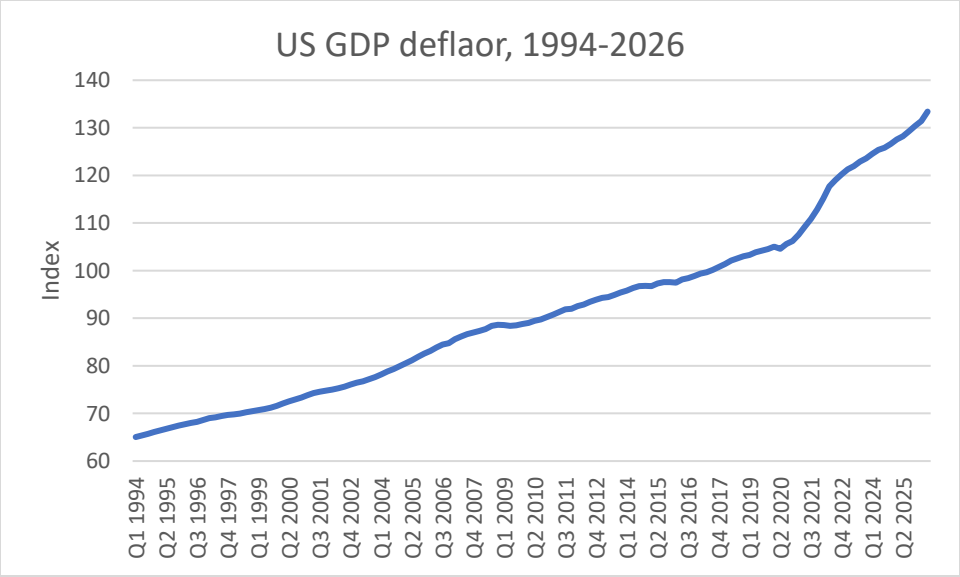
[19] Brian Wheeler, 2025: "Japan's M&A Boom: A Private Equity Powerhouse in 2025," Foley & Lardner LLP.

[20] That colorful phrase is owed to: Bryan Burrough and John Helyar, 1989: *Barbarians at the Gate: The Fall of RJK Nabisco*, New York; Harper & Row.

companies that have a price-to-book ratio (PBR) of less than one.[21] A PBR of less than one suggests either that the assets of the company are not being utilized efficiently or their book value is being overstated. Either way, a management shakeup or a corporate restructuring would seem to called for.

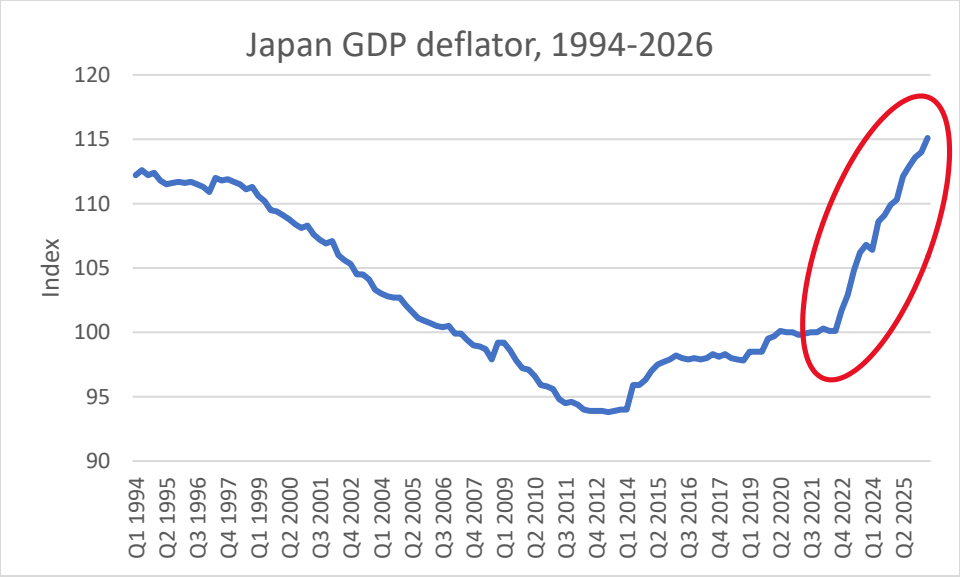
Before I end, I would like to zoom out and look at the big macroeconomic picture in Japan. The normal situation in an economy is for the overall price level to rise gradually and steadily over time. That's what inflation means. Here is a picture of the overall level of prices in the US economy in the last 32 years, using the GDP deflator as the measure. The price level has more than doubled in those three decades or so. This mild continuous inflation is good for nominal GDP, which is real GDP multiplied by the GDP deflator. Loosely, we can think of nominal GDP as being the top line of the economy and the revenue top line for the corporate sector and for the stock market too. Nominal GDP in the US has increased by a whopping four and a half times in this period.

[21] Yoshio Kawatani, "Actions and Results of TSE and Listed Companies to Improve P/B Ratio," Dai-ichi Life Research Institute Report, 2024.3.



Source: U.S. Bureau of Economic Analysis via Federal Reserve Economic Data.

Now, here is a chart of the overall price level in Japan over the same 32-year period. Oops, it went down for nearly 20 years. Those were the so-called “lost decades.” Then, during the period of Abenomics, Japan started to get out of deflation and the price level started to move up, helped arithmetically by the doubling of the consumption tax rate from 5 to 10 percent that took place during this period.



Source: Cabinet Office, SNA (National Accounts of Japan).

But look what has happened in the past four years: the price level has risen sharply. Consumers feel this a rising cost of living, but a rising price level and rising nominal GDP represent a strong tailwind for the corporate sector and for the stock market. Nominal GDP in Japan is up by only 32 percent in the past 32 years, but it is up 18 percent in just the past four years. No wonder the stock market has taken off, more than doubling in the past year and a half.

Corporate Japan is sitting on a pile of cash. This can be seen in the macro numbers. In the latest financial year, Japan ran a current account surplus of about 5 percent of GDP.[22] This represents how much Japan increased its

[22] The numbers cited here and in the next paragraph come from the Bank of Japan's Flow of Funds (and Cabinet Office for the denominator, nominal GDP) and reflect the national accounting identity, equating the excess of domestic savings over domestic investment to the current account surplus. The precise numbers are: 5.1 percent, 1.3 percent, 1.9 percent, and 4.4 percent, respectively. See Bank of Japan, *Flow of Funds for the Second Quarter of 2026 (Preliminary report)*, September 17, 2026, p.11.

financial claims on the rest of the world in that year; its equals the excess of domestic savings over investment. Japan has been running a current account surplus since the early 1980s, which is why it is the biggest net creditor in the world.[23]

Where are these surplus domestic savings coming from? Not the government because it runs a budget deficit – in fiscal year 2025 it was a bit over 1 percent of GDP; this soaks up some of the surplus. The household sector throws off surplus savings – about 2 percent of GDP last fiscal year – but the biggest source is the corporate sector, to the tune of about four and a half percent of GDP last year.

To put it bluntly, companies that sit on piles of cash rather than deploying the cash into investment or M&A activity, paying higher wages to their workers, or returning it to shareholders make themselves prime targets for proxy battles and takeover bids.

Taken together, the myriad incremental changes to the corporate governance environment, toolkit and mindset over the past 35 years in Japan add up to something resembling a revolution. For better or worse, the old cozy system of Japan Inc. has been transformed into one that is starting to resemble the Anglo-American system of shareholder primacy, even as that

[23] See Ministry of Finance, *International Investment Position of Japan (end of 2025)*, May 26, 2026.

system has moved a little in the direction of the stakeholder model of capitalism.[24]

Whether the pressure is coming from shareholders, the stock exchange, the government or an aging society at large, top management in Japan is facing increasing pressure to manage the productive assets of the country more efficiently and effectively, and to take bold action to do so.

Could Japan be on the cusp of an era of mega corporate restructuring, something I foreshadowed a little too early in my 2000 book? All the pieces for that to happen are falling into place. And the macroeconomic conditions are propitious too.

Thank you very much for your kind attention.

[24] Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans': Updated Statement Moves Away from Shareholder Primacy, Includes Commitment to All Stakeholders," August 19, 2019.