



RIETI Policy Discussion Paper Series 25-P-014

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# **Overview of the Evolution of Corporate Governance: The impact of reforms and the future of Japanese firms<sup>\*</sup>**

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## **Abstract**

This paper examines the evolution of corporate governance systems in Japanese firms in the 21st century. It highlights the current state of governance, focusing on external mechanisms such as bank–firm relationships and ownership structures, as well as internal mechanisms including board composition and CEO compensation. It also reviews organizational architecture, with particular attention to the employment system. The analysis considers the role of corporate governance reforms in shaping these systems. We then assess whether these reforms have effectively altered corporate behavior and/or improved firm performance. Finally, we evaluate the extent to which the reforms have contributed to advancements in ESG practices.

**Keywords:** Corporate Governance, Japanese Economy

**JEL classification:** G32, G34

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This paper is an extended version of Chapter 1 of Miyajima and Arikawa (2026), incorporating several additional topics for further analysis. This study is conducted as a part of the Project “Frontiers in Corporate Governance Analysis” undertaken at the Research Institute of Economy, Trade and Industry (RIETI). The draft of this paper was presented at the RIETI DP seminar for the paper. We would like to thank participants of the RIETI DP Seminar for their helpful comments. We also thank Marco Becht, Julian Franks, Gregory Jackson, Katsuyuki Kubo, Colin Mayer, Naoko Nemoto, Konari Uchida, and Kenichi Yoshida for their helpful comments. This study was financially supported by the Ministry of Education, Culture, Sports, Science, and Technology (MEXT) research grant KAKENHI (15H01958).

## 1. Introduction

There is a growing interest in the stakeholder model and the purpose of firms among law academics and economists (Hart and Zingales 2017,2022; Mayer 2018, 2024; Edmans 2020; Bebchuk and Tallarita 2020; Broccardo, Hart, and Zingales 2022). This increase in attention toward the stakeholder-oriented corporate governance (CG) model contrasts with the situation from the 1980s to the 2000s until the global financial crisis hit. During this period, faith in the market and a shareholder-oriented CG model appeared to be uncontested with the development of globalization in trade and financial markets. Hansmann and Kraakman (2001) declared that there are no longer any serious competitors in the shareholder-oriented model. Since the 1990s, the financial globalization and the CG reforms aligned with a shareholder-oriented model have had a significant impact on economies that have traditionally adhered to a stakeholder-oriented approach.<sup>1</sup>

However, concerns over high-powered managerial incentives and pressure from portfolio investors and activist hedge funds, which may encourage excessive risk-taking and managerial short-termism, prompted regulatory interventions in both the US and the UK. For instance, the 2011 Dodd-Frank Act introduced a "say on pay" provision in the US, while the UK implemented stewardship codes to engage institutional investors in promoting environmental considerations and discouraging short-term managerial practices.<sup>2</sup> These facts illustrate that policymakers began incorporating stakeholder perspectives into CG during this period, albeit with some skepticism and reservations.

In contrast to global trends, Japan's CG evolved toward a shareholder-oriented model, even after the global financial crisis. Japanese firms have long embraced stakeholder-oriented CG models by institutionalizing, for example, "lifetime" employment and internal promotion systems for boards of directors. Among many Japanese firms, the CEO or president is more of a "top employee" than a shareholder representative

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<sup>1</sup> In relation to this argument, research in law and finance, starting with La Porta et al. (1997), argues that the protection of minority shareholders is crucial for the development of financial markets.

<sup>2</sup> See Hill (2013), Goto Koh, and Puchniak (2020), Katelouzou and Siems (2021).

(Jackson and Miyajima 2007). The benefits of stakeholder-oriented CG models in Japan have been described in many studies since the work of Aoki (1988). However, the cost has been overwhelming, and since the early 2000s, Japanese CG has gradually shifted toward a shareholder-oriented model. This trend has accelerated drastically since 2013 due to reforms undertaken by the Abe administration, which aimed to resolve long-lasting economic stagnation by strengthening shareholders' power, such as increasing the appointment of external directors, encouraging shareholder involvement, and dissolving cross-shareholding.

Furthermore, the CG reforms under Abenomics incorporated the promotion of sustainable and responsible growth into their agenda. The Corporate Governance Code (CG Code) in 2015 requires firms to consider sustainability in their management practices, while Japan's Stewardship Code (JS Code) in 2014 encourages institutional investors to engage in Environment, Social and Governance (ESG) activities. A distinctive feature of Japan's approach is the proactive role of the Government Pension Investment Fund (GPIF), the world's largest public pension fund, in promoting responsible investments. In this way, the CG reforms in Japan have pursued a dual objective: enhancing capital efficiency while encouraging firms to address environmental and social challenges.

This paper provides the comprehensive overview of the CG arrangement of Japanese firms, updating the work of Aoki, Jackson, and Miyajima (2007).<sup>3</sup> Traditionally, Japanese CG arrangement is characterized by a combination of (1) stable shareholders with reciprocally held cross-shareholdings between firms and banks, (2) monitoring by main banks through a contingent governance mechanism (Aoki and Patrick 1994), and (3) a stakeholder-oriented model in which the interests of employees play a predominant role in corporate governance.

Updating the analysis of the Japan's evolutionary process of CG following the global financial crisis and Abenomics-era reforms reveals that traditional characterizations of

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<sup>3</sup> Notable works following Aoki, Jackson, and Miyajima (2007) include Shaede (2008), Olcott (2009), Aoki (2010), Buchanan, Chai, and Deakin (2012), Lechevalier (2014), Vogel (2018), Whittaker (2024), among others.

Japan's CG system are no longer accurate, especially for leading global firms. The main bank system and cross-shareholding between firms and banks have largely faded as defining institutional features of Japanese firms. Instead, Japanese CG has shifted toward a more shareholder-oriented model, characterized by a growing presence of outside independent directors, and more importantly, the increasing influence of institutional shareholders including activist hedge funds and buyout funds. This paper also highlights how these governance changes have influenced corporate behavior, affecting areas such as ESG investing, financial policies, and corporate performance.

However, in this paper, we emphasize that the evolution of Japanese CG is not a simple convergence with the Anglo-American system. In terms of organizational architecture, long-term employment for core workers remains largely unchanged, and the ranking hierarchy (Aoki 1988) is maintained as an incentive system. Correspondingly, the majority of CEOs are promoted internally rather than recruited externally. In addition, CEO compensation in Japan remains lower and less sensitive to firm performance than in the US and Europe. Furthermore, insider ownership remains substantial, supported by mechanisms such as strategic blockholdings and Japanese Employee Stock Ownership (JESO) plan (Kato, Miyajima, and Owan 2026). These features highlight the refinement of hybrid governance model (Jackson and Miyajima 2007), in which new CG arrangements are layered on top of traditional institutional structures, preserving distinctive elements of the Japanese corporate system while integrating market-oriented practices.

This paper contributes to the long-standing debate on the convergence or persistence of national CG characteristics across countries.<sup>4</sup> The notion of hybridization provides a deeper understanding of the evolution of CG in Japan and its broader relevance to global governance trends. We interpret this hybridization as the result of a shift in the balance of power between outsiders and insiders within firms, with

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<sup>4</sup> See Gordon and Roe (2004) and Streeck and Thelen (2006) for the details of this debate in the early 2000s. With the growing influence of global portfolio investors and activist hedge funds, the focus of the debate in this area has shifted to financialization. See, for example, Gopspel, Pendleton, and Vitols (2014).

shareholders (outsiders) gaining greater influence to counterbalance the power held by top managers (insiders).

The defining elements of the hybrid CG model include the growing role of institutional investors, especially foreign shareholders, who pursue shareholder value maximization more aggressively than domestic shareholders. These investors replace the main banks as monitors of top managers, thereby limiting managerial discretion and reducing their ability to extract private benefits. Since the globalization of financial markets is not unique to Japan and the growing influence of institutional shareholders is a widespread phenomenon, the concept of hybridization may be relevant beyond Japan. This framework may also be applicable to firms in other non-common law jurisdictions or coordinated market economies where traditional governance structures are gradually adapting to market-oriented pressures.

The remainder of this paper is organized as follows. Section 2 reviews institutional reforms and changes from the 1990s to the 2020s. Section 3 provides an overview of the evolution of CG arrangements in Japanese firms, with a particular focus on the impact of CG reforms. Section 4 discusses the impact of these reforms on corporate behavior and performance. Section 5 offers perspectives on the future development of corporate governance in Japan.

## **2. A Short History of Corporate Governance Reforms: 30 Years' Experience**

### **2.1. The First Phase: Responding to the Banking Crisis**

The CG reforms in Japan that aimed at strengthening shareholder rights in 2015 was the second peak of the CG reforms in the so-called “lost decades” of Japan’s economic history. Table 1 summarizes major events related to the CG reforms. Throughout the period from the 1990s to the 2020s, three factors drove the change in the CG in Japan: 1) economic shocks, such as the banking crisis in the late 1990s and the Global Financial Crisis; 2) financial globalization with the increase in institutional and foreign investors; and 3) regulatory changes in CG arrangements.

<Table 1 here>

The banking crisis of the 1990s triggered the first wave of the CG reforms, which peaked between 1997 and 2003.<sup>5</sup> Following the banking crisis, the banks' role in CG declined significantly. Main banks faced their own crisis because of the non-performing loan problem caused by the collapse of the asset price bubble, and they could no longer impose managerial discipline on underperforming firms (Arikawa and Miyajima 2007). The bank-firm relationship, especially for large firms, became much weaker and shifted to a more arms-length structure. Main banks are no longer the only entities responsible for restructuring troubled firms (Arikawa, Miyajima, and Ogawa 2026).

Second, the ownership structures of Japanese firms changed significantly after the banking crisis. Until the mid-1990s, ownership structures remained highly stable, dominated mainly by "stable" shareholders, including other corporations, banks, and insurance firms.<sup>6</sup>

The Japanese government implemented a series of measures to curb bank's equity holdings and mitigate the impact of falling stock prices on bank's balance sheets. In September 2001, the government introduced fair value accounting for equity holdings, requiring banks to reflect the market value of their equity holdings on their balance sheets. This accounting policy change gave banks an incentive to sell their stakes in other firms and reduce their exposure to market fluctuations. An even more decisive measure was the enactment of the Act on Limitation on Shareholding by Banks and Other Financial Institutions, which took effect in January 2002. This law required banks to reduce their shareholdings, which at the time amounted for approximately 15% of the TIER 1 capital (equivalent to 8% of the total assets for major international banks), by September 2004. As a result, the proportion of total outstanding shares held by banks in firms listed in the Tokyo Stock Exchange (TSE) First section declined by 10 percentage points, falling from 15 % in 1995 to just under 5 % in 2005. This reduction in bank shareholdings contributed to a significant decline in insider ownership in Figure1. Insiders are defined as the

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<sup>5</sup> For more about the reform process in this period, see Jackson and Miyajima (2007) and Vogel (2018). For more detail regarding the legal reforms, see Shishido (2007).

<sup>6</sup> See Miyajima and Kuroki (2007) and Franks, Mayer, and Miyajima (2014) for the evolution of Japanese ownership structures through the 2000s.

combined shareholdings of city banks, regional banks, insurance companies, and business corporations, while outsiders include foreign and domestic institutional investors as well as individual shareholders. This sharp decline in bank stock ownership led to a rise in outside ownership, thereby increasing the influence of institutional and foreign investors in Japanese CG.

<Figure 1 here>

Against the backdrop of these changes in bank-firm relationships and ownership structures, a reexamination of Japanese firms' CG began. The first area of focus was the boards of directors of Japanese firms. Compared to US firms, Japanese boards were significantly larger and did not clearly separate management from monitoring function. Another problem was the lack of independence. Since the vast majority of directors were promoted internally and simultaneously held executive roles, the board's oversight function was compromised, making self-auditing unavoidable.

To enhance the effectiveness of the board of directors as a monitoring mechanism, the Commercial Code was amended in 2002, allowing firms to adopt a US-style board structure known as a company with committees (*linkai setchi gaisha*). In a company with committees, the majority of committee members on the nominating, audit, and remuneration committees must be outside directors. However, the impact of these amendments on the Commercial Code was limited. Only 39 of the firms listed on the First Section of the TSE adopted a company with committees' structure immediately after the revision. Moreover, the introduction of outside directors remained slow. By 2006, only 39.8% of firms had appointed at least one outside director, and by 2012, this figure had increased to 55% in 2012, as shown in Figure 2.

<Figure 2 here>

Instead of adopting a US-style board structure, most Japanese firms introduced an executive officer system, which is not explicitly defined under the Companies Act. The introduction of this system provided the following advantages: (1) by reducing the number of the board members, firms were able to enhance decision-making efficiency; (2) the system organizationally distinguishes between executive and supervisory functions giving each equal importance; and (3) the executive officer system maintains



executive position as a key goal in promotion tournaments, thereby strengthening the incentive with long-term and seniority-based employment system. Therefore, the introduction of an executive officer system, while retaining the company-with-auditors structure, became the dominant governance model for Japanese firms during this period.

The CG reforms, including the introduction of independent directors, aligned with the global trend of reforms implemented through either hard law (e.g., company law revisions) or soft law (e.g., CG codes or the amendment of listing rules). The first phase of the CG reforms in Japan can be understood as part of this broader international movement.<sup>7</sup> However, the extent of CG changes in Japan during the 2000s was far less significant than in other countries. This limited progress could reflect the enduring influence of corporate insiders, who may have resisted US-style governance reforms.

## **2.2. The First Wave of Hedge Fund Activism**

In the post-banking crisis period, from 2004 to 2008, institutional shareholders' external discipline and hostile takeover mechanisms began to influence Japanese firms.

First, the exercise of voting rights by institutional investors began to affect the CG of Japanese firms during this period. From the high-growth period after World War II to the end of the 1990s, domestic institutional investors rarely voted against companies' proposals at shareholder meetings. The case of Mitsui Trust Bank (currently the Mitsui Sumitomo Trust Bank) voting against a company's proposal in 1998, was believed to be the first case of institutional investor in Japan voting against a company proposal. In the early 2000s, the Pension Fund Association published its voting guidelines, and the Japan Investment Advisers Association decided on the "self-regulation rules for the exercise of voting rights." Following this, trust banks and investment advisory companies established detailed criteria for voting and started to exercise their voting rights while presenting those criteria to their portfolio companies in advance. In 2001, Institutional Shareholder Services (ISS), a proxy advisor, began to operate in Japan. During this period, traditional

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<sup>7</sup> For discussions on the global CG trend initiated by the UK's integrated code, see Enriques and Volpin (2007), Kim and Lu (2013), and Fauver, et al. (2017).

institutional investors and their parent companies, many of which were affiliated with corporate groups (e.g., Mitsubishi Trust Bank, Tokyo Marine Asset Management), no longer automatically supported proposals from the firms in which they had invested.

Along with the development of the voting rights infrastructure, the ratio of institutional investors exercising their oppositional voting rights increased, and the rejection of companies' proposals became a real threat to Japanese firms in this period.<sup>8</sup> For example, the introduction of anti-takeover measures was contentious in 2005.<sup>9</sup> A proposal to increase authorized capital was rejected at a general shareholder meeting of FANUC, the leading company in the robotics industry, considering that it made it easier to introduce a takeover defense measure. This was the first case where a company's proposal was rejected at a shareholder meeting. During this period, some firms began to withdraw their proposals because of the possibility that their proposals would be rejected.

Second, activist hedge funds have become influential in CG in Japan. Figure 3, Panel A, shows the number of firms in which activist hedge funds hold more than 5% of the shares each year. The number of those cases peaked at nearly 80 cases in 2007. Although owning more than 5% does not always mean that they have become more involved in the firm, there has been an increase in the activity of activist hedge funds that proposed their requests to firms through the media, with more than a dozen cases per year. Murakami Fund's activities between 2001 and 2004 and Livedoor's purchase of Nippon Broadcasting System shares in 2005 drew significant media attention.

<Figure 3 Panel A and Panel B here >

Third, unsolicited Takeover Bids (TOBs) first appeared in the mid-2000s (Figure 3, Panel B). The headline case was Oji Paper's unsuccessful TOB for Hokuetsu Paper in

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<sup>8</sup> In 2004, the percentage of dissenting votes in stocks managed by Pension Fund Association reached 25%. Among asset management firms, the percentage of dissenting votes reached 10% in 2004 and 15% in 2005.

<sup>9</sup> Figure 3, Panel A shows the number of anti-takeover measures adopted by Japanese firms. For a detailed discussion of these measures and their impact on stock prices during the 2000s, see Arikawa and Mitsusada (2011). Sai, Tsukioka, and Yamada (2024) empirically demonstrate that, in the 2010s, Japanese firms with asset managers who endorsed the JS Code were less likely to adopt anti-takeover provisions.

2006. Despite the seemingly rational proposal by Oji Paper in the context of a shrinking domestic paper market, the proposal faced strong opposition from all stakeholders of Hokuetsu Paper, including its incumbent management, employees, unions, suppliers, and other industry peers, while no support from outside shareholders was expected.

There are two key points regarding the role of the first boom in hedge fund activism. First, the stock market reacted positively to the filings by “hostile” activist investors who acquired stakes of more than 5% in target firms. This positive abnormal return was mainly driven by expectations of the changes in financial policies such as increased dividend and stock repurchase (Hamao and Matos 2018). Second, hedge fund activism in this period yielded limited structural outcomes. Few cases led to successful board reforms or organizational restructuring.<sup>10</sup> According to Becht et al. (2021), only about 30% of the proposals were accepted and led to changes in corporate activities. Compared to international benchmarks, this success rate was relatively low, suggesting that a key barrier to hedge fund activism in Japan during the 2000s was the reluctance of institutional investors to support activist campaigns. At this stage, the traditional institutional investors were not so actively engaging with firms, resulting in minimal collective action between activist funds and traditional institutional investors. This lack of collaboration limited the effectiveness of shareholder activism in Japan.

### **2.3. The Impact of Global Financial Crisis: A Short-lived Reverse Course.**

The trajectory of CG in Japan was temporarily redirected in response to the global financial crisis. Following the formation of the Democratic Party of Japan (DPJ) administration in 2009, policymakers who placed greater emphasis on addressing income inequality were reluctant to impose a stronger US-type CG framework. Although never realized, some DPJ members proposed a reform plan to introduce labor representatives to corporate boards.

In 2011 the Olympus scandal broke, revealing an attempt to hide massive losses through fraudulent accounting. The scandal was particularly significant because

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<sup>10</sup> See Kubo (2014), Becht et al. (2017), Miyachi and Takeda (2021).

Olympus was considered a leader in CG in Japan. As a result, the case raised serious concerns about the effectiveness of outside directors in overseeing management (Aoki 2026; Shibano 2026). As expectations of the US-style governance model diminished, the focus of CG shifted to strengthening measures to prevent corporate misconduct.

After the global financial crisis, interventions by activist hedge funds declined significantly from 2007 onward. The number of firms with more than 5% of their outstanding shares held by activist hedge funds fell from 76 in 2007 to just two in 2010 and remained at this low level until 2012 (Figure 3, Panel A). This decline coincided with the rapid adoption of anti-takeover measures in 2008, and the number of firms adopting anti-takeover measures quickly reached 569 (Figure 3, Panel A).

Behind this “reverse course,” however, was the return of foreign institutional investors to the Japanese stock market by 2010. As shown in Figure 1, the ratio of foreign ownership, which had fallen to 23.5% by the end of the fiscal year 2008, rebounded to 26% by the end of the fiscal year 2009. With increasing pressure from institutional investors, who were consistently opposed to anti-takeover measures, the number of Japanese firms adopting such measures gradually declined.

During this period, gradual progress was made in the disclosure of information in Japan’s capital markets. In March 2010, several major disclosure requirements were introduced, including mandatory disclosure of voting results at general shareholder meetings, executive compensation of JPY 100 million or more, and details of relational shareholding (*seisaku-hoyu-kabu*) policies. These measures were an important step toward greater transparency in the CG of Japanese firms.

#### **2.4. The Second Phase: Corporate Governance Reforms under Abenomics**

The CG reforms aimed at strengthening shareholder rights gained renewed momentum following the formation of the Abe administration of the Liberal Democratic Party (LDP) in late 2012. For the new administration, the CG reforms were considered a core

component of its growth strategy, which, alongside active fiscal policy and a bold monetary policy, formed one of the three pillars of Abenomics.<sup>11</sup>

In the Japan Revitalization Strategy (“Japan is Back”) of June 2013, the Abe administration announced that it would strengthen the fiducial duties of institutional investors by introducing the JS Code, which was implemented in February 2014. The CG Code was implemented in June 2015 to promote independent outsider directors. These codes were revised every three years, and many guidelines for supplementing codes were continuously introduced (see Table 1).

The CG reforms under Abenomics can be summarized as follows. First, they aimed to rebalance the influence of various corporate stakeholders by strengthening shareholder rights, addressing the concerns that CG in Japan was biased toward insiders, particularly management and employees. The use of the CG reforms as a tool for promoting economic growth was not necessarily unique to Japan but was in line with a broader global trend (Kay 2012; OECD 2012).

However, the challenges in Japan differed significantly from those in the US and UK. In these countries, CG concerns centered around myopic management and excessive risk-taking driven by the high-powered compensation system tied to stock prices and intense shareholders’ pressure. In Japan, by contrast, the primary issue was excessively conservative managerial behavior, stemming from a lack of appropriate shareholder monitoring. Therefore, one of the goals of the governance reforms in Japan was to improve corporate performance, which is regarded as extremely lower than the global counterparts (see Arikawa, Inoue, and Saito 2026). The direction of the reforms, which emphasized greater shareholder primacy to enhance firm competitiveness, mirrored the 1992 Cadbury Report, which helped initiated the global wave of CG reforms in the early 2000s. In this respect, Japan’s CG reforms lagged behind the global trend, only gaining momentum in the mid-2010s under Abenomics.

A key premise of Abenomics was that the fundamental problem facing Japanese firms was a lack of effective CG, resulting in managerial conservatism and a preference

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<sup>11</sup> For the CG reforms under Abenomics, see also Miyajima and Saito (2021).

for risk-averse firm behaviors. In general, CG problems typically stem from either excessive managerial risk-taking, which can lead to overinvestment or excessive conservatism, which leads to underinvestment (Bertrand and Mullainathan 2003). During this period, the primary focus of the CG reforms in Japan was to address the overly conservative behavior of Japanese firms, thereby encouraging more proactive corporate strategies.<sup>12</sup>

Second, the CG reforms under Abenomics not only strengthened shareholder rights but also incorporated ESG factors in management decision-making, in line with a growing global trend. In other words, the CG reforms under Abenomics aimed at layering dual objectives: enhancing capital efficiency while encouraging firms to address environmental and social issues.

In 2014, the JS Code required investors to consider ESG factors in their investment decisions. The following year, the CG Code required that firms consider ESG factors in decision-making and disclose relevant information through appropriate formats, such as integrated reports. Further revisions to the CG Code in 2018 strengthened these requirements, encouraging firms to disclose ESG-related information as a valuable component of corporate transparency.

A pivotal moment in Japan's ESG agenda came when Prime Minister Abe announced at the United Nations summit in September 2015 that the GPIF signed the United Nations Principles for Responsible Investment (PRI). This commitment meant that the GPIF would formally integrate ESG consideration into its investment's strategy, strengthening ESG principles in Japan's financial markets.

## **2.5. Post-Abenomics and “the New form of Capitalism”**

In September 2020, Prime Minister Abe resigned for health reasons, leading to the formation of the short-lived Suga administration. This was followed by the formation of the Kishida administration in October 2021, introducing the concept of “a new form of capitalism.” This new policy framework emphasized a departure from the neo-liberal

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<sup>12</sup> See Ikeda, Inoue, and Watanabe (2018).

policies that had been in place since the Koizumi administration. Instead, it aimed to create a virtuous cycle between economic growth and wealth distribution. While proposals such as capital gains tax and regulations on stock repurchases were initially considered, they were not ultimately implemented. Regarding the CG reforms, the Kishida administration largely continued the policy trajectory established under Abenomics, maintaining its core principles and direction (Table 1).

Four notable developments have occurred during this period. First, the TSE highlighted that, as of July 2022, 43% of TOPIX 500 firms had a price-to-book ratio (PBR) below 1, compared to only 5% in the US and 24% in the EU.<sup>13</sup> In March 2023, the TSE required these firms to disclose improvement plans in their CG reports. These plans must take into account the cost of capital and share price performance, reflecting greater emphasis on increasing shareholder value.<sup>14</sup>

Second, in April 2022, the TSE restructured its market segments, replacing the First Section, Second Section, Mothers, and JASDAQ with three new segments: Prime, Standard, and Growth.<sup>15</sup> This new market segmentation provides clearer distinctions among markets, making it easier for investors to align their investment strategies with the appropriate market segment. The restructured framework aimed to promote sustainable growth by establishing listing and maintenance criteria tailored to each market segment. The specific requirements for listing include thresholds for the number of tradable shares, market capitalization, profit levels, and net sales. Additionally, following the 2022 reorganization, shares held by domestic commercial banks, insurance companies, and business corporations were excluded from the definition of tradable shares, even if they were held solely for investment purposes. This stricter definition enhances market liquidity and strengthens investor protection.

Third, in 2023, the Ministry of Economy, Trade and Industry (METI) released the Guidelines on Takeovers, introducing the term “unsolicited takeovers” in place of “hostile

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<sup>13</sup> “The TSE to Boost Low PBR Firms,” *Nihon Keizai Shimbun*, January 27, 2023 (in Japanese).

<sup>14</sup> For the details, see the TSE, Action to Implement Management that is Conscious of Cost of Capital and Stock Price, at: <https://www.jpx.co.jp/english/news/1020/dreu250000004n19-att/dreu250000004n8s.pdf>

<sup>15</sup> For the details, see the TSE, Market Restructuring, at: <https://www.jpx.co.jp/english/equities/improvements/market-structure/01.html>

takeovers.” The new guidelines set out two key principles: 1) Boards must provide sincere consideration to a “bona fide offer,” meaning they cannot simply reject an unsolicited offer outright, and 2) Negotiations should aim to secure the best possible transactional terms for shareholders. This new guideline represents a significant policy shift in the government’s stance on unsolicited takeovers, from a suppressive approach in the mid-2000s, as exemplified by the Guideline on Takeover Defense (2005),<sup>16</sup> to a more neutral position in the mid-2010s, and finally to a supportive and proactive position. Amid delays in corporate restructuring and a rise in unsolicited takeover cases, the government’s new approach signals a clear commitment to facilitating a more dynamic and market-driven corporate control environment.

Finally, building on the policy established by Abenomics, ESG activities continue to be actively promoted, with significant emphasis on the disclosure of ESG-related information. The 2021 revisions to the CG Code required firms to clearly articulate their approaches to sustainability and disclose their initiatives to stakeholders. Additionally, firms listed on the Prime Market were also expected to enhance their climate-related disclosures in line with the Task Force on Climate-related Financial Disclosures (TCFD) or an equivalent international framework. This includes assessing and disclosing the impact of climate change-related risks and opportunities on business activities and profitability. Beginning in 2023, Japanese firms are required to include sustainability information in their annual securities reports (*Yuka-Shoken Hokokusho*), further reinforcing the importance of ESG transparency in corporate governance.

### **3. Corporate Governance Arrangement after the Reforms**

#### **3.1. Diversified Corporate Governance Arrangement**

As discussed in the previous section, Japan’s CG landscape experienced a significant transformation following the 1997 banking crisis.

Jackson and Miyajima (2007) argue that the crisis and subsequent CG reforms led to a diversification of governance structures among Japanese firms, resulting in the

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<sup>16</sup> [https://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/shishin\\_hontai.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf)



emergence of three distinct groups: traditional Japanese firms (J-firms), hybrid firms, and an intermediate category.

This classification is based on three key dimensions. The first is external governance, which is either market-based, driven by institutional investors, or relationship-based, maintained through main bank relationship. The second is internal governance, reflected in board structures, which range from market-oriented boards with a higher proportion of outside directors to relationship-oriented insider boards. The third is organizational architecture, which includes employment systems that range from market-based, US-style systems to relationship-based systems characterized by long-term (lifetime) employment and seniority-based pay systems known as ranking hierarchy.

Traditional J-firms are characterized by their reliance on relationship-based external and internal governance as well as relationship-based employment systems. In contrast, hybrid firms adopt market-based external governance and partially market-based internal governance, while retaining relationship-based employment systems.<sup>17</sup> Jackson and Miyajima (2007) find that the hybrid governance model became increasingly prevalent in the 2000s, especially among large firms. However, they also note that most Japanese firms continued to rely on relationship-based external and internal governance, as well as relationship-based organizational structures, thereby retaining their classification as traditional J-firms.<sup>18</sup>

Building on this framework, this section provides an overview of the evolution of CG arrangements in Japanese firms, with a particular focus on the impact of the CG reforms.

## **3.2. External Governance**

### **3.2.1. Bank-firm Relationship**

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<sup>17</sup> There is another type of hybrid firm that combines relationship-based external governance with market-based internal governance and organizational architecture. These are relatively new and entrepreneurial firms, which we call the adversarial type of hybrid, represented by Softbank, Fast Retailing, and Rakuten.

<sup>18</sup> They comprise “managerial companies” with high cross-shareholdings; “family companies” controlled by the founding family; and “listed subsidiaries” where a parent corporation is the controlling shareholder. They are relatively small in terms of market capitalization and old in terms of firm age. In detail, see Jackson and Miyajima (2007).

Among leading firms, main bank relationships ceased to play any significant role in corporate finance and governance, particularly following the creation of megabanks.<sup>19</sup> The sharp decline in corporate leverage ratios reduced firms' reliance on external financing and, consequently, diminished the necessity of close main bank relationships (see Arikawa, Miyajima, and Ogawa 2026).

Since the early 2000s, a clear divergence has emerged between firm performance and its relationship with the main banks. Firms with lower main bank ownership demonstrated significantly higher market capitalization. In addition, these firms consistently outperformed their counterparts with higher bank ownership, achieving higher returns on assets (ROA) and Tobin's q.

A significant shift in corporate restructuring practices emerged, marked by a decline in the dominance of the main bank leadership. Instead of relying on private workouts led by main banks, alternative methods have become increasingly important. The introduction of the Civil Rehabilitation Law in 2000 expanded legal resolution options available for corporate rehabilitation (Xu 2007). Additionally, innovative new frameworks for private workouts, such as Alternative Dispute Resolution (ADR) facilitated by independent third parties, have been introduced since the Japanese banking crisis of the 2000s and the global financial crisis (Saruyama and Xu 2026).

With the rise in mergers and acquisitions (M&A) in Japan, non-financial firms have increasingly assumed a central role in restructuring efforts (Saito, Kawanishi, and Kawamoto 2026; Kubo 2026). Distressed firms often place their shares with strategic investors, facilitating acquisitions or significant ownership transfers. A significant shift in the mid-2010s saw large conglomerates, such as Hitachi and Toshiba, divesting their listed subsidiaries to private equity firms as part of their comprehensive restructuring strategies. A prominent example is Hitachi's divestment of its subsidiaries to Kohlberg Kravis Roberts & Co. (KKR), a prominent US private equity firm, in transactions that took place in 2017 and 2023. These developments highlight the transition from traditional

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<sup>19</sup> By 2006, three megabanks were formed through the mergers of more than ten major banks. For a detailed discussion of bank-firm relationships in Japan following the creation of these megabanks, see Arikawa, Miyajima, and Ogawa (2026).

bank-led corporate restructuring to alternative approaches, such as acquisitions by other corporations or private equity funds.

### **3.2.2. Ownership and Control**

The CG reforms under Abenomics had a significant impact on ownership structure. The insider-outsider framework in Figure 1 suggests relative stability in ownership structure during the 2010s. However, there were significant shifts within both the insider and outsider categories during this period.

#### **Increased Participation of Foreign Institutional Investors**

One of the most notable shifts was the increased participation of foreign institutional investors in mid-cap firms. In the early 2000s, foreign institutional investors exhibited a strong home bias, resulting in a substantial gap in ownership between large-cap and small- to mid-cap firms. While foreign ownership of large firms subsequently stabilized at a high-level (Miyajima and Ogawa 2026), the CG reforms helped reduce informational asymmetries between investors and mid-cap firms. Consequently, the share of foreign institutional investors in the mid-cap firms rose from 11.6% in 2011 to 20.0% in 2018.

This shift meant that mid-cap firms, which had traditionally been insulated from capital markets discipline, began to face external scrutiny and pressure through shareholder activism. However, this disciplinary effect was not universal. Only firms with clear growth opportunities or distinctive competitive advantages were able to attract foreign investor interest. Others remained largely unaffected and continued to operate in a "disciplinary vacuum".

#### **The Emergence of the Market for Corporate Control**

The CG reforms also facilitated the resurgence of activist hedge funds and were accompanied by increasing diversification in their strategic approaches. With the introduction of the JS Code, which strongly encouraged active shareholder engagement, activist hedge funds regained momentum. Since 2014, the number of cases in which these funds acquired stakes exceeding 5% has steadily increased, with notable

acceleration in the 2020s (Figure 3, Panel A). This second wave of activism differs from the first in several key respects.

First, activist strategies diversified. Many funds adopted quieter, collaborative approaches, favoring private engagement over public confrontation. These funds tended to work closely with target firms and sought to influence management from within.<sup>20</sup>

Second, unlike the first wave, which focused primarily on small- and mid-cap firms, the second wave increasingly targeted large-cap firms. For example, Sony was targeted by Third Point in both 2013 and 2019, and SoftBank Group faced pressure from Elliott in 2020 (Miyajima and Ogawa 2026). This shift may have been reinforced by the 2017 revision of JS Code, which required that signatory investors disclose their proxy voting on an individual agenda basis. Given that traditional institutional investors held over 50% of the total issued shares in many large firms, hedge funds, even with small stakes, could influence outcomes when their proposals aligned with institutional investors' governance principles. A case in point was Sony's reconsideration of its business portfolio, including a potential spin-off of its semiconductor division, following Third Point's campaign. Although Sony ultimately rejected the proposal, the case illustrates the catalytic role activist hedge funds can play in prompting corporate restructuring.

Third, alongside the rise in shareholder activism, hostile takeovers gradually became more common in the late 2010s. The number of unsolicited TOBs has increased since 2019, reaching eight in 2021 (Figure 3, Panel B). The first notable success was Itochu Corporation's acquisition of Descent Co. in 2018, followed by NIDEC's takeover of Takisawa in the machine tools sector. By the early 2020s, unsolicited takeovers had become an established feature of Japan's corporate landscape, as illustrated by high-profile cases such as the Canadian retailer Couche-Tard's unsolicited bid for the retail giant Seven & i in 2024.

### **The Rise of the Index Funds as Universal Owners**

In the 2010s, we also find the gradual shift from active to index (passive) funds among

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<sup>20</sup> Furthermore, engagement agencies such as the Japan Engagement Consortium (JEC) and the Japan Shareholder Services (JSS) were newly established (Becht et al. 2021).

domestic institutional investors. Sushko and Turner (2018) estimate that the passive funds' share of investment funds asset increased from 31% in 2007 to more than 60% in 2017. This trend was supported by the increasing allocation of GPIF to passive funds from 2014. In addition, increasing purchases by the Bank of Japan on Exchange Trade Fund (ETFs) have contributed to it. In March 2020, the percentage of shares held by the GPIF and Bank of Japan in the market capitalization of the TSE was 6.7% and 5.8% respectively.

In general, passive funds have less incentive to address idiosyncratic risks such as addressing firm-specific management and governance issues (Gilson and Gordon 2013). However, they also have a strong incentive to reduce the systemic risks that affect the broader market and society. In the context of ownership structures that support long-term commitment to addressing global challenges, the GPIF, as a universal asset owner, has played an active role in promoting responsible investments and ESG initiatives (Jackson and Bartosch 2026; Nemoto 2026).

### **Divestment of the Relational Shareholding**

The CG reforms had a significant impact on insider ownership. Especially, by requiring firms to disclose information on relational shareholdings (*seisaku-hoyu-kabu*), these reforms sought to reduce such holdings.<sup>21</sup> Note that relational shareholdings include both cross-shareholdings and intercorporate blockholdings, though they serve different purposes. The former are reciprocal holdings of shares in companies where individual holdings are small but cumulatively amounted to large concentrations, often motivated by a defense against takeovers or other changes in corporate control. In contrast, intercorporate blockholdings involve significant single block of shares of one company in another and are held primarily for strategic reasons (alliances and joint ventures). Therefore, cross-shareholdings may be reasonably regarded as value-destroying from the perspective of outside shareholders, a concern that is less evident in the case of strategic intercorporate holdings (Franks et al. 2023).

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<sup>21</sup> The government's efforts to reshape corporate ownership through regulatory measures such as the CG Code and other soft laws are considered unique in the international context.

A significant increase in the divestment of relational shareholdings was observed, following the implementation of the CG Code. The average number of securities held by listed firms decreased from 53.0 in 2010 to 34.7 in 2019 (Miyajima and Saito 2025). Moreover, the probability of divesting relational shareholdings increased from 3.9% in 2011 to 9.4% in 2019. This trend was particularly pronounced in the case of cross-shareholdings, suggesting that the reforms played a critical role in accelerating the unwinding of cross-shareholdings arrangements.

The probability of the divestment of relational shareholdings was also positively correlated with the presence of independent directors, suggesting that they played a significant role in promoting the unwinding of cross-shareholdings. Firms were more likely to divest when they had weaker transactional relationships with the other firm and held relatively smaller stakes. While the CG reforms contributed to the reduction of smaller cross-shareholdings, committed corporate shareholdings remained relatively stable.

This trend accelerated in the 2020s, driven by the TSE's tightening of listing and maintenance rules, including the stricter criteria for the number of tradable shares as part of its market restructuring efforts. Interestingly, blockholdings also became a focus in the reassessment of relational shareholdings. A symbolic turning point occurred in 2023 when the Toyota Group, widely regarded as a central pillar of Japanese corporate groups, announced its intention to reassess its relational shareholding practices. Following this decision, Toyota, along with its core group companies such as Denso and Aichi Body, began to divest their relational shareholding, signaling a broader shift in corporate ownership strategies.<sup>22</sup>

### **Managing Ownership by Management**

An often-overlooked link between the CG reforms and ownership structure is the role of stock repurchases. Unlike in the Anglo-American markets, where stock repurchases are driven primarily by motives such as reducing free cash flows or signaling the value of the

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<sup>22</sup> Keohane, D., Lewis, L., and K. Inagaki, "Toyota's \$2bn Denso Share Sale Spurs Hopes of Governance Revolution for Japan," *Financial Times*, December 5, 2023.

firm, repurchases in Japan are also influenced by control-related concerns. According to Franks et al. (2023), repurchases in Japan are not limited to open-market transactions. Nearly half of these repurchases are conducted as quasi-private block transactions involving relational shareholders such as parent companies, banks, and founding families, executed through the Tokyo Stock Exchange Trading Network System (ToSTNeT).<sup>23</sup> This prevented them from being otherwise sold and dissipated in the market. Thus, block repurchases are more likely to be motivated by controlling reasons when insiders want to cash out their relational shareholdings. In contrast, open market transactions are more likely to be motivated by financial objectives such as returning capital to shareholders or managing excess cash flows.

This practice contrasts with the US, where repurchased stocks are typically canceled or used for secondary market sales and M&A payments. In Japan, the repurchased stock cancellations are less common, accounting for 38% of total repurchases. The majority of repurchased shares are used for private placement and group M&A transactions. Unlike conventional treasury stock sales to existing shareholders, which are often used to revive cross-shareholding, private placements in Japan are predominantly used for value-preserving or value-enhancing activities such as joint ventures and strategic alliances. These placements are particularly common among new strategic corporate investors (Franks et al. 2023).<sup>24</sup> This is the main reason why, despite the decline in cross-shareholding, corporate shareholding levels in Japan have remained relatively stable since the mid-2010s.

### **3.3. Internal Governance**

#### **3.3.1. Board Reforms**

The CG reforms had a discontinuous impact on the board structures of Japanese

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<sup>23</sup> The price is set at the previous day's closing price. Unlike open market transactions, where the buyer initiates the trade, sellers typically notify the buyer in advance (see Franks et al. 2023).

<sup>24</sup> Franks et al. (2023) report that the market response to the revival of cross shareholding is zero, or often negative, while that of strategic alliance is significantly positive (2.85%, five days windows)

firms, especially traditional Japanese firms.<sup>25</sup> The CG Code in 2015 required the appointment of at least two independent outside directors (hereafter, independent directors), and there was a huge jump in the number of firms that appointed at least one independent director from 61 % in 2012 to 98% in 2015, as is shown in Figure 2. The percentage of firms with boards composed of more than one-third independent directors increased from 11.2 % points in 2012 to 96.1 % in 2022. Having at least one-third of independent directors has become the standard practice for Japanese firms. This was a significant development, as it marked the first time that minority shareholder interests were meaningfully reflected in board decisions. Prior to the CG reforms, independent directors were rarely appointed in traditional Japanese firms. For example, if we divide firms listed on the TSE into leading firms, which are more closely associated with the hybrid governance model, and mid-cap firms, which consist mainly of traditional Japanese firms, a clear disparity emerges. In 2010, the average ratio of independent directors (independent directors /total number of directors) in mid-cap firms was 9.2%, while only 6.8% of these firms had more than three independent directors (Table 2). However, the CG Code encouraged these firms to appoint more independent directors, leading to a significant increase in their average ratio to 34.3% and raising the proportion of firms with more than three independent directors to 59.8%.<sup>26</sup>

<Table 2 about here>

The CG reforms have significantly affected leading global firms. A notable example is Toyota, which appointed three independent directors for the first time just before the introduction of the CG Code, while retaining its traditional board structure as a company with board of company auditor (*kansa yakukai setchi gaisha*). In addition, following the introduction of the CG Code and the revision of the Companies Act in June 2015, Mitsubishi Heavy Industries adopted the new board structure as a company with an audit and supervisory committee (*kansa to iinkai setchi gaisha*). This change resulted in an

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<sup>25</sup> For a discussion of the evolution of the board structures in Japan, see Nguyen, Kubo, and Thai (2026) and Tanaka (2026).

<sup>26</sup> In parallel, the board composition was gradually diversified by the introduction of female and foreign outsider directors (Nguyen, Kubo, and Thai 2026).



increase in the proportion of independent directors to more than one-third through the appointment of independent directors, including non-Japanese directors, a reduction in the number of internal directors, and the voluntary establishment of nomination and compensation committees.

These cases suggest, first, that the number of independent directors increased rapidly after the introduction of the CG Code and its subsequent revisions, making boards with a majority of independent directors increasingly common. Second, by delegating substantial decision-making authority from the board of directors to the executive officers to improve the efficiency of decision-making, corporate insiders were able to retain their discretion while integrating independent directors into the governance framework.

During the first phase of CG reform in the 2000s, the introduction of independent directors was primarily adopted by large-cap, leading firms. However, following the introduction of the CG Code and its subsequent revisions, the practice gradually spread to listed firms beyond large firms. As a result, the gap between leading firms and other listed firms has narrowed, leading to a convergence in board structures (Table 2). Thus, insider-dominated boards are no longer a defining characteristic of Japanese firms.

However, it is important to recognize that the CG reforms have not necessarily led to a convergence toward the US-type monitoring board model. Only 8.0% of leading firms in 2022 adopted the typical US-type board structure known as a company with nominating committee, etc. (*shimei iinkai to setchi gaisha*). Moreover, it is noteworthy that in 94 % of firms listed on the TSE Prime Market, the chairman of the board of directors also serves as the CEO. While the board structure underwent significant changes, key decision-making authority remained delegated to the management team. As a result, corporate insiders retained control over critical governance issues such as CEO appointments and the board meeting agendas.

### **3.3.2 CEO Compensation: Modest Use of High-Powered Incentives**

One of the most significant impacts of CG reforms on internal governance has been the transformation of the CEO compensation system. It is well-known that the level of CEO

compensation in Japanese firms was exceptionally low compared to that in other advanced countries. Moreover, high-powered incentives such as stock-based compensation were rarely used, resulting in low pay-performance elasticity with CEO compensation system. Although stock options were introduced in 1997, their impact remained limited. Consequently, the disparity in CEO compensation between Japan and other advanced countries grew during the 2000s (Kubo and Saito 2008).

However, the 2015 CG Code marked a shift by requiring firms to establish remuneration policies that define the level and composition of CEO compensation, including fixed and performance-based components. The 2018 revision further encouraged firms to form voluntary remuneration committees with a majority of independent directors. The 2021 revision required firms to disclose cash- and stock-based compensation separately, which was a significant trigger for the adoption or expansion of stock-based compensation scheme.

Figure 4 shows the progressive increase in CEO compensation following the introduction of the CG Code in 2015 and its subsequent revisions in 2018 and 2021.<sup>27</sup> The average compensation for the top 10% of sample firms (ranked by firm value, measured as market capitalization plus debt) increased from 60 million JPY before the reforms to 160 million JPY in 2022. Additionally, the proportion of performance-based compensation within total CEO pay among these top 10% of sample firms increased from 10% in 2011 to 45% in 2022, facilitated by regulatory changes, particularly the 2016 deregulation, that made restricted stock available.

Two points should be noted. First, as Figure 4 shows, the increase in CEO compensation is only observed among leading firms with firm values greater than the 66th Percentile, while the CEO compensation remains largely unchanged for firms with firm values less than the 66th Percentile

<Figure 4 here>

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<sup>27</sup> This analysis is based on research conducted jointly by Waseda University and Deloitte Tohmatsu. Using data from the Executive Compensation Survey conducted by Deloitte Tohmatsu Consulting and Sumitomo Mitsui Trust Bank, this study examines historical trends in executive compensation in Japan. As CEO compensation disclosure is not mandatory except for cases exceeding 100 million yen, a threshold introduced in 2010, this dataset provides valuable insights into long-term compensation trends.

Second, even among leading firms, the change in CEO compensation is very modest compared to their US and European counterparts. From an international perspective, the median CEO compensation in Japan in 2023 of 160 million JPY is still far below that of the US in S&P 500 firms (1.48 billion JPY) and that of Germany (630 million JPY). Therefore, the pay ratio (CEO compensation / average employee wage), even among the largest group in Japan, is estimated at 10-15 times, which is still significantly lower than the US ratio of 248 times and the UK ratio of 119 times. Although the proportion of stock-based compensation increased to 30%, it is still lower than in the US and Europe.

The relatively low level of CEO compensation in Japan, particularly the limited use of stock-based incentives, has dual implications. First, it is institutionally complementary to the ranking hierarchy (rank tournament) of employment systems. In the traditional Japanese employment system structured around a ranking hierarchy, the CEO position represents the final goal in a rank-order tournament.<sup>28</sup> The CEO's role is more closely associated with a representative of employees rather than an agent focused solely on maximizing shareholder value. Given this structure, CEO compensation is inevitably designed as an extension of the employee compensation system. Consequently, the pay gap between the CEO and the average employee remains relatively small, in stark contrast to the US-style CG model, where CEO compensation is often significantly higher. This modest pay gap contributes to a broader sense of social equality, which may help mitigate the rise of populism, a phenomenon that has gained significant traction in the U.S. and Europe in recent years.

Second, low CEO compensation is regarded as a factor contributing to conservative corporate behavior. This includes risk-averse decisions, such as limited investment in R&D, reluctance to restructure, excessive cash holdings, and low leverage. These practices have been increasingly criticized in contemporary CG debates.

### **3.4 Organizational Architectures**

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<sup>28</sup> Section 3.4.1 discusses the details of the ranking hierarchy.

### 3.4.1 Relational Employment

Conventionally, Japanese firms have a lower degree of employee specialization compared to US firms, and information sharing and coordination among employees are major sources of their competitive edge (Aoki 1988). Under this relationship, to encourage firm-specific investments such as improving coordination skills for employees, it is necessary to maintain long-term (lifetime) employment and seniority-based wage systems. This incentive scheme, known as ranking hierarchy, is consistent with the internal governance arrangement, in which the board size is large, and directors are exclusively promoted within firms. The position of director or manager functions as a prize in a long-term promotion tournament (Coles and Uchida 2018), which incentivizes employees to contribute to performance and make firm-specific investments.

This organizational architecture was challenged after the banking crisis. Jackson and Miyajima (2007) report that facing economic shock and the increasing pressure of institutional shareholders, leading firms started to introduce a performance-based wage system but maintained long-term employment by using traditional ways of labor adjustment, such as early retirement, transferring employees to group firms, and avoiding the dismissal of regular employees.

After the global financial crisis and the labor market reforms under Abenomics, these practices, initially concentrated among leading firms, became more widespread among traditional Japanese firms. The performance-based wage system, which replaced traditional skill-based wages with job-based wages, became more widespread, including traditional J-firms. This shift is reflected in Figure 5, Panel A, which shows the wage profile by employee age. By 2023, the wage profile across generations had become significantly flatter, indicating a gradual but noticeable shift.

<Figure 5 Panel A and Panel B here>

However, long-term employment among core employees was largely maintained by the combination of traditional employment adjustments and the extensive use of non-regular employees. The ratio of non-regular employees increased from 20.9% in 1995 to 34% in 2008 and 38% in 2014, and then afterward, the upward trend slowed down to 37.3% in 2024 (Figure 5, Panel B). Labor mobility among employees for more than ten

years of tenure remained stable in the 2010s, indicating that the internal labor market continued to function effectively (Kambayashi and Kato 2017).

The ranking hierarchy among core employees remained largely intact, aligning with Japan's traditional pattern of managerial succession, in which CEOs were mainly selected within firms, even after the CG reforms. As of June 2019, of the 208 firms in the Nikkei 225 whose founders and their descendants do not hold management positions, the top managers of 198 (95%) firms were internally promoted employees who had worked at the firm for at least ten years before being appointed to the top management team, and the managers of 174 firms had worked at the firm for at least 30 years. By contrast, we found only ten cases of external appointments by top managers (Miyajima and Saito 2021).<sup>29</sup> Although Takeda Pharmaceutical, which recruited Christophe Weber from overseas for his management ability, and Shiseido, which hired Masahiko Uotani for his marketing expertise, have garnered significant social attention, such external appointments remain exceptionally rare in Japan.

Further evidence of the persistence of the ranking hierarchy is the increase in the average tenure between a manager's initial entry into the firm and his or her appointment as CEO. The average tenure increased from 25.7 years in the 2000s (2002–2007) to 27.4 years in 2009–2018 (Uchida, 2025).

### **3.4.2 Alternative Mechanisms for Stabilizing Organizational Architecture**

Traditionally, institutional complementarity between relationship-based external governance and organizational architecture has been understood as follows: When there is a change in control, such as bankruptcy, takeover, or shareholder activism, the rules of the promotion tournament would change, weakening the incentives for employees to strive for long-term career advancement. As the likelihood of winning a future prize (i.e., promotion to senior management) diminishes, employees may lose motivation to invest in firm-specific skills. As a delegated monitor, the main bank historically played a supervisory role, providing financial support in times of distress, thereby reducing the risk

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<sup>29</sup> An external appointment is defined as the appointment of a new executive who has been with the company for less than 10 years prior to his or her appointment.

of bankruptcy firm (Sheard 1994). In addition, cross-shareholding among firms, including those with main banks, guaranteed managers with greater discretion by insulating firms from external pressures. In this context, relational external governance, such as the main bank, which preserves the stability of promotional tournament rules, maintained a strong institutional complementarity with Japan's traditional relationship-based internal governance and ranking hierarchy (Aoki, Patrick, and Sheard 1994). With the shift in external and internal governance to the more market-based governance, a natural question arises: Why has organizational architecture, such as the ranking hierarchy, persisted despite changes in the governance environment?

One reason for the persistence of Japan's organizational architecture (ranking hierarchy) structures despite changes in external governance is that firms have mitigated default risk by deleveraging rather than relying on bailouts from major banks (Uchida 2025). Following the banking crisis, Japanese firms significantly reduced their leverage (Arikawa, Miyajima, and Ogawa 2026). By the 2010s, a significant portion of firms listed on the TSE first section, about 56%, had zero net debt. Moreover, the debt-equity ratio of firms declined from 2.04 in 2004 to 1.62 in 2010 and further to 1.21 in 2019, significantly reducing the default risk.

Beyond deleveraging, firms have actively managed their corporate ownership to counter the threat of a change in control. In divesting relational shareholdings, firms repurchased shares from both outsiders and insiders seeking to liquidate their holdings. These repurchased shares were then allocated to new strategic investors through private placements, allowing firms to maintain ownership stability (Franks et al. 2023). Another critical development is the shift in long-term ownership patterns. Instead of traditional blockholders such as banks and insurance firms, passive investors have emerged as the new long-term shareholders. While they exercised their voting rights according to their guidelines, they are generally expected to hold these stocks for an extended period, ensuring continuity in the ownership structure.

### **3.5 Convergence Toward a Hybrid Form**

The CG reforms under Abenomics encouraged leading Japanese firms to refine their

hybrid governance arrangements. They moved from partially insider board structure to market-based board structure and began implementing high-powered incentives for CEO compensation, signaling a shift toward a more market-oriented internal governance structure. On the other hand, in response to an increase in outside shareholders, these firms managed ownership through stock repurchases and private placements to maintain control. Conversely, the changes in organizational architecture progressed at a more gradual pace. Notably, job security, a fundamental component of the prevailing ranking hierarchy, remained relatively unaltered, particularly for core employees. The CG reforms enabled leading Japanese firms with the hybrid CG model to further develop market-based internal and external governance structures while preserving their relationship-based employment system.

The CG reforms also encouraged traditional Japanese firms to revise their relationship-based governance, shifting to a market-based model, characterized by a dissolution of cross-shareholding and an increase in independent directors. As a result, traditional Japanese firms have been gradually converging toward the hybrid CG arrangements following the CG reforms in the 2010s.<sup>30</sup>

## **4. The Economic Consequences of CG Reform**

### **4.1 Impact on Corporate Behaviors and Performance**

CG arrangements were significantly changed during the CG reforms under the Abe administration. A key question that follows is: How have these changes affected corporate behavior?

Table 3 presents summary statistics on firm performance and corporate behavior for companies listed on the TSE First Section, excluding those in the financial sector, over the period 2000 to 2018. The final row reports the coefficient on the CG reform dummy, which takes a value of 1 for observations after 2014. This dummy variable captures the impact of the CG reforms on various measures of firm performance and behavior. Table

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<sup>30</sup> Referring to Figure 1.3 from Jackson and Miyajima (2007), these changes can be interpreted as a shift in traditional Japanese firms, originally positioned at the top right of the figure, toward a hybrid form located at the bottom left.

4 reports regression results based on the same sample of firms, where performance and policy choices are regressed on governance variables and other controls.<sup>31</sup> The analysis in Table 4 focuses on two aspects: 1) the role of institutional investors and 2) how this role is influenced by the CG reforms, as captured by the interaction term between the institutional investors ownership share and the corporate governance reform dummy.

<Table 3 and Table 4 here>

First, since 2013, when the Abe administration was formed, Japanese firms' performance steadily improved (Table 3). However, this improvement in profitability, measured by ROE, or ROA, was not driven by an increase in total asset turnover ratio (sales/total assets) or an increase in leverage. The stable total asset turnover ratio means that corporate restructuring did not progress significantly during this period. Instead, the main cause of the performance improvement was an increase in the net margin or profit margin. However, there is no clear evidence that the CG reforms have had a direct effect on this increase in the margin rate, either through the increased influence of institutional investors or the appointment of new independent directors (Morikawa 2020; Miyajima and Saito 2021; Yasu 2026).<sup>32</sup>

Second, despite the improvements in firm performance, the CG reforms did not clearly lead to increased investment activities. As shown in Table 3, the estimated results for the CG reform dummy provide no evidence that capital expenditure, M&A activity, or R&D investment increased during the reform period. Moreover, although Table 4 shows a positive correlation between percentage share held by institutional investors and both capital expenditure and R&D investment, this relationship weakened in the post-reform period. Instead of reinvesting higher profits into growth or innovation, firms used earnings primarily to reduce debt. Similar findings were reported in relation to the divestment of relational shareholdings encouraged by the CG reforms: Miyajima and Saito (2025) find that proceeds from the divestment of relational shareholdings were exclusively used for

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<sup>31</sup> Tables 3 and 4 extend the analysis of Miyajima and Saito (2021), incorporating additional revisions.

<sup>32</sup> However, Miyajima and Saito (2025) report the independent directors played a significant role in encouraging firms to divest their relational shares.



stock repurchases, with little evidence of reinvestment in capital expenditures or R&D investment.

Lastly, the CG reforms had a clear impact on the distribution of earnings. As shown in Table 3, following the reforms, the payout ratio, defined as the sum of dividends and share repurchases divided by equity, increased by about 0.7 percentage points above the pre-reform level. Furthermore, columns (7) and (8) of Table 4 show that institutional investor ownership had a statistically significant positive effect on both the payout ratio and the dividend ratio. In addition, the interaction terms between the institutional investors' shareholdings ratio and the CG reform dummy are also significantly positive. This suggests that while higher institutional investors' shareholding was already associated with higher payout ratio, this effect was further intensified after the CG reforms. An increase of eight percentage points (equivalent to one standard deviation) in institutional investors' ownership is associated with a 0.31 percentage point increase in the payout ratio after the CG reform, highlighting the increased influence of institutional investors on dividend policy.

In sum, although macroeconomic conditions during Abenomics supported improved firm profitability, these gains were not primarily allocated to capital investment. Instead, firms used increased earnings to reduce debt, expand shareholder payouts, and accumulate cash reserves.

The slow pace of change in corporate behavior, aside from payout policy, can be understood as a natural consequence of the evolution of the hybrid corporate structure. While the influence of outside shareholders has increased, insider control remains significant. According to Arikawa, Inoue, and Saito (2026), Japanese firms continue to underperform their global peers even after the implementation of the CG reforms, and this underperformance is partly attributed to an employment system that limits the flexibility of workforce adjustments. It is well established that when employees have significant influence over CG, firms tend to prioritize job security over aggressive growth strategies. This often results in lower investment spending, reduced risk-taking, lower

leverage, and slower growth.<sup>33</sup> Within this framework, despite the CG reforms, Japanese firms continue to prioritize financial stability, maintaining high cash reserves while gradually increasing shareholder returns through dividends and share repurchases, rather than significantly expanding investment activities. As a result, corporate behavior often diverges from the shareholder value maximization model, reflecting the persistent influence of insiders in shaping corporate strategy.<sup>34</sup>

## **4.2. ESG investment**

### **GPIF as a Driving Vehicle**

The second layer of the CG reforms, in addition to improving capital efficiency, has been to improve ESG performance. Before 2014, top management paid little attention to ESG issues, particularly environmental and social materialities. As a result, the ESG scores of Japanese listed firms were significantly lower than those of their global counterparts in the early 2010s (Jackson and Bartosch 2026; Nemoto 2026). However, following the implementation of the CG reforms, ESG performance gradually improved. Figure 6 illustrates this trend using the FT Blossom Score, comparing Japan's ESG performance with the global average. In 2015, Japan's ESG score was 0.8 points behind the global average. By 2023, the gaps had narrowed to 0.2 points, reflecting significant progress in ESG adoption among Japanese firms.<sup>35</sup>

< Figure 6 here >

Following the CG reforms and the growing preference of foreign investors for firms with active ESG practices, a key driver of this shift has been the active engagement of GPIF.<sup>36</sup> After Prime Minister Abe's pledge to the United Nations in 2015, GPIF intensified

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<sup>33</sup> This leads to limited job creation and lower productivity as well. For further discussion on this topic, see Faleye, Mehrotra, and Morck (2006), Simintzi, Vig, and Volpin (2014), Mehrotra and Morck (2017), and Francis et al.(2018).

<sup>34</sup> Hirota (2015) posits that maintaining corporate sustainability is the most important factor in determining the capital structure of Japanese corporations.

<sup>35</sup> In 2015, Japan's ESG score was 1.65 points behind France, one of the most active countries in ESG activities. By 2023, these gaps had narrowed to 0.7 points relative to France.

<sup>36</sup> There is a systematic relationship between firms' ESG/CSR activities and their ownership. Specifically, ESG/CSR activities are positively associated with foreign institutional ownership and negatively correlated with cross-shareholdings (Yoshida, Kurita, and Managi 2023).

its efforts to encourage asset managers to engage in constructive dialogue with portfolio firms on key ESG issues. Importantly, since 2017, GPIF has adopted a well-designed dual strategy to further integrate ESG considerations into its investment approach.

The first strategy, implemented in July 2017, involves selecting of three “best-in-class” ESG indices (FT Blossom, MSCI ESG Leaders Index, and the MSCI Women’s Empowerment Fund) and the linkage of passive asset management to these indices. As the second strategy, in 2018, GPIF introduced performance-based management fees for two selected asset management firms, Asset Management One and Fidelity, rewarding them for proposing and implementing effective engagement strategies. Asset management firms were required to submit plans detailing their ESG approaches, which GPIF evaluated through follow-up discussions to assess the effectiveness and progress of their strategies (Henderson et al. 2019; Becht et al. 2023).

Through the dual strategies, GPIF provided strong incentives for asset management firms to engage more actively with their portfolio firms on ESG issues.<sup>37</sup> A key mechanism in this process was that improving ESG scores increased the likelihood of a firm’s inclusion in these ESG indices, which, in turn, was associated with the expectation of stock price appreciation. Recognizing the success of these initiatives, GPIF expanded its ESG investment from 4.2% of total passive domestic equity holdings in 2017 to 13.5 % in 2021. At the same time, the number of delegated financial institutions eligible for additional fees also increased to include three major trust banks in Japan (Becht et al. 2023).<sup>38</sup>

### **The Expansion of ESG Activities.**

Against the background of GPIF’s influence, Japanese firms have gradually increased their commitment to ESG initiatives.

First, Japanese firms began to broaden their corporate purpose, expanding their stakeholder focus beyond employees and local communities to include non-regular employees, global supply chains, and the environmental concerns. This broader

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<sup>37</sup> For an analysis of GPIF’s impact on woman’s empowerment, see Mehrotra et al. (2025).

<sup>38</sup> Becht et al. (2023), Appendix Table 14,15.

perspective has led to more proactive ESG initiatives. As a result, an increasing number of firms are articulating the impact of their ESG activities and linking them to long-term value creation (Jackson and Bartosch 2026).

Second, the issuance of ESG bonds increased significantly. As of the end of March 2023, the market size of ESG-related bonds reached 15.4 trillion JPY, accounting for 20 % of the outstanding balance of public corporate bonds (Nemoto 2026). According to Miyajima and Ujita (2025), investors respond positively to the announcement of green bonds issuances, which are often issued at significant discounts (greeniums). In addition, issuers tend to improve their environmental performance after issuance as indicated by lower CO<sub>2</sub> emissions, and experience increased ownership by long-term and green investors, reinforcing their commitment to environmental sustainability.<sup>39</sup>

Third, given the growing trend of clarifying the materiality of ESG goals, leading firms have begun to establish dedicated ESG or sustainability departments. The establishment of sustainability committees with independent directors to monitor executives' decision-making is becoming more common among ESG-advanced firms. The contribution of ESG performance is also being incorporated into executive compensation criteria. According to a survey, 53 % of sample firms established a sustainability committee, and 16 % of sample firms integrated ESG performance as a factor in determining executive compensation.<sup>40</sup>

Finally, leading Japanese firms are making progress in ESG-related disclosure, particularly in Scope 3 greenhouse-gas emissions reporting. An increasing number of firms are publishing integrated reports, which include non-financial ESG-related information. Among Nikkei 225-listed firms, the proportion of firms issuing integrated reports increased from 19% in 2015 to 89 % in 2023 (Nemoto 2026).

While the ESG scores of Japanese firms have steadily improved, they remain lower than those of major developed countries, particularly in the areas of social and governance (Jackson and Bartosch 2026). Low social scores reflect insufficient diversity

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<sup>39</sup> For a discussion of greeniums, see also Okimoto and Takaoka (2021). These results are broadly consistent with findings for the US. (Flammer 2021).

<sup>40</sup> Deloitte Tohmatsu Consulting and Sumitomo Mitsui Trust Bank, Executive Compensation Survey, 2024, p.185 and p.245.

and inclusion. Low CG scores are due to issues such as a low ratio of independent directors, cases where a CEO also serves as the chairman of the board, a lack of individual executive compensation disclosure, and the persistence of cross-shareholding.

## **5 . Perspectives**

This paper provided an overview of the evolution of the Japanese firm in the 21<sup>st</sup> century. Over the course of more than two decades, several defining characteristics of traditional Japanese firms have largely disappeared. The main bank system has lost its former role, cross-shareholdings have been significantly reduced, and large, insider-dominated boards have been restructured.

This change has been driven by global financialization and the growing influence of institutional investors. Regulatory reforms such as the introduction of the JS Code and the CG Code, and subsequent efforts to enforce these frameworks have had a significant impact on CG arrangements in Japanese firms. As a result, the engagement of institutional investors has become widespread. The influence of outside investors has grown substantially, affecting corporate policy decisions such as corporate restructuring (Kubo 2026), diversification strategy (Ushijima 2026), CEO turnover (Miyajima and Saito 2018), and efforts to address corporate misconduct (Aoki 2026).

In addition, the increased engagement of outside investors has encouraged Japanese firms to redefine their corporate purpose by broadening their stakeholders focus beyond employees and local communities to include non-regular employees, global supply chains, and the environment. This shift has led to more proactive ESG initiatives (Nemoto 2026). However, despite the growing influence of the external capital markets, key organizational architecture such as the long-term employment of core workers, which underpins the ranking hierarchy, has remained largely unchanged even among global leading firms.

This persistence is partly due to strict labor regulations that constrain firms' ability to dismiss employees. Moreover, new mechanisms have emerged to support the coexistence of market-based external governance and relationship-based organizational architectures. Instead of relying on the traditional main bank bailout, corporate

deleveraging since the 2000s has helped reduce firms' default risk. Similarly, rather than cross-shareholdings, alternative mechanisms play a role in sustaining these organizational architectures, including blockholdings by other firms, Japanese Employee Share Ownership plan (JESO), and the growing presence of index funds.

Changes in internal governance reflect a dual evolution in governance arrangements. First, board structures have changed significantly with a rapid increase in the presence of independent directors, while greater authority has been delegated to management. Second, the expansion of equity-based compensation is intended to better align management's interests with those of external shareholders. However, the extent of these changes has largely preserved the traditional ranking hierarchy, avoiding a fundamental disruption of existing organizational structures.

In this sense, the evolution of CG arrangements in Japan is moving toward a hybrid model rather than fully converging with a market-based model for both leading firms and traditional Japanese firms. This pattern of evolution also helps explain current challenges in corporate behavior and performance. While these governance changes have led to a significant increase in shareholder payouts, they have also reinforced conservative corporate behavior and risk-averse attitudes. Difficulties in adjusting employment inherent to the hybrid models have limited the ability of firms to undertake large-scale investment and corporate restructuring. Concerns about default risk have also discouraged firms from increasing leverage, leading them to maintain high levels of cash holdings.

These observations provide valuable insights into the future of CG arrangements in Japanese firms. First, because the evolution of organizational architecture is shaped by the responses of corporate insiders to changing external conditions, a transition to a fully market-based system is unlikely to occur organically. Instead, the trajectory of CG evolution is likely to be shaped by external shocks affecting internal labor markets, such as labor shortages, as well as by the effects of overseas activities, including both inbound and outbound M&A. It is also determined by the increasing pressure of outside investors. They gradually trigger incremental changes in organizational architecture, which in turn lead to corresponding adjustments in internal governance. In any case, the evolution is

expected to follow a path-dependent trajectory, unfolding gradually over an extended period of time.

Second, regulatory enforcement will play a critical role in shaping the future of CG, particularly for traditional J-firms. Many of these firms have remained largely insulated from external market discipline, making them unlikely to experience such forces organically. As a result, their evolution may depend on the effectiveness of regulatory interventions. In this regard, the impact of stricter listing rules imposed by TSE, METI, and the TSE's initiatives to encourage firms to improve their PBR above 1, and the introduction of the more flexible takeover defense regulations (Guidelines on Takeovers) by METI are noteworthy. These measures represent attempts to exert market discipline on traditional J-firms to compensate for the relatively weaker influence of institutional investors.

Lastly, it is important to recognize that Japanese firms have faced challenges similar to those encountered by firms in the US and UK, especially in addressing the adverse effects of increasing outside shareholders. In other words, they are tasked, for the first time, with consciously managing the market for corporate control. At the beginning of CG reforms, the issue was not "too strong governance" by shareholders, but "too weak governance". However, some Japanese firms began to face the myopic pressure from portfolio investors and activist hedge funds, especially after the introduction of the Guidelines on Takeovers. Shareholder rights in Japan are legally strong by international standards; for example, the adoption of legally permissible anti-takeover measures or the issuance of class shares requires shareholder approval. Within this framework, the recent changes run the risk of excessively eroding managerial discretion beyond an optimal level. Therefore, the future evolution of CG in Japan will fully depend on striking a balance between strengthening market discipline and preserving appropriate managerial discretion.

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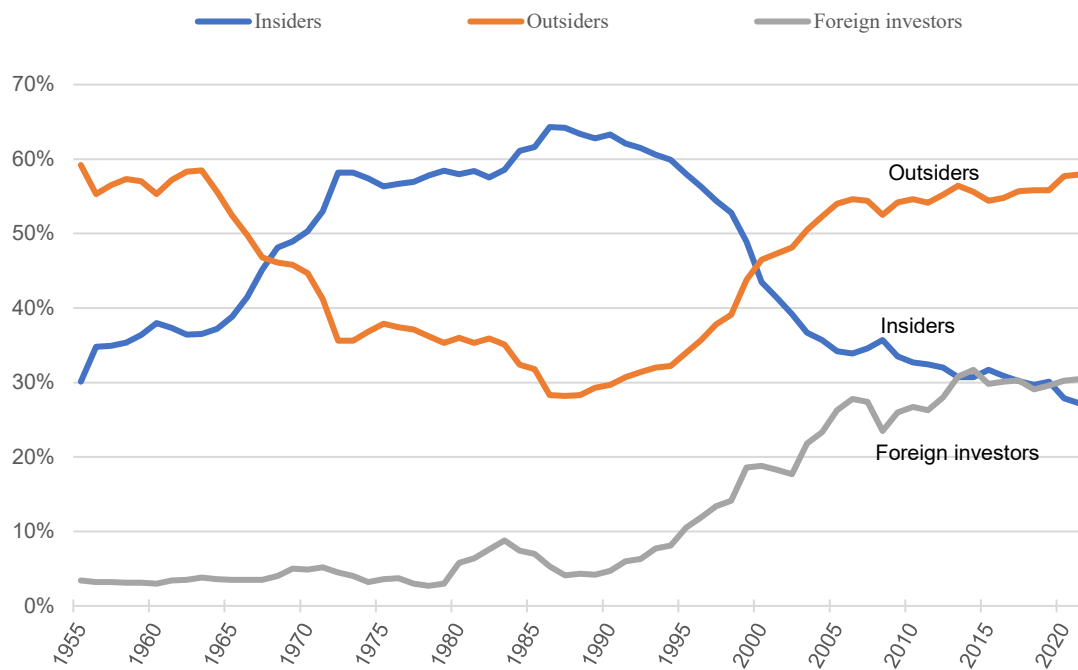
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**Figure 1: Ownership Structure in Japan**

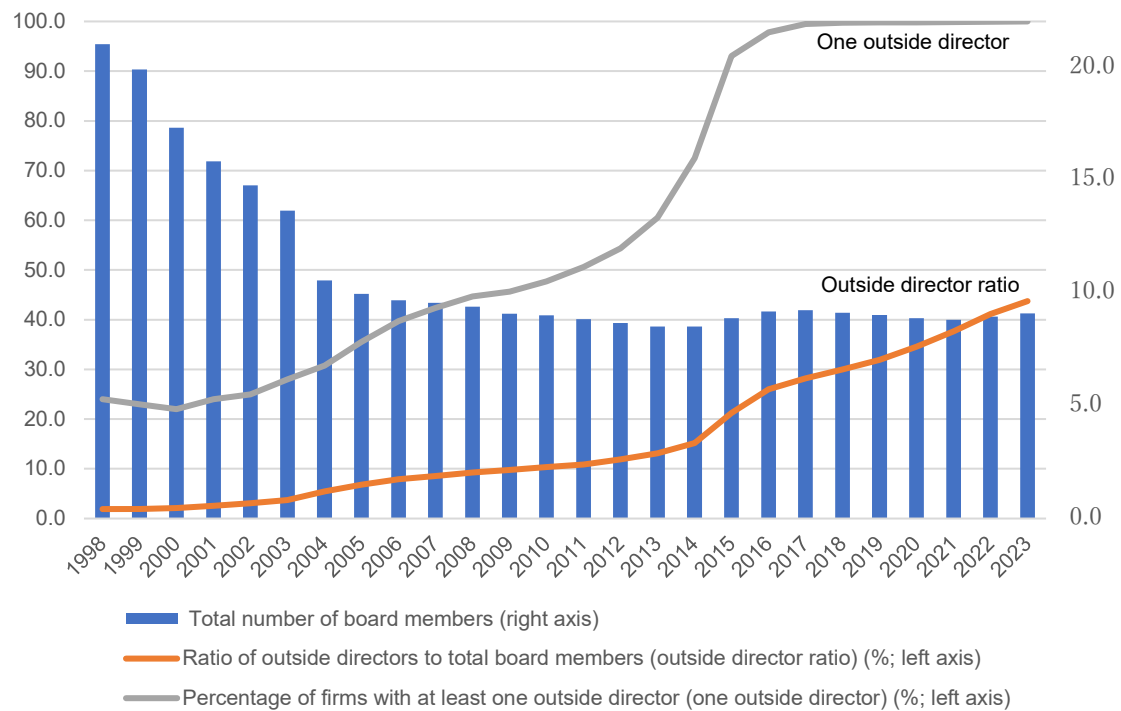
Insiders are defined as the proportion of shares held by city banks, regional banks, insurance companies, and business corporations relative to total shares. Outsiders are defined as the proportion of shares held by foreign investors, individual investors, mutual funds, and pension funds relative to total shares. Foreign investors are defined as the proportion of shares held by foreign investors. Data: TSE, Share Distribution Survey.





**Figure 2: Board Structure in Japan**

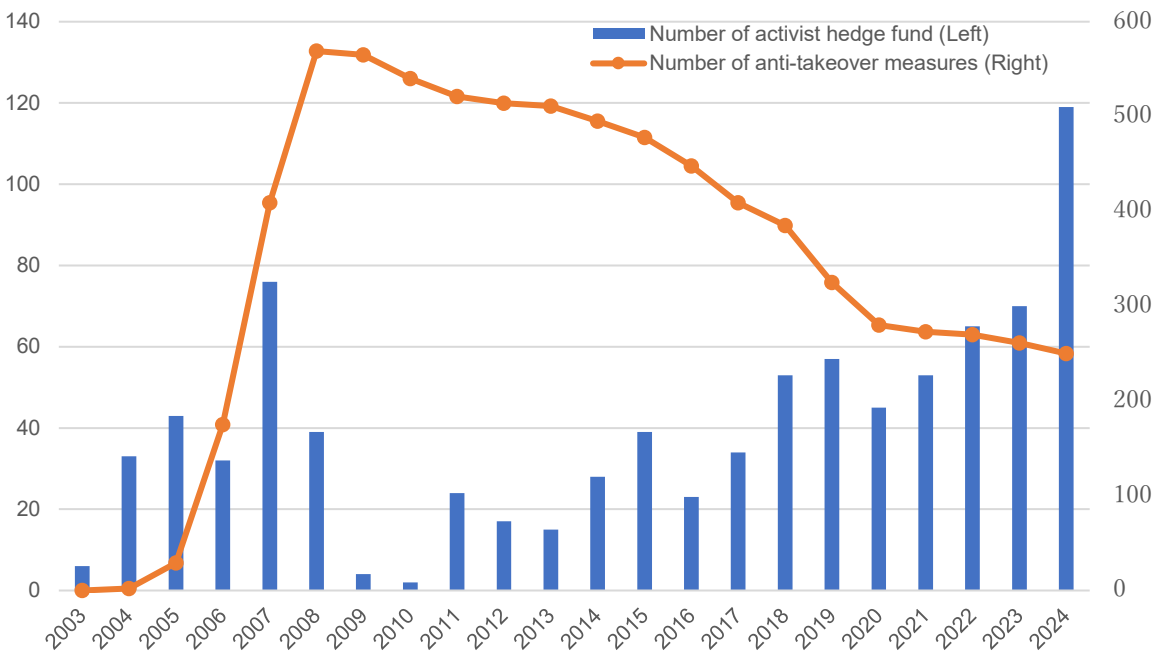
This figure presents the total number of board members (right axis), the ratio of outside directors to total board members (outside director ratio) (%; left axis), and the percentage of firms with at least one outside director (one outside director) (%; left axis). The sample consists of firms listed on the TSE First Section (renamed the Prime Market in 2022) from 1998 to 2023. Data: Nikkei NEEDS-CGES and Yakuin Shikiho (Directory of Executives) by Toyo Keizai Inc.



**Figure 3: Activity of Activist Hedge Funds (2003-2024)**

**Panel A: Activist Hedge Funds and Takeover Defenses**

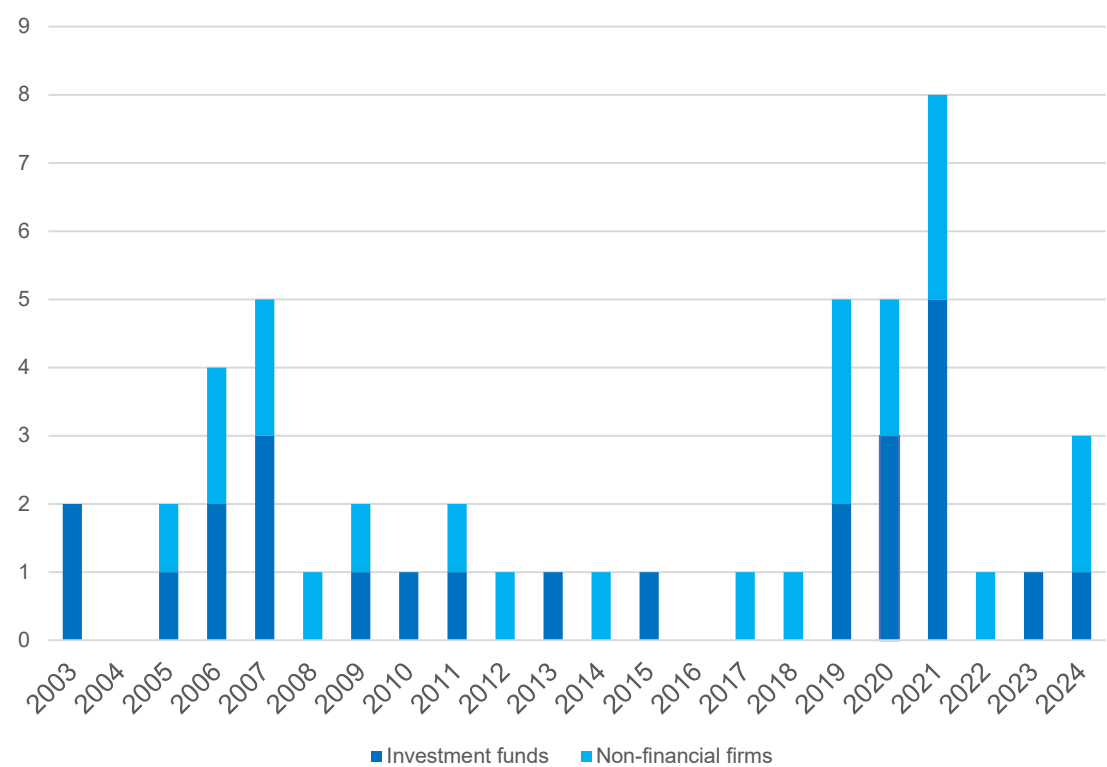
The number of activist hedge funds is measured by the number of firms with more than 5% of their shares held by activist hedge funds (left axis). The number of anti-takeover measures is defined as the number of firms with anti-takeover measures in place (right axis). The sample period is from 2003 to 2024, with the 2024 data spanning from January to November. Data: Recof M&A database.



**Figure 3: Activity of Activist Hedge Funds (2003-2024)**

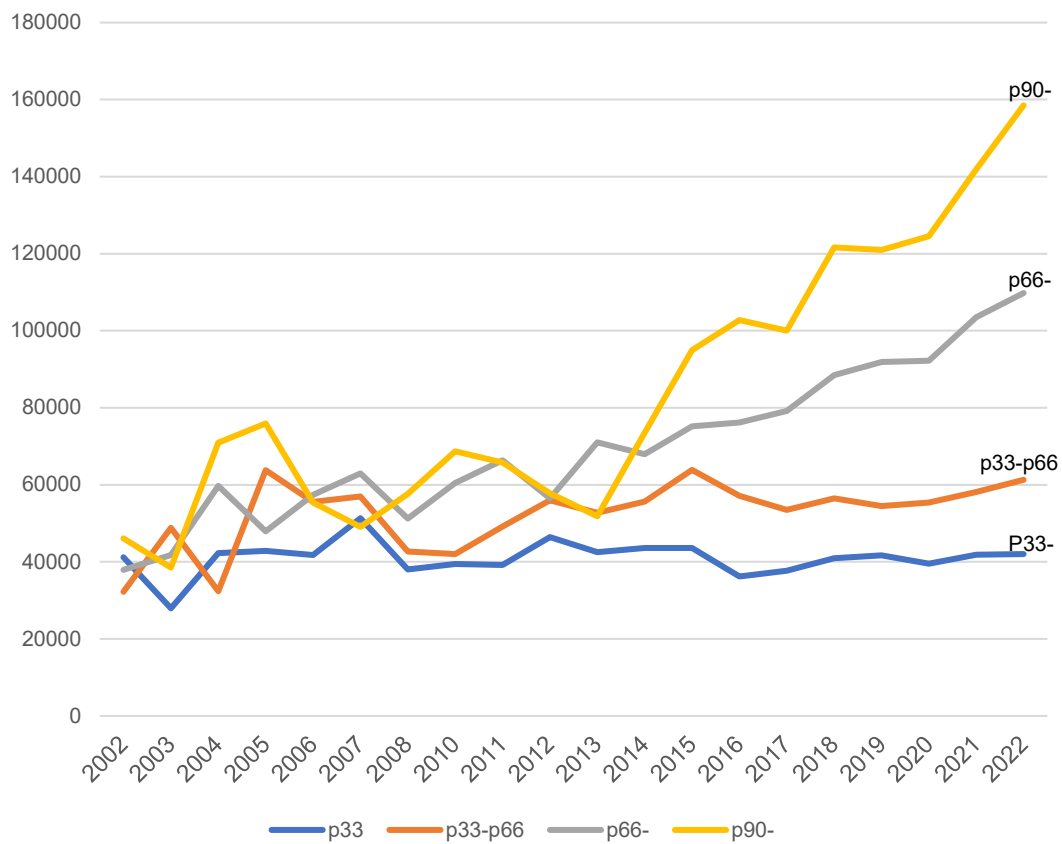
**Panel B: Number of Unsolicited TOBs**

This figure shows the number of unsolicited TOBs. Investment funds include the number of unsolicited TOBs by investment funds. Non-financial firms include the number of unsolicited TOBs by non-financial firms. The sample period is from 2003 to 2024, with the 2024 data spanning from January to October. Data: Recof M&A database.



**Figure 4: Long-term Trend of CEO Compensation**

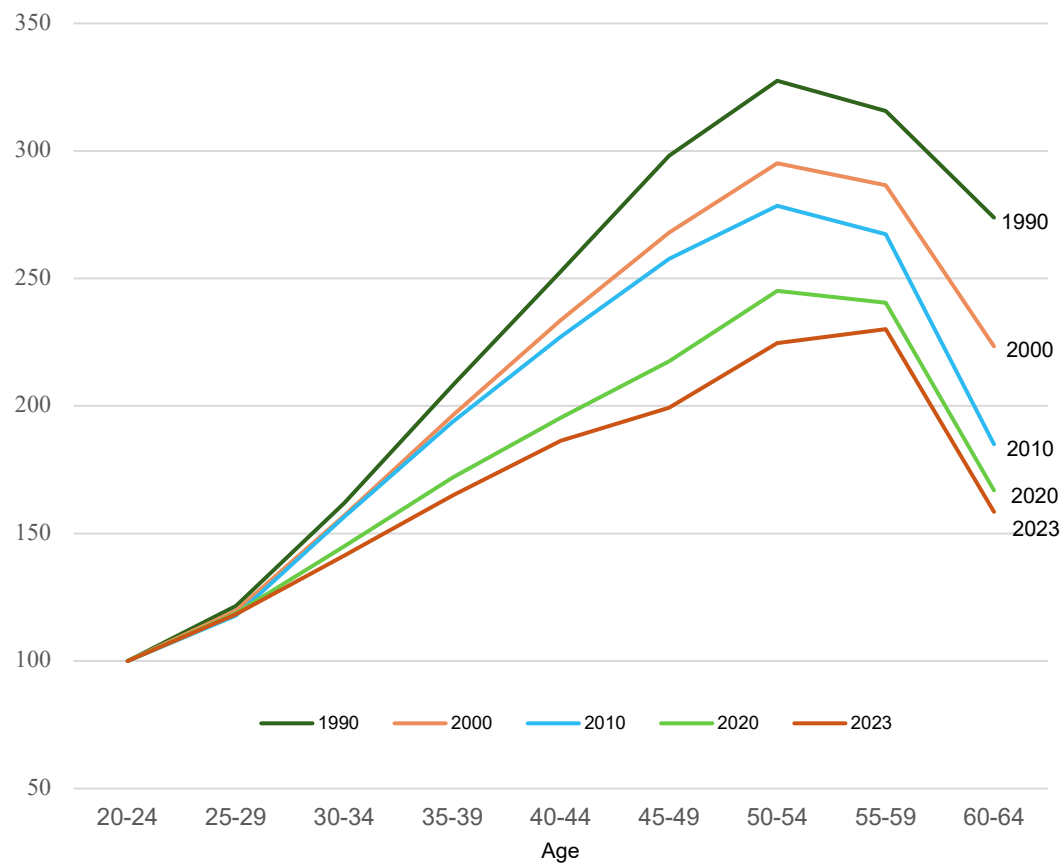
This figure is based on Deloitte Tohmatsu's survey on executive compensation. The sample period is from 2002 to 2022, and the sample size each year ranges from 19 in 2002 to 1218 in 2022. We categorized the sample firms into four groups based on firm value (debt + market capitalization). p33 indicates that a firm value below the 33rd percentile of firm value each year. p33-p66 indicates that a firm value is between the 33rd and 66th percentile of firm value each year. p66- indicates that a firm value is higher than the 66th percentile of firm value each year, and p90- indicates that a firm value is higher than the 90th percentile of the firm value each year.



## Figure 5: Wages and Employment

### Panel A: Wage Profile of Employees in Large Companies

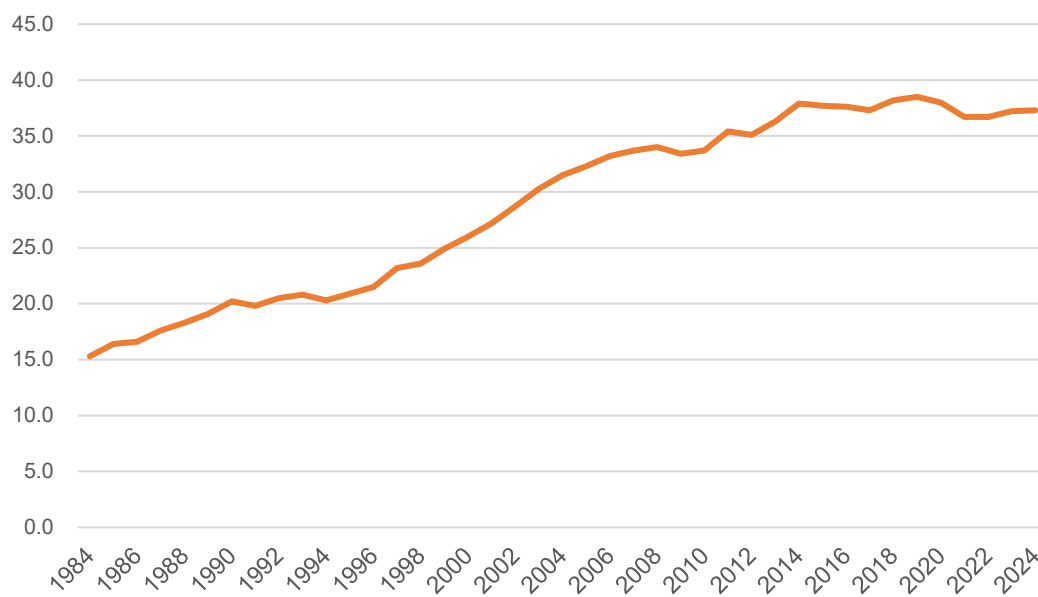
This figure shows the wage profile of male employees with university degrees in large companies with over 1000 employees in the year 1990, 2000, 2010, 2020, 2023. Wages of workers aged 20 to 24 are set to 100. Data: Basic Survey on Wage Structure, Ministry of Health, Labor and Welfare.



## Figure 5: Wages and Employment

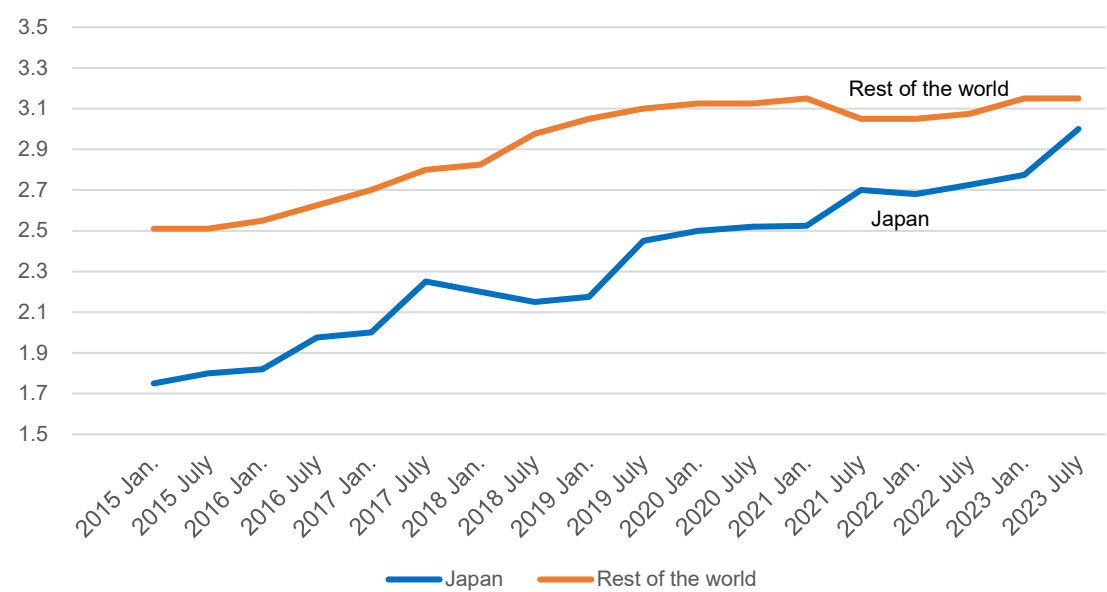
### Panel B: Percentage of Non-Regular Employees

Until 2008, the data on "Non-regular employees" are aggregated from the categories "Part-time worker/Arbeit", "Dispatched worker from a temporary labor agency", "Contract employee or entrusted employee," and "Other." From 2009 onward, the data are based on the newly established category "Non-regular employee." Data: Statistics Bureau of Japan, "The Special Survey of the Labor Force Survey" from 1984 to 2001, and "Labor Force Survey (Detailed Tabulation)" since 2002.



**Figure 6: Evolution of FTSE ESG Scores Over Time**

The Japanese sample is largely comprised of TOPIX500 companies. Scores are plotted bi-annually at the end of June and the end of December of each year. Source: Becht et al. (2023).



**Table 1: Major Regulatory Changes in Corporate Governance Reforms**

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May 1997:	Stock options were permitted following revisions to the Commercial Code.
Jun. 1997:	Holding companies were legalized through amendments to the Antimonopoly Act.
Jun. 2001:	The ban on treasury stock was lifted through revisions to the Commercial Code.
Mar. 2004:	The Tokyo Stock Exchange (TSE) established the Principles of Corporate Governance for Listed Companies.
May 2005:	METI released the Guidelines Regarding Takeover Defense, outlining strategies for protecting corporate value.
Jun. 2005:	The Companies Act was introduced, consolidating all relevant provisions into a single comprehensive statute.
Jan. 2006:	TSE institutionalized the Corporate Governance Report.
Jun. 2006:	The Internal Control Reporting System was established through amendments to the Financial Instruments and Exchange Act.
Aug. 2009:	The Democratic Party of Japan (DPJ) assumed power.
Mar. 2010:	Listed firms were required to disclose executive compensation for individuals earning JPY100 million or more.
Dec. 2012:	The Liberal Democratic Party (LDP) returned to power, establishing the Second Abe administration, marking the beginning of Abenomics.
Jun. 2013:	The Japan Revitalization Strategy introduced principles for institutional investors, promoting long-term corporate growth through engagement.
Jan. 2014:	The JPX 400 index was launched to promote capital efficiency.
Feb. 2014:	Japan's Stewardship Code (JS Code) was implemented to enhance institutional investor responsibility.
Jun. 2014:	Amendments to the Companies Act introduced the Company with Audit and Supervisory Committee, introduced the "Comply or Explain" rule for the election of outside directors, and established stricter criteria for outside directors, with a greater emphasis on independence.
Aug. 2014:	The Ito Report (METI) emphasized the importance of Return on Equity (ROE).
Oct. 2014:	The Government Pension Investment Fund (GPIF) increased domestic equity allocation from 12% to 25%.
Jun. 2015:	The Corporate Governance Code (CG Code) was implemented.
Sep. 2015:	GPIF signed the UN Principles for Responsible Investment (PRI), integrating ESG criteria into its investment decision-making process.
April 2016:	Tax reforms for restricted stock adjusted the timing of income tax recognition from "when earned" to "when restrictions are lifted."
May 2017:	The revised JS Code required institutional investors to disclose their voting records for each agenda item.
Jun. 2017:	GPIF published its proxy voting policy, requiring asset managers to provide detailed disclosures on their voting decisions.
Jun. 2018:	The revised CG Code required listed firms to disclose their policy on relational shareholdings, including plans for their reduction.
Dec. 2019:	Amendments to the Companies Act mandated the appointment of outside independent directors.



May 2020: The second revision of JS Code required institutional investors to actively engage with investee firms to promote long-term corporate value and sustainability.

Jun. 2021: The second revision of CG Code introduced new requirements for firms listed on the Prime Market, mandating the appointment of at least one-third independent directors, the establishment of sustainability policies, and the disclosure of ESG-related information.

Oct.2021: The Kishida administration announced the “New Form of Capitalism” policy.

Apr. 2022: TSE restructured its market segments, replacing First Section, Second Section, Mothers, and JASDAQ with Prime, Standard, and Growth.

Mar.2023: TSE required firms with a price-to-book ratio (PBR) below one to disclose improvement plans.

Aug.2023: METI issued the Guidelines for Corporate Takeover.

Oct. 2023: Prime Minister Kishida announced at the PRI Annual Conference that seven public pension funds were in the process of signing the PRI.

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**Table 2 Board Structures of Two Groups**

The sample includes firms listed on the TSE First Section, excluding those in the financial sector. Leading firms are defined as those in the top 33% of the firm value distribution, while the remaining firms are classified as Mid-cap firms. Firm value is defined as the sum of debt and market capitalization. The Independent director ratio is defined as the number of independent directors divided by the total number of directors.

Data: Nikkei NEEDS-CGES.

Year		2010	2015	2019	2022
Number of firms		1,523	1,830	2,033	1,569
Independent director ratio	Leading firms	14.7%	27.9%	36.4%	45.8%
	Mid-cap firms	9.2%	26.1%	34.3%	43.5%
Percentage of firms with an independent director ratio exceeding 33%	Leading firms	14.4%	32.3%	71.3%	99.4%
	Mid-cap firms	6.8%	27.7%	59.8%	95.8%
Percentage of firms with a majority (>50%) of independent board members	Leading firms	4.0%	7.8%	14.7%	37.7%
	Mid-cap firms	2.0%	4.8%	12.6%	32.0%
Percentage of firms that have adopted a nominating committee system	Leading firms	4.2%	5.6%	5.3%	8.0%
	Mid-cap firms	0.9%	0.7%	0.5%	1.0%

**Table 3: Performance and Corporate Behavior Before and After CG Reform**

The sample consists of firms listed on the TSE First Section, excluding those in the financial sector, over the period 2000 to 2018. The definitions of key variables are as follows: ROE is defined as net income divided by total assets (TA); ROA is defined as operating income divided by total assets(TA); Net margin is defined as net income divided by sales; Profit margin is defined as sales divided by total assets(TA); Capex ratio is defined as capital expenditures divided by tangible fixed assets; Acquisition ratio is defined as acquisition cost of subsidiaries divided by total assets (TA); R&D ratio is defined as R&D expenditure divided by sales; Payout ratio is defined as the sum of dividend payments and stock repurchases divided by equity; Dividend ratio is defined as dividends payments divided by equity; Debt ratio is defined as total debt divided by total assets (TA); Cash ratio is defined as (cash and cash equivalents) divided by (total assets - cash and cash equivalents). The periods 2010–2012 and 2014–2018 represent the average values of each variable before and after the CG reforms, respectively. The coefficient on the CG reform dummy represents the impact of the CG reforms on each dependent variable in a regression model that includes control variables such as the log of total assets, foreign sales ratio, debt ratio, cash ratio, cash flow to total assets, Tobin's q, industry-level sales growth, and the CG reform dummy, which equal one if the year is between 2014 and 2018. Figures in parentheses are standard deviations. \*\*\*, \*\*, and \* indicate statistical significance at the 1%, 5%, and 10%, levels, respectively. For R&D expenditure, data are restricted to manufacturing and information sectors.

Dependent variables	ROE	ROA	Net margin	Profit margin	Sales / TA	Capex ratio	Acquisition ratio	R&D ratio	Payout ratio	Dividend ratio	Debt ratio	Cash ratio
2000	1.2%	6.0%	1.5%	5.8%	1.01	13.6%	0.1%	2.5%	1.7%	1.3%	26.6%	18.8%
2001	-0.8%	4.7%	0.4%	4.5%	1.03	12.9%	0.1%	2.7%	1.9%	1.3%	25.8%	18.6%
2002	1.8%	5.5%	1.3%	5.3%	1.07	11.9%	0.1%	2.7%	2.1%	1.3%	24.6%	19.1%
2003	4.9%	6.2%	2.6%	6.0%	1.08	12.2%	0.1%	2.7%	2.0%	13.1%	22.4%	19.7%
2004	6.4%	7.0%	3.3%	6.7%	1.11	14.5%	0.1%	2.6%	2.1%	1.5%	21.0%	20.2%
2005	6.2%	7.1%	3.5%	6.8%	1.12	16.1%	0.1%	2.5%	2.2%	1.6%	19.2%	18.7%
2006	7.0%	7.2%	3.7%	6.9%	1.13	17.2%	0.2%	2.4%	2.6%	1.8%	18.5%	18.8%
2007	6.1%	7.3%	3.3%	6.7%	1.18	17.0%	0.2%	2.4%	3.0%	2.1%	18.8%	18.7%
2008	-1.6%	5.2%	0.4%	4.4%	1.20	15.7%	0.2%	2.7%	3.6%	2.4%	21.5%	19.9%
2009	1.5%	4.8%	1.2%	4.3%	1.09	12.0%	0.2%	2.8%	2.3%	1.8%	20.9%	22.9%
2010	5.4%	6.5%	2.9%	6.1%	1.14	12.6%	0.2%	2.6%	2.3%	1.8%	20.0%	24.8%
2011	5.0%	6.3%	2.8%	5.9%	1.13	14.0%	0.3%	2.7%	2.4%	1.9%	19.3%	25.4%
2012	5.8%	6.4%	3.3%	5.9%	1.11	15.9%	0.3%	2.7%	2.4%	1.9%	18.9%	27.2%
2013	7.5%	7.0%	4.1%	6.6%	1.12	16.8%	0.3%	2.5%	2.4%	1.9%	17.9%	27.5%
2014	7.3%	7.1%	4.4%	6.8%	1.10	16.9%	0.3%	2.5%	2.6%	1.9%	17.5%	28.0%
2015	7.4%	7.3%	4.3%	7.2%	1.11	17.4%	0.3%	2.5%	3.1%	2.2%	17.7%	29.7%
2016	7.9%	7.3%	4.7%	7.3%	1.08	17.2%	0.4%	2.6%	3.2%	2.3%	17.6%	30.7%
2017	8.6%	7.5%	5.1%	7.7%	1.07	17.2%	0.4%	2.5%	3.1%	2.4%	17.0%	31.1%
2018	8.1%	7.5%	5.1%	7.8%	1.08	19.1%	0.4%	2.5%	3.5%	2.6%	16.7%	32.7%
2010–2012	5.4%	6.4%	3.0%	6.0%	1.13	14.2%	0.2%	2.6%	2.3%	1.8%	19.4%	25.8%
2014–2018	7.9%	7.3%	4.7%	7.4%	1.09	17.6%	0.4%	2.5%	3.1%	2.3%	17.3%	30.4%
Difference in average values before and after the CG reforms	2.4%	0.9%	1.7%	1.4%	-3.9%	3.4%	0.1%	-0.1%	0.7%	0.4%	-2.1%	4.6%
Coefficient of the CG reform dummy	0.000	-0.001	-0.002	0.001	-0.010**	0.000	0.000	0.000	0.001***	0.005***	-0.032***	0.007***
	(0.003)	(0.001)	(0.001)	(0.001)	(0.005)	(0.003)	(0.000)	(0.000)	(0.000)	(0.001)	(0.002)	(0.002)

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

**Table 4. The Effect of Corporate Governance Reform by Institutional Investors**

This table shows the results of models in which various dependent variables, defined in the Table 3, are regressed on control variables such as the log of total assets, foreign sales ratio, debt ratio, cash and deposits to total assets, cash flow to total assets, Tobin's q, industry-level sales growth, and the CG reform dummy, which equal one if the year is between 2014 and 2018. Institutional ownership is defined as the proportion of shares held by institutional investors. The impact of the 8% increase in institutional ownership after the CG reforms is equal to 0.08 times (Institutional ownership + the CG reform dummy times Institutional ownership). The sample consists of firms listed on the TSE First Section, excluding those in the financial sector. Figures in parentheses are standard deviations clustered at the firm level. \*\*\*, \*\*, and \* indicate statistical significance at the 1%, 5%, and 10%, levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Dependent variables	ROE	ROA	Profit margin	Capex ratio	Acquisition ratio	R&D ratio	Payout ratio	Dividend ratio	Debt ratio	Cash ratio
Institutional ownership	0.006 (0.019)	0.033*** (0.007)	0.033*** (0.008)	0.080*** (0.025)	0.002 (0.002)	0.005** (0.002)	0.022*** (0.006)	0.016*** (0.002)	-0.127*** (0.015)	0.025** (0.012)
CG reform dummy × Institutional ownership	-0.003 (0.005)	-0.003 (0.002)	0.002 (0.006)	-0.058*** (0.014)	0.001 (0.001)	-0.000 (0.002)	0.017*** (0.003)	0.004*** (0.001)	0.000 (0.010)	-0.014 (0.009)
CG reform dummy	0.000 (0.004)	-0.001 (0.001)	-0.001 (0.001)	0.012*** (0.004)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.001)	-0.000 (0.000)	-0.028*** (0.003)	0.009*** (0.003)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of Observations	17,004	17,004	16,996	16,826	16,826	10,696	16,850	16,850	16,850	16,850
R-squared	0.074	0.134	0.144	0.026	0.030	0.066	0.052	0.118	0.212	0.066
No. of sample firms	2,003	2,003	2,003	1,984	1,984	1,266	1,984	1,984	1,984	1,984
Impact of an 8% increase in institutional ownership after the CG reforms	0.02%	0.24%	0.28%	0.18%	0.02%	0.04%	0.31%	0.16%	-1.02%	0.09%

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1